

Do GP Commitments Matter?

by

Gregory Brown

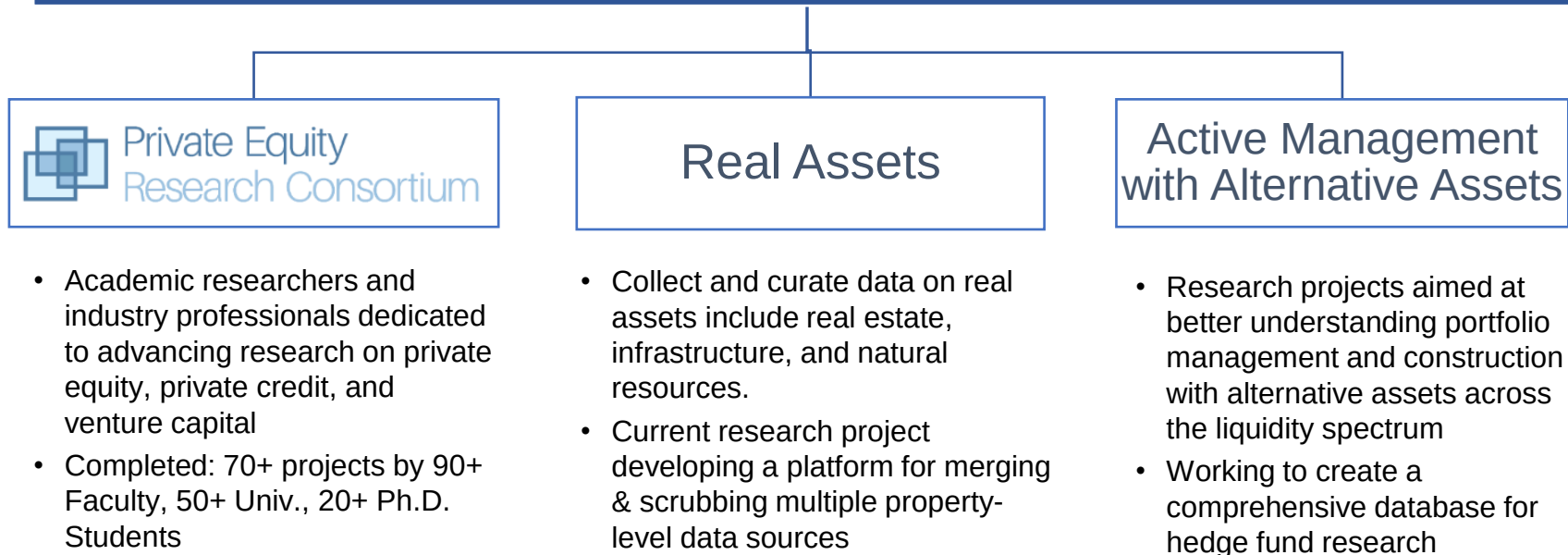
William Volckmann

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Full research paper is available here:

<https://uncipc.org/index.php/publication/do-gp-commitments-matter/>

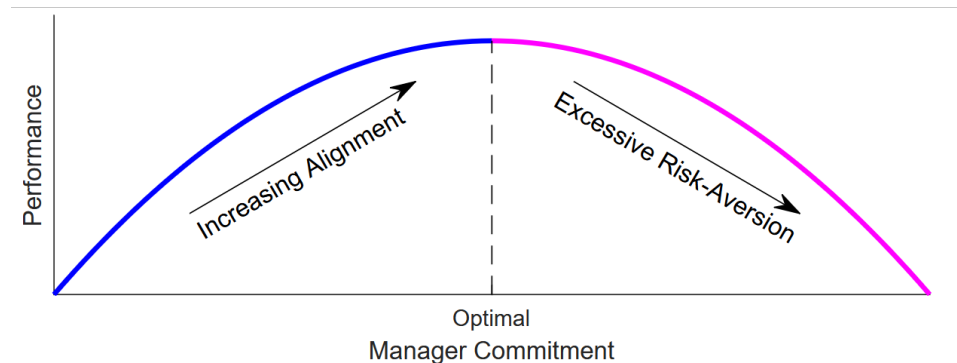
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Agency Theory for Private Equity

