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Will strategic partnerships in private equity become more common?

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Adoption could grow as the benefits of such partnerships for external managers and limited partners become more visible.

The use of strategic partnerships in private equity remains relatively limited. But as private markets continue to rise, that may be changing. In this video, McKinsey partners Bryce Klempner and Matt Portner discuss what such partnerships entail, the benefits for external managers and limited partners, and the effect they could have on fundraising. An edited transcript of their remarks follows.

Interview transcript

Matt Portner: Over the past few years, we've seen a number of limited partners state their desire to become direct investors. That's a lot harder than it looks, and I think many limited partners are starting to realize that. And when you look at the data, while limited partners are certainly pursuing more co-investment, the number of direct investments where they're the lead sponsor in the deal is relatively flat. Where they're turning their attention to instead is strategic partnerships.

Bryce Klempner: Different people have different names for these things. Some people call them "separately managed accounts," or SMAs. Other people call them "strategic partnerships." But the intent is generally twofold: number one, get a lot of capital out the door quickly; number two, use the scale that you have to get more out of your partners than just performance.

Matt Portner: What do we mean by strategic partnerships? What we mean is limited partners allocating larger amounts of capital to fewer external managers.

They're saying, "We want to give a large allocation across private markets asset classes, private equity, real estate, infrastructure, and private debt to an individual external manager."

And we will recycle the earnings from that relationship back into it so that the external manager has a consistent source of capital and it significantly reduces the friction that they have in fundraising. What it also does for the external manager is it provides them what we call an "anchor tenant" for their new funds—basically, an influential, important limited partner that signed up for their new vehicles.

So, you ask, "What do limited partners get in exchange for this?" What they tend to get is reduced fees, both in terms of management and carried interest. Perhaps just as important as the reduced fees is the ability to allocate capital. As we've discussed, putting your capital to work as a limited partner is no small task. And these large allocations to single managers allow them in a single allocation to put a lot of capital to work.

Bryce Klempner: From the limited partner's perspective, they're increasingly saying, "Look, if, historically, we were writing you a large check and saying, 'Please just make it grow as quickly as you can,' now we're realizing that your capabilities have gotten so broad and your insights are so deep that they have a lot of relevance to the other activities that we have. Private equity may be only 10 percent of our allocation, and this fund that we're allocating to may represent only 1 percent, or half a percent, of our overall fund, but you have insights that can apply to the whole thing."

The logic for separately managed accounts has very much become one of, "How can you help us build our own capabilities? How can you inform us with your global insights, such that they help our broader investing activities across asset classes?"

Matt Portner: In many of these strategic partnerships, what we're seeing is shared research, heads of firms on speed dial—the ability to connect people from a pension fund or a sovereign wealth fund to a general partner. It really helps you to learn and build your skill set. So, there are a number of financial and nonfinancial benefits for the limited partners.

Recently, there has been a lot more enthusiasm for strategic partnerships. There's been one significant one in the past year, and we see more on the horizon. We think this will be relatively quickly adopted by limited partners. As the benefits of these strategic partnerships for both external managers and limited partners become more apparent, the pace of adoption will increase.

An interesting dynamic with strategic partnerships is the degree to which they'll continue to drive the consolidation of fundraising to the biggest funds, or the megafunds, as we call them. Strategic partnerships tend to happen with large limited partners and large external managers that can accommodate allocations of that magnitude. We think this will continue to drive consolidation. And the benefits will accrue primarily to the largest limited partners and the most influential limited partners that are able to do these deals. □

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