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ESG and the thorny issue of pay

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Syntaxis Capital's ESG consultant and former LP Rupert Coull, argues that for a true alignment of interests to exist between LP and GP, the latter should rely more on carry and take home a smaller base salary.

When reporting their internal efforts as far as ESG is concerned, GPs are quick to trumpet certain facts and figures – money given to charity, waste recycled, reduction in energy use, and so on. But what of those things harder to measure – distribution of carry amongst team, employee training, payment of taxes? It doesn't look so impressive in a presentation, but at Syntaxis we think it is equally important.

Carry is distributed amongst all investment professionals, not just the chosen few; the firm is not a closed shop, forever dominated by a small core, but everyone knows what they must do to rise through the ranks. To us this is a governance issue every bit as important as the composition of portfolio company boards we support and invest with.

And now to a topic that I believe is the single biggest issue amongst the LP community. It came up at every single gathering of LPs I ever attended.

It seems to me that there is a rather large, dancing, pink elephant in the room when it comes to the ethical credentials of many GPs: executive compensation. Pay. Bluntly, many GPs pay their employees too much. More specifically, they are rewarded not for the performance of their investments, through the generation of carry, but by an overly large base salary.

At Syntaxis, we have no shame in declaring what we pay ourselves, and would argue that the industry as a whole needs to look at its levels of compensation. We are proud that staff are incentivised not through salary, but through a combination of salary, carry, bonus and a clear path to ownership. To give you an idea, the percentage of the partners' compensation that comes from projected carry is more than 70 percent – for the firm as a whole it is over 50 percent.

By contrast, the figure across the entire industry is just a shade over 20 percent. Or, to put it another way, the average employee is over four times more incentivised to keep his job than he is to make his investors money.

LPs should ask themselves whether they want their managers to be asset gatherers / preservers, or asset growers – desperate to generate carry because it is the only way they will make real money themselves.

The problem of individuals paying themselves too much in salary is clear. When a fund achieves a 30 percent IRR

and 3x multiple, everyone is happy, because everyone makes a lot of money. But what happens when after six years the fund is showing a negative IRR, and the hurdle rate seems a long way off? Where is our manager then? Sweating away in the office, working late nights, desperately trying to get the fund into profit? Looking for another job? Or on the golf course, safe in the knowledge the salary will keep rolling in? A true alignment of interests works in both directions, not just upwards.

As most LPs know, but few GPs would acknowledge, all too often the management fee is going on the marble floors in the Berkeley Square office, the corporate entertainment, and the investor relations exec who flies in to deliver 30 seconds of fluff on their latest fund. So next time you sit opposite a GP who is trumpeting their ESG credentials, ask them what proportion of their firm's total compensation (and not just their senior partners') comes from carry. From our perspective that would determine if they walk the walk, or just talk the talk.

Rupert Coull joined Syntaxis Capital in 2013 to establish and lead the firm's ESG function.

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