- Principal-Agent Problem
 - A fund manager (GP) making investment decisions and overseeing operation of fund on behalf of the principal investors (LPs) that provide capital
 - GP incentives may not fully align because of information asymmetry and risk aversion
 - Classic principal-agent theory suggests equity exposure for GPs, such as carried interest and fund capital commitments, can align incentives.
- GP commitments represent “skin in the game” but can be a double-edged sword:
 - Not enough skin in the game → GP may invest with excessive risk (given call-option nature of carried interest) or shirk (given guaranteed management fee)
 - Too much skin in the game → GP risk aversion can lead to overly cautious investment, excessive due diligence, and over-diversification



Data Summary Statistics

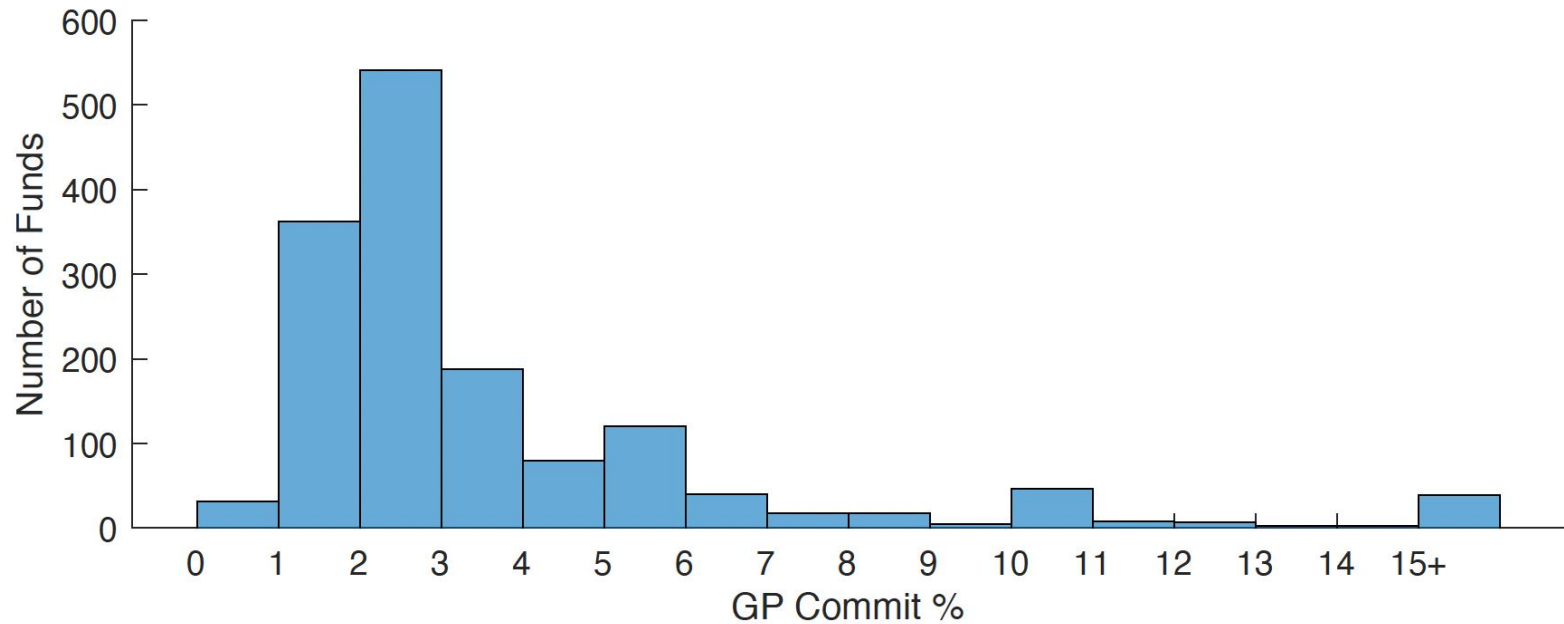
- 1,503 private equity funds
- Vintages 1998 through 2019 (and 1994)
- 38 countries and 14 industries
- Buyout: small, medium, large, global
- Venture: early stage, balanced, late stage
- Growth: small, medium, large

Variable	Obs	Mean	Std-Dev
GP Commit (%)	1,503	3.5%	3.8%
Fund Size (million USD)	1,503	1,500	2,620
Called (%)	1,256	89%	19%
Number of Investments	1,193	19	17
Fund Sequence	1,503	4	3
GP AUM (million USD)	1,445	12,521	32,693
MOIC	1,430	1.85	0.86
IRR (%)	1,280	19.9	14.0

Region	Number	Percent
North America	1035	66%
Europe	232	22%
Asia-Australia	191	11%
Other	45	1%

