PRIVATE EQUITY WIRE

NEW & EMERGING MANAGERS

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BCF

HIGH STAKES WITH NEW & EMERGING MANAGERS

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Let's face it, when it comes to new and emerging managers, the stakes are high. Whichever way you define them, be it first-time funds, funds one to three, sub-$250m funds, sub-$1bn AUM firms, underrepresented manager profiles or backgrounds, veteran investor hook-ups, young entrepreneur combos, or just the classic "team spin-out", raising capital as an emerging manager is difficult.

To paraphrase Mike Tyson: everyone has a fundraising plan – until they get punched in the face. Rolling with the punches is a large part of what it means to raise a fund in today's environment. Particularly for emerging managers, the competition is huge, and the cost can be prohibitive. The investor universe is also a difficult one to navigate and even the investors who are in a position to access and underwrite emerging managers, well, they're inundated and seemingly exhausted. If you fall into one of the above emerging manager categories, you need to listen up.

In many ways, the risk that making a commitment to an emerging manager represents for an investor is mirrored by the risk that any emerging manager takes when they strike out and seek to raise capital. In doing so, successful emerging managers will often embody an inherent contradiction: confident, resilient and optimistic, while at the same time remaining humble and facing a daily reality check that means they don't underestimate what it takes to get a fund over the line. They understand that fundraising as an emerging manager is high stakes.

However, just as the best poker players in the world, with the right experience and preparation, can turn what is seemingly a game of chance into a game where they come out on top more often than not, in a similar fashion, well prepared and experienced emerging managers can stack the odds in their favour when it comes to the successful launch of their business.

This article explores what it means to play high stakes poker with new and emerging managers, from both the investor and manager perspectives.

BCF Approach #1

At BCF, we work with managers across asset classes, strategies and geographies, and at various stages of their existence, from new firm setups to new fund strategies and platform extensions. This involves first-time funds as well as managers who have been around for decades and are looking at new products and approaches. These funds will often be building out new teams and rethinking fundraising tactics. In many ways, these established firms could also be regarded as emerging managers. We're often encouraging these funds to confront the first-time fund dynamics that they can still exhibit when fundraising.

It rehearses some familiar emerging manager themes, and also seeks to offer a fresh perspective that taps into the nuances and peculiarities of private capital fundraising. We've adapted the rules of poker for this purpose, and in doing so we follow a familiar structure:

- **The Flop:** the basic requirements for track records, structure and setup
- **The Turn:** the critical steps for identifying early investors and early deals
- **The River:** the ultimate reveal across differentiation, team dynamics and investor approaches

1. THE FLOP

Track record – "Past performance is not indicative of future returns", apparently. Or so the legal disclaimers tell us. While in many ways funds are in the business of selling the future, the first thing any prospective investor will do is review the success that the team has had to date. They will assess the strength and relevance of this prior success. If they like what they see, they will conduct performance analysis, attribution analysis, verification analysis, benchmarking analysis. Has the team done deals together? Have they taken these deals through a full cycle? Who led on these deals? What's the extent of the shared tenure and teamwork on these deals? Does the team have permission to say what it is saying about the track record, or is it backed up by publicly available sources? Where the track record is unavailable, weak, thin, irrelevant, dispersed, patchy or, let's say, "non-traditional", the investors that do the work will dig into other priority areas and you can guarantee they will conduct team references that will extend well outside of your immediate network and curated reference pack. Track records come in all shapes and sizes, but you always need one. You also need to be able to use it – before you spin-out, pay attention to LLP and carry agreements as well as any attribution letters or separation agreements. Think about what you legally do and do not own, what confidentiality requirements you need to adhere to, and what restrictive covenants you face. Your biggest worries should be action against you from your prior firm for any breaches as well action against you from potential investors who point to any misrepresentations.

