9Questions – Michael Kirchner, GCM Grosvenor – Investing in private credit's next generation

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9Questions is our Q&A series featuring key decision-makers in the corporate credit markets — get in touch if you know who we should be talking to!

Capital raising in private credit today is dominated by a small group of large firms. But LPs in the hunt for higher returns and seeking to diversify their private credit investment strategy are looking further afield, particularly at emerging firms in the space.

GCM Grosvenor seeks to pair up LPs with less-established firms in private markets through its emerging managers platform. Last month, the **New Jersey State Investment Council** approved a $300m commitment to the very program backed by **Apollo**.

9fin spoke to Michael Kirchner, managing director, strategic investments at **GCM Grosvenor**, about why it is a good time for investors to start looking at emerging managers in private credit.

1. Could you tell us what the emerging markets program is and what you intend to accomplish with it?

Our emerging managers strategy allows our clients to enhance their private credit portfolios' diversification and risk-adjusted performance while generating a pipeline of next-generation talent for their direct programs. It builds on our firm's long history and experience in the space. GCM Grosvenor has invested in emerging managers for over 20 years across alternative asset classes, and we currently manage over $20 billion in the strategy.

In private credit, we focus on newly launched private credit managers and new credit capabilities built within private equity firms. There is good data on the outperformance of smaller credit managers compared to larger ones. However, there is also more dispersion in the return streams. Therefore, it is crucial that you make the right selection. Yet, many institutions find it difficult to manage these programs themselves, given the resources required to source, underwrite, and execute these investments. The result is a strong value proposition at GCM Grosvenor and a natural opportunity for partnership. Many emerging managers are also owned and operated by underrepresented groups, a feature many of our clients are passionate about.

All of this has helped us establish a reputation in the marketplace as strategic capital for significant new launches globally.

2. A lot of capital is being directed to the largest funds in the private credit market in the last few years. Is it fair to say LPs are particularly drawn to larger funds and does that create an obstacle for developing newer, less established players?

This dynamic is both a headwind and a tailwind for emerging managers in private credit. Capital raising is very competitive, and the largest funds continue to raise most of the total assets. This has caused increased competition for the larger deals these firms pursue, causing spreads to compress and potential returns to decrease. However, emerging managers can focus on a broader set of investment opportunities, including smaller capital structures, and can be nimbler and more flexible in the marketplace allowing them to seek more alpha. This means better potential returns for investors who can access these firms, making them an attractive option. In our experience, the best emerging managers have been able to successfully raise capital and establish themselves even in highly competitive capital-raising environments like you see today.

3. What is driving investor interest in emerging managers?

The potential for higher quality returns, increased diversification, and building a pipeline of future talent are the key drivers of investor interest in emerging managers in private credit. It’s important to emphasize that the potential for higher-quality returns is a significant motivator for investors. Your leverage as an LP is highest when these managers are formative. It puts you in a position to secure lower fees, future capacity, and other attractive economic arrangements that are often unavailable when pursuing established managers. These additional economic benefits are also structural and do not require emerging managers to outperform for them to be realized.

4. How can small, newer, and diverse managers outperform more established managers and offer higher returns?

While there are exceptions, it is very common for returns and alpha to diminish as managers increase in scale. This results from the fact that generally speaking, as AUM grows, managers are forced to focus on a smaller opportunity set of larger deals where there is increased competition to deploy capital. Emerging managers’ ability to be nimbler and more flexible in pursuing a broader opportunity set, including smaller deals, is the main source of potential outperformance. The tradeoff is that there is more dispersion in the returns of emerging managers, making the sourcing and selection process crucial to realizing the benefits.

5. The emerging managers program has worked with private equity and real estate funds in the past. Do you anticipate the private credit program facing any similar challenges to grow?

Our experience in the private equity and real estate markets has been a valuable asset for the private credit program. We've been able to leverage the expertise of colleagues who have been focused on emerging managers for decades. 10 years ago, it was less clear to us that the opportunity set of emerging managers in private credit would scale in a way that we hoped. However, we have been pleasantly surprised to the upside regarding the depth and quality of managers we have been able to partner with over the years. Today, we could comfortably deploy multiples of our existing capital into attractive emerging credit opportunities.

6. What do you look for in terms of due diligence when partnering with emerging managers? What is good emerging talent?

The biggest challenge is that emerging managers, by definition, do not have an established track record as an independent entity. This requires us to dig in to assess a manager's historical success in investing capital. Understanding previous roles and responsibilities and utilizing our extensive network to spend time with their former firms and colleagues, allows us to form an accurate picture of historical performance and attribution. Consistency of performance is crucial, as a history of strong performance across various market conditions is a key indicator of a manager's ability to deliver reliable results. Alongside our evaluation of the investment talent, we put particular emphasis on risk and portfolio management experience and a focus on the operational side of the business. Private credit strategies require significant operational infrastructure, and this aspect of the enterprise should not be overlooked.

7. Among the strategies overseen by emerging managers, what do LPs most favor?

Historically, LPs have favored corporate credit opportunities, including direct lending and opportunistic strategies. However, the investment landscape is undergoing a transformation. The non-corporate or asset-backed space is not just gaining traction but witnessing a significant surge in interest and capital inflows. This is not a passing trend, but a substantial development in the private credit sector, one that we expect to see accelerating in the coming years as investors continue to pursue higher quality returns through diversification.

8. What's your outlook for the development of emerging managers within the private credit market? Is now a good time to enter the market?

Absolutely. It is a great time to be investing in emerging private credit managers. You have all the structural benefits we discussed combined with relative value in private credit, generally in today's environment of higher interest rights and attractive spreads. There is plenty of talent out there and real inefficiencies in the market. While we do not generally advocate trying to time these things, the current environment is very favorable.

9. We understand you have a background from the University of Illinois. Tell us about your favorite memory from your time there?

There are so many great memories to draw from. It was a top-quality business education that set me up well for my career. I particularly enjoyed my semester abroad in Vienna, the Final Four, the Rose Bowl, and all the lifelong friendships I formed along the way. I really enjoyed my time there.