Playing Both Sides – A Formula For Failure

From Judas Iscariot, Benedict Arnold, Marcus Brutus, to Mir Jafar, history is strewn with cautionary tales of figures who played both sides. Whether for eventual personal gain, due to a weak philosophical compass, an overemphasis on decorum, or merely a shortsighted marketing strategy, playing both sides almost always ends poorly. During interactions between GPs and LPs, the temptation to be all-appealing, all-accepting, and all-agreeing can sometimes become irresistible. However, failing to resist the temptation to posture as all things to all people can result in detrimental and irreversible labels that eventually nurture resentment and erode trust. Both GPs and LPs have been known to be, at times, guilty of being overly flexible; LPs, when stating preferences and expectations, and GPs, when describing strategies/philosophies and promising outcomes.

All things being equal, it is hard to dispute that during initial interactions between GPs and LPs, the power dynamic tends to favor the prospective LP. This is probably because investment-ready LPs or investible capital are usually scarcer than GPs willing to accept capital. This phenomenon is further worsened in periods like the current one, where LPs face lower liquidity, reducing their available capital for new private investments, and making them more selective with commitments. Of course, as GPs build more tangible track records that prove outsized returns, power quickly shifts in favor of such GPs. I use the term "playing both sides" as a shock factor synonym for "not clearly setting expectations" or "misrepresenting flexibility in rigid areas". Below, I detail my views on why GPs and LPs not setting expectations can lead to undesirable outcomes.

<u>**GPs**</u>

- **Yes, fundraising is tough, but are all dollars equal?**: Many GPs, particularly when times are hard, indiscriminately want to take capital from every available source. Just be aware that there are always strings attached. A challenging fundraising environment should not equate to lower standards when attempting to build a tribe of investors who are philosophically aligned. Non-sophisticated investors can become the most debilitating migraine when least expected. A large commitment check could come with crippling demands on your resources (time, ownership stakes, personnel, co-investments, etc.), which will surely be regretted in the future. A highly sought-after brand LP with an okay-sized commitment check could bog you down with ongoing bureaucratic tasks and thousand-cut you with side letter asks that will weaken your authority and autonomy as a GP. Not all dollars are equal, so beware when desperation beckons the lowering of standards.

- **Overpromising or overstating the characteristics of a strategy is not advised**: Some GPs are tempted to bend the attributes of their strategy to fit the current flavor of the month or to sound fresh and with the times. Doing so, either verbally (mainly as a marketing ploy) or in reality, is a recipe for disaster. LPs will hold you to your promises, so the marketing angle will eventually bite you hard and limit future fundraising from these LPs. On the other hand, executing a strategy that attempts to pollinate every newly blossoming flower will ultimately define you as rudderless and lacking any philosophical grounding and strategic direction. "You can put us in any category you want that fits your asset allocation, because we do a version of that," or "we don't care how you choose to categorize us, just know our goal is to make you money" – I have heard variations of these statements from GPs. They are all well and good if the GP has clearly articulated what its strategy is and is not. I stress this point because I have also heard the reverse from disgruntled LPs who have said, "We thought this GP was one thing, but they turned out to be something completely different". My advice to GPs is to embrace an LP's categorization flexibility only after you have given a detailed explanation of who you are and who you are not, and that explanation has been understood by the LP. This will immunize you from the LP's potential buyer's remorse based on misunderstanding your strategy.

LPs

- **Don't let politeness lead to false hope:** I have been guilty of this on many occasions. Sometimes, bluntly slamming the door on a GP does not feel like the right thing to do, and praising that GP while also rejecting the investment opportunity feels patronizing. So, like a big adult baby, you let the situation linger and linger and linger. Some GPs have been in the game for a while and can quickly read the signs. For many other GPs, false hope starts to brew, and they think the LP that is not taking any assertive action to move the relationship forward is just busy or getting their ducks in a row. As an analyst, I often find myself in "leading on" or "pseudo might invest" situations when I genuinely like the people behind the strategy, find it interesting from a personal perspective, or the initial meeting was perfect in terms of rapport and information. However, I know the clients I represent would not touch it. Usually, what eventually happens is that I come clean about the lack of interest from the clients and do my best to make introductions to other LPs – this lessens the guilt of leading a GP on. These days, I try to be direct about the fact that the rapport is there, that I am personally intrigued by the strategy, and that I enjoyed the initial meeting, but I don't know how the ultimate decision makers will receive it. This forthrightness eases the conscience, allows for fully transparent ongoing dialogue, and protects the time of all parties.

- **Be sure about your non-negotiables**: Since the world hardly ever serves up a perfect dose of anything, the art of compromise is second nature to most people. LPs are no different. The existence of a perfect fund is a myth. No fund will have everything you want or expect. The fund with amazing returns may give you very little time with senior staff. The fund with fantastic investor relations may be taking a lot longer than usual to generate distributions. Funds that were perfectly sized two cycles ago are now bordering "way too big," but like many LPs do, out of loyalty, you justified an investment in a fund that you believe is oversized. LP non-negotiables go flying out the window when access is gained into a fund that is known to be "hard to access". With this newly established access, all of a sudden, the fact that the fund is several times larger than the fund sizes you typically invest in doesn't matter. Also, by some magic spell, the fact that the access-constrained manager has a bevy of sister funds with interconnected compulsory commitment systems does not seem like a big deal. I am not even trying to play a holier-than-thou role here, because I have felt this temptation firsthand. In some circumstances, I have compromised aspects such as ongoing clear communication with the management team to gain access to an exclusive fund. It is not worth it. Regardless of the level of exclusivity and the promise of continued mind-blowing returns, no investment is worth compromising your core beliefs. LPs should know their non-negotiables and hold tight to them, regardless of how tempting the prospects may be if they are jettisoned.

Both GPs and LPs must anchor themselves in transparent communication and strong principles. Authenticity earns enduring trust, while flexibility without limits erodes it. In a field driven by relationships and reputation, standing for something is the only sure foundation.

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