Achieving Cruising Altitude

How to tap institutional capital to fuel growth

EVESTMENT
Private Markets

Taking-off and gaining altitude

If you are like most emerging managers in the private markets, you probably launched and grew your firm with a mix of capital from friends & family, high net-worth individuals ("HNWIs"), and a family office or two.

And while this seed capital propelled your firm to take-off, it can only elevate you so high. The reality is that these smaller investors who fueled your first few funds are not guaranteed to re-up with you during your next fundraise, and even if they do, it's unlikely that they will return with substantially larger check sizes.

As you attempt to gain altitude and scale your firm you must build relationships with and secure investments from large institutional limited partners ("LPs"). It is their capital that will fuel your firm's long-term flight.

Staying aloft and securing a new, long-term source of fuel

As your target fund size grows, your roster of investors and the size of their commitments will have to follow suit. To stay aloft and sustain your firm's flight you must win commitments from the investors at the larger end of the institutional market. Larger, more sophisticated institutional investors, such as public pension plans, will have the ability and desire to commit these larger sums of capital. But building relationships with and securing commitments from these investors is just one of the many hard parts of being an emerging manager.

Turbulent times ahead

The fundraising environment for general partners ("GPs") in the private markets has never been more competitive, and this is especially true for emerging managers. Most institutional investors are focused on investing with well-established firms and allocate very little to emerging managers.

Take for example the Teacher Retirement System of Texas. The pension plan is one of the most active investors in emerging managers the industry yet they commit a mere 1.1% of their total portfolio to emerging managers.[1] Most investors have no explicit emerging manager mandate at all.

As if you needed one more obstacle to overcome to access institutional capital, having demonstrable outperformance is no longer the guarantee to a successful fundraise that it once was.

> "I naively thought that given our performance, we would just walk right in, raise Fund II, and be set. No, it still took real work.
>
> *Bradley Tusk, Founder and CEO, Tusk Ventures*[2]

From an LP perspective, investing in emerging managers is perceived as riskier when compared to investing with their more stable, blue chip competitors.

[1] https://www.trs.texas.gov/Pages/investment_team_emerging_managers.aspx
[2] Fortune Term Sheet, December 19, 2019

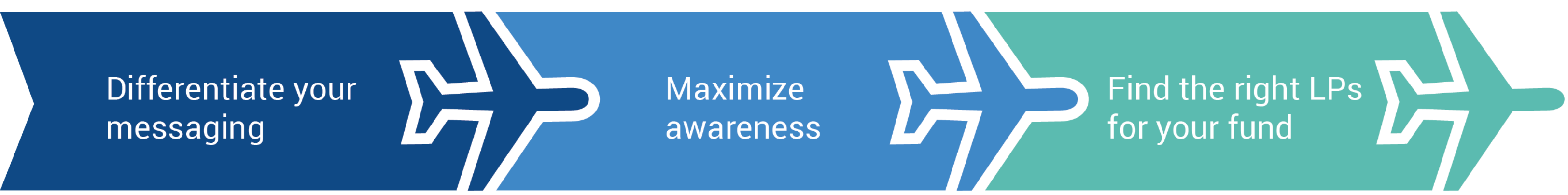
All this creates an incredibly daunting atmosphere for emerging managers to navigate. But for managers with an innovative flight plan and the right navigation tools, cruising altitude is within reach.

Chart a new course for your fundraising and investor targeting

Today many emerging managers struggle when attempting to fundraise using the traditional private equity playbook. They strain their limited resources trying to execute the textbook approach of pushing their pedigree, their strategy, and their track record to any and all institutional investors and consultants who will take their calls and meeting requests. The results of this approach is often lackluster in terms of actual commitments and troubling in terms of the over-expenditure of time and resources.

> To raise capital from institutional investors as an emerging manager, you must do what your peers and the large established managers in the industry are not doing: leverage technology tools and data.

This pragmatic approach to fundraising can be distilled into three key goals:



Change your call sign

Differentiate your message and stand out from the crowd

The first step in this approach is differentiating your message. It is imperative that you come to the market with your unique story and ensure that it resonates with investors.

At this point you have likely heard this kind of advice ad nauseam. The idea of “differentiate yourself to stand out” is by no means revolutionary but it remains crucial for emerging managers as the market remains incredibly crowded and competitive. While 2019 fundraising didn’t match the highs of 2018, there is still a healthy appetite for private markets funds from LPs. And there are thousands of funds seeking to meet this demand. As of January 2020 there were over 3,500 private equity funds in market, a remarkable figure given that over 1,300 funds raised $595 million in 2019, down slightly from the $628 million raised in 2018.[3]

The burgeoning supply of funds resulting from the voracious demand from LPs has made life more challenging for both sides of the market. Institutional investors globally are now inundated with pitches and meeting requests from prospective fund managers vying for commitments. Consequently, many investors have a hard time differentiating one lower middle market buyout firm from the next.