Structure – Not all first-time funds are created equal. Fund size, domicile, entities, establishment, governing documents, tax, reg, fees, terms, discounts, GP commits, LP protections, waterfalls, authorisations, regimes, registrations etc, etc. Advisers are expensive but the one thing emerging managers really can't afford is not getting the fund structure right first time round. Your structure needs to be like a tank – bullet-proof, water-tight and ready to roll. In addition to the fund structure, investors want to see how the structure will work "below the fund" at the investment level and "above the fund" at the management company level. It's not just the fund LPA or term sheet that investors will review (or in most cases, rip apart). One of the biggest risks with first-time funds is potential disruption or fallout between the founding partners, so pay attention to the structure and drafting of your LLP/LLC agreements too, in particular provisions relating to ownership, voting, carry, disputes and leavers/joiners. It's also worth contemplating the ever-evolving set of alternatives to the traditional "closed-ended, third-party, blind-pool, private-fund" structure: think pledge funds, search funds, evergreen funds, seed funds, co-investment funds, funds-of-one, warehousing vehicles, continuation vehicles, club deals, single asset deals, fundless sponsors, joint ventures, separate managed accounts, and sidecars, to name a few.

Setup – You may be a new fund that is only a fraction of the size of one of the mega funds, but investors still want to see the right business infrastructure in place, from back office and in-house functions to the right suite of outsourced solutions and technology providers. As an emerging manager, you can celebrate not having the legacy issues and systems that blight old firms. But be careful not to imbed your own early on. Implementing best practices from the start shows intent and professionalism, and instils confidence that you are building a business where success is deliberate and repeatable. Navigating the landscape for fund counsel, offshore counsel, co-sec, fund administrators, auditors, banks, compliance and ESG consultants, IT providers and all the ancillary and related services – yes, it's daunting and time consuming,

> *As an emerging manager, be ready to deal with rejection*

BCF Approach #2

At BCF, we get involved with thinking through the main strategic and practical questions that need to be addressed when firms and funds launch. From early marketing materials and service provider coordination, to data room build-outs, investor perception studies, AGM planning and ESG frameworks, we work across the fund lifecycle and offer funds dedicated expertise and resources to help them free up time across the team to focus on other priorities. Finding the right fund counsel, placement agent, administrator or tech providers for your fundraise is challenging and time consuming. Coordinating the timelines and understanding the right sequencing and "chicken or egg" order of events is paramount. We streamline these processes, we know what to look out for, we can help you with the timelines, and guide you through the process.

but investors want you to create an institutional setup and they appreciate it more than you'd believe. You'll be surprised by how much grief things like opening bank accounts can cause you. But sweat the small stuff and do your best to get it right from the get-go.

2. THE TURN

Early deals – Whether you choose to make your first investments via pre-fund deals, or prefer to wait for dedicated fund commitments, investors are ultimately looking for the same thing: the ability for a manager to build a robust and differentiated pipeline, and to be able to close on deals competitively. Pre-fund deals offer investors that chance to see the team in action before making a long-term commitment. Investors that finance or part-finance these early deals alongside you get the chance to see first-hand how you execute and operate as a team. Fundraising is always a battle between spending time closing capital and spending time closing deals. Pre-fund deals can be the bridge here. Whether you're deliberately starting out deal-by-deal, or warehousing deals or seed assets for the fund, simply doing deals that are on strategy, on target, and on time will show investors you can do what you say you can do.

Early investors – Regardless of whether you're into sailing ("anchor" investor), gardening ("seed" investor) or construction ("cornerstone" investor), your first third-party investors are the biggest endorsement and momentum drivers for your fund. You are off to the races and subsequent investors will sit up. You can start to do deals and build out the team. But investors will still ask questions. Have these early investors closed, or have they only made soft commitments? Has the anchor been given an overly favourable deal? What role has the anchor had in negotiating fund terms? What proportion of the fund will they represent? Who even is the anchor, and do they have a strong reputation? These early investors are famously ones that placement agents can rarely help you with. Alongside high-net-worths and their own networks, funds will typically need to make their own forays into the family office and fund of funds space to see if there are any investors out there interested enough (mad enough?) to make an early bet on their fund.

3. THE RIVER

Differentiation: *Are you spinning out with a distinct proposition or are you just jumping on the roulette wheel?*

> *Alongside differentiation, team cohesion and dynamics are up there with your top priorities for your fundraise*

"Differentiation" must be one of the most talked about, but also one of the most elusive, concepts in fundraising. It's not just new private equity managers that deserve terms like "JAMBOG" (Just Another Middle Market Buyout Group). These days it applies across pretty much every asset class. Part of the problem is a failure to use simple language, but the failure to articulate what makes you different also runs much deeper. Before asking "why are we different", ask "why are we doing this". Before listing out credentials and coming up with new ways of saying what your competitors are saying, ask "why do we deserve for this fund to exist in the first place". Emerging managers have an inherent advantage in that they are agile and nimble. They can be creative and are not held back by any legacy language, problems or structures. They should be excited about what they do or see or feel or think about the world that is fresh and different. But it's not just about "talking things up" all the time, as tempting and reassuring as that may be. Funds that confront the hard lessons learned, understand their mistakes and their foibles, and spend time thinking about the reasons why they may fail as well as why they simply must succeed – it's these funds that will earn attention and respect (the precursors to any commitments and subsequent reups) from investors.