Industry Focus	Number	Percent
Generalist	779	72%
Technology	282	13%
Consumer	72	4%
Health Care	128	3%
Financial Services	47	2%
Industrials	56	2%
Other	139	4%

Distribution of GP Commitments



Statistics by Commitment

- Divide GP commit % into three intervals (alternative in the appendix)
 - Low: < 2.5%
 - Medium: between 2.5% and 5%
 - High: above 5%

	IRR			MOIC	
	Average	Median		Average	Median
Low Commit (<2.5%)	19.3%	16.9%		1.81	1.64
Middle Commit	20.6%	19.0%		1.88	1.74
High Commit (>5%)	21.3%	20.4%		1.94	1.72

- However, there are potentially confounding factors that must be accounted for...

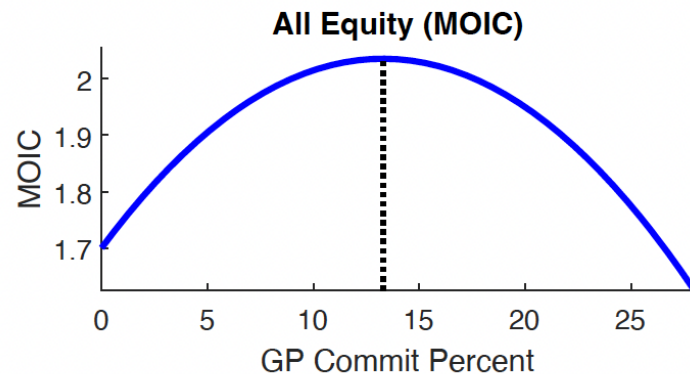
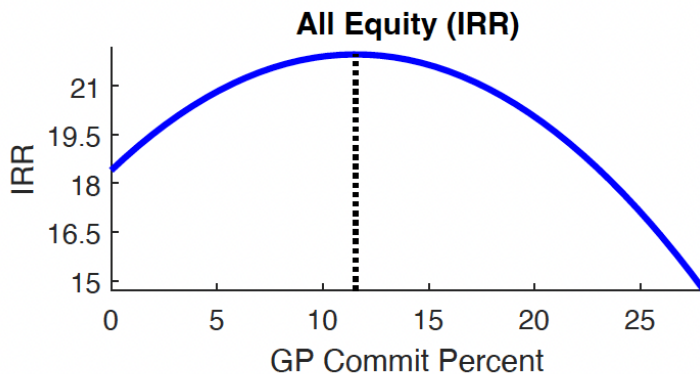
- For the most part, performance is highest for “high-commit” funds
- But other things are also different, on average
 - Mid commit funds are smaller (and GPs are younger) than high or low commit funds
 - High commit funds have different % capital called and # of investments
 - High commit funds have higher allocation in Asia-Australia and tech
 - **It’s possible that these other differences are driving observed performance differentials, and GP commitment % is coincidental**

Correlations between Performance Metrics and Other Factors								
	Fund Size	AUM	Percent Called	# Investments	Vintage	Region	Industry	Combined
MOIC	-0.09	0.10	0.14	0.10	0.24	0.14	0.24	0.48
IRR	-0.08	0.02	-0.08	-0.06	0.32	0.10	0.22	0.44

Regression Approach & Results

- **Multiple linear regression model** isolates relationship between fund performance and GP commit by holding these constant...
... and also allows for estimating the **potentially nonlinear relationship** between GP commit and fund performance
- The relationship between GP commitment % and IRR is positive and statistically significant for the sample of all equity funds and just buyout funds
 - (Similar results for MOIC)
- There is a statistically significant “inverse-U” shape suggesting an optimal level of GP commitment in the 10-15% range

OPTIMAL GP COMMIT PERCENT



Optimal GP Commitment

- The inverse-U shape generates estimates for optimal GP commitment %
 - Estimates are similar using either IRR or MOIC as the performance metric
 - The similarity of these results suggest that the findings from the regression model are robust

	All Equity		Buyout		Venture/Growth	
	IRR	MOIC	IRR	MOIC	IRR	MOIC
Optimal GP Commit	11.5%	13.0%	12.3%	13.0%	10.5%	12.6

Open Questions for Future Research

- What other factors are likely to determine the observed level of GP commitments?
- Are there important interactions with carried interest?
- Are certain types of GPs going to face a different set of incentives (publicly-traded, Softbank, SWF)?



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