Team dynamics: *Has everyone in the team got their chips all-in and confronted any chips on-the-shoulder?*

> *Understand the career risk you represent for any investment professional tasked with diligencing your fund*

BCF Approach #3

At BCF, we insist on spending many hours interviewing the individuals that comprise the core team of any fund we work with. Group-think may sometimes have a role in developing new strategies and drafting materials, but getting one-on-one with team members means we can hear their backstories, ask for feedback on other team members, throw things back at them, interrogate what they think the strategy is, and, crucially, draw out any quirks or inconsistencies. Funds will always be wonderful, dynamic and volatile mixes of people and perspectives. Beyond generic references to "diverse and complementary skills and expertise", when you really understand the team's quirks and inconsistencies, indulge them and mould them, challenge them and layer them, only then can you arrive at what it is that's special here, and only then think about the language that resolves it and polishes it. Funds can't afford for these subtleties and potential frictions to play out in an unconstructed way in front of prospective investors. They will see right through it all. We have seen first-hand how lazy and dismissive approaches to things like awkward internal dynamics, toxic work practices and clear personality differences can end up disrupting, delaying, or even destroying, fundraising processes.

Building a successful investment firm is not the same as being a superstar investment professional. For a lot of emerging managers, it may be their first time being an "entrepreneur". Yes, you may have led your team at your prior shop, and yes, you may have built-out that team and run a phenomenally successful division of the business. But it wasn't your business or brand, or even you making the final job offer when hiring, and the infrastructure, support and protection your prior shop gave you counted for more than you give credit. The investment world can be stressful, but nothing will compare with the stress of having lights to keep on and people with mouths to feed, with no certainty around back-office, balance sheets or budgets. You're also probably quite used to getting your own way. As an emerging manager, be ready to deal with rejection. The way you adapt and learn from setbacks and failures as an emerging manager will define not just the success of your fund but also the long-term success of your firm.

For this reason, it's important that everyone in the team rolls up their sleeves and is "all-in" from day one. Everyone needs to pull together. Juniors need to recognise the stress the founders are under. Founders need to be generous and forever grateful for the trust, belief and career risk the rest of the team has decided to take on them. This isn't just about carry and comp – what's the firm's approach to flexible working, setting goals, employee wellbeing, firm culture, holidays, weekends? It's also important that everyone in the team at least considers the idea of the infamous chip "on the shoulder". Like with the quirks and inconsistencies that can determine great strategies, these chips

> *Before an investor makes a commitment to your fund, you've got to make a lot of commitments to them*

can be wonderful things. That hunger, determination, tenacity, grit, drive to succeed – it comes from somewhere and there will always be people in the team at an emerging manager who have something to prove or harbour feelings of imposter syndrome alongside ambition. Investors pay attention to these dynamics like you wouldn't believe. Who showed up to the meeting? Who was the most driven and energetic? Who sought to bring a junior colleague into the discussion? Who talked over whom? Whose personalities clash? Who said what about who, when who wasn't in the room? You may be asking, who cares? Well, investors certainly do. Alongside differentiation, team cohesion and dynamics are up there with your top priorities for your fundraise. At the most basic level, everyone needs to genuinely enjoy working with the people they spend time with every day. The heightened partnership risk with emerging managers versus established funds means more time needs to be spent understanding the true dynamics of the team and triangulating on the different goals, egos and working approaches to make sure partners are not pulling in different directions or ending up frozen into indecision.

> *It's harder than you think, it takes twice as long as you think, and it costs twice as much as you think*

Investor approaches: *Can you convince prospective investors that you're not bluffing and decipher their poker faces?*

Most institutional investors aren't interested in new or emerging managers. With the ones that are, you can guarantee one thing: they are looking at you to work out whether one day you will be a future successful brand-name manager or franchise, where getting in early and building the relationship presents real opportunities for scaling alongside outperforming managers in terms of long-term access, structural alpha, insights, intel, alignment, discounts, products, goodwill, co-investment, enhanced governance, transparency, bespoke arrangements, and a whole host of other potential strategic benefits. With all investors, the first thing you should be thinking is: who are they, what do they need, and when do they need it? What are you offering them that they don't already have? What bucket do you fit in? How do they define these buckets? What niche or edge, specialism or sector, market or macro trend do you play in that the investor is targeting or currently leaning in to? What are you offering that will resonate and standout? It's totally obvious what the investor is providing for you. They are essentially putting you in business. But at all stages you've got to be thinking: what's in it for them?

Don't waste time with investors who are unlikely to say yes (or take forever to say no). Spend time working out who the right prospects are. Have they already shown signs of being interested in this space or asset class or opportunity? Are they a viable candidate for your time? Even the ones that aren't viable will often still take the meeting. It's free learning for them, but it can be expensive and time wasting for you. Know your leads from your misleads. Before an investor makes a commitment to your fund, you've got to make a lot of commitments to them. Investors move in mysterious ways. Have empathy for the investor underwriting and decision-making process, the political battles they need to fight internally, the resourcing issues that constrain the time they can spend with you. Understand the career risk you represent for any investment professional tasked with carrying out diligence on your fund. Often there will be something instinctive or emotional, a gut feeling, or a particular characteristic, that means they feel compelled to present it to IC, despite any red flags or shortcomings. So, listen to the questions they ask and help them get the deal over the line. It sounds simple but it's amazing how much funds forget to listen. Not only is listening the best way to learn about an investor's requirements and process, but it's also one of the best ways to get great feedback and help you hone your pitch, iterate and improve.

BCF Approach #4

At BCF, we spend a lot of time reviewing investor diligence processes and questionnaires, and understanding innovations in investor approaches to sourcing and underwriting emerging managers. Are you aware of the emerging manager programs run by large US pensions such as LAFPP, Connecticut, TRS Illinois, TRS Texas, CalPERS, New Jersey or the Michigan Small Emerging Manager Program? Or the emerging manager events hosted by ILPA, PE Wire, McGuireWoods, EMex, BVCA, TRS/ERS or AIMA? Did you know about the emerging manager programs led by specialist investor groups, which at BCF, we have mapped in full from the OCIOs & endowments to the fund of funds & asset managers.

Everyone knows the River can make or break your hand in poker, and the same applies for emerging managers when it comes to the ultimate reveal across these core themes of differentiation, team dynamics and investor approaches.

If there's one request that brings everything together across the considerations we've outlined in the Flop, the Turn and the River, it's got to be this: be as thoughtful and considerate as possible at every step of the way. Being an emerging manager is being in it for the long haul. You can't just "have a go". It's not a lifestyle business. It's about creating and owning your own destiny. As part of this, you've got to make a lot of foundational decisions about the type of firm you want to build, and you've got to constantly think and rethink your approach with investors. Trust us when we say this: it's harder than you think, it takes twice as long as you think, and it costs twice as much as you think. Being an emerging manager is high stakes and will always feel like a bit of a gamble, but you can prepare to win. They say luck is what happens when preparation meets opportunity, so pay attention to your fundraising plan and the way you interact with investors when the time comes to pitch. Or, to paraphrase a potential investor relations strategy from The Gambler by Kenny Rogers:

"You got to know when to call 'em, know when to stall 'em, know when to talk no more, and know when to run. You never count your commitments, when you're sittin' with a prospect. There'll be time enough for countin', when the closin's done."

For more details on the advisory services provided by BCF, see www.bcf-advisory.com. We'd be happy to chat.

> *Be as thoughtful and considerate as possible at every step of the way*

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About BCF:

Briggs Capital Formation LLP ("BCF") is a fundraising & ESG advisory business that helps fund improve the quality of the offerings they take to market as well as the quality of the ongoing service they provide to their investors. BCF provides a critical additional resource and expertise that enables funds to address institutional investor expectations and requirements. The business is pioneering a new approach to capital formation and redefining the fundraising & ESG advisory landscape in the process. Please contact Joe Briggs at joe@bcf-advisory.com if you'd like to hear more.