[3] https://www.pionline.com/private-equity/private-equity-funds-amount-raised-slip-2019-preqin

How hard can it really be for an LP?

To understand what LPs are facing as they traverse the private markets landscape, we leveraged Market Lens, eVestment's market intelligence platform, to review the words and language used by a cohort of fundraising GPs in their presentation materials. We found that a surprisingly high number of GPs are using very similar language to describe their firms and funds to LPs. A majority of GPs descriptions of their firms and value was centered on offering a "differentiated strategy" led by a "proven team" with "deep industry expertise."

When every manager pitch starts to sound the same it becomes an incredibly difficult task for institutional investors to separate the contenders from the pretenders.

At the other end of the table, for motivated emerging managers who strike out on their own seeking to capitalize on the LP demand, standing out from the crowd of "top quartile" performers has never been more difficult.

So how do you achieve differentiation?

Differentiation can be achieved through insight into how other GPs, especially other emerging managers, are positioning themselves in the market and how LPs and their consultants view these managers.

Gaining access to competitor pitch decks and consultant recommendation memos is crucial for collecting this insight.

While these kinds of documents are not something you can find with a simple Google search, they are also not as unobtainable as you might think. All U.S. public pension investors must disclose these documents to individuals who request them through the proper channels, most commonly a Freedom of Information Act ("FOIA") request. Managers can go the route of making these requests themselves, or they can turn to technology platforms like Market Lens to do the job for them.

The importance of access to competitors' pitch decks is clear. They contain the exact language and messaging rival GPs are using to position their funds and strategies during fundraising. Consultant recommendation memos are valuable because they elucidate on what LPs value in their GP relationships and make clear what characteristics and qualities they are looking for from prospective fund managers. Access to these insights will help you craft a compelling and differentiated value proposition with your own pitch deck. One that highlights your strengths in the areas that matter most to LPs.

Above all, what is truly unique about your firm is the personal journey of your team and your firm. It is important to highlight this story in your foundational message to make connections with your prospective LPs. Private equity is above all a relationship business and your story can create a human connection between your firm and a prospective institutional LP. A connection that can be the key to unlocking a commitment from the investor.

Find the Jetstream

Maximize awareness of your firm with institutional investors

In a 2019 eVestment Private Markets survey of institutional investors, when asked "how far out investors begin to track a fund manager with a view to making a new commitment," 57% of respondents stated that they manage a forward calendar lasting between 12-24 months in duration.[4] In most cases this means that if an emerging manager has not been engaged with a potential LP for at least a year prior to their targeted close date, they are unlikely to see a commitment from that investor.

To ensure success in your next fundraise, you need to start building awareness and relationships with prospective investors well ahead of your projected close date. All the advanced work and planning put in now will have a direct impact on your ability to win commitments when your fundraising begins in earnest.

[4] *2019 eVestment Private Markets Due Diligence Survey*

For emerging managers, scaling awareness of your firm among institutional LPs means leveraging strategies that deliver meaningful return on investment without extensive allocation of your limited time and resources.

In today's market, institutional investors have become intensely data-driven in their manager selection processes. A core feature of this quantitative approach is leveraging private markets databases to source new investment opportunities and conduct preliminary due diligence on promising managers. As a result, database profile creation and population has become an effective method, with vast upside potential, for raising awareness of your firm. While you focus on managing your active investments or researching prospective LPs, your firm's data could be generating inbound interest from investors simply by being available and up-to-date on the numerous databases LPs are using to source prospective GPs.

Database Population Considerations: What types of private markets databases are out there?

Private markets databases can be grouped into three main categories, each with their advantages, disadvantages, and caveats. All of which you should consider before executing a database population strategy.

Public Databases

As the name suggests, public databases allow any interested and paying party to access their platform. Users of these databases range from LPs and GPs to journalists and academic researchers. Public databases are typically operated by third-party companies who collect their data both directly from participating GPs and through publicly available sources.

Private Databases

Private databases are those built and operated by industry consultants. The audience of these databases is restricted to the institutional-quality clients of their respective consultant operators. This limited audience is one of the advantages of private databases because it means that those leveraging the data are either potential investors or the consultants who advise them. In regards to the firm and fund data on private databases, it is sourced from GPs or from the documents LPs receive as investors in funds. Public sources for data may also be used.

Targeted Databases

Targeted databases are similar to private databases in that their audiences are exclusively institutional-quality investors. However users of targeted databases are not limited to the clients of any one consultant in the way that private database users are. Many LPs who use private databases supplement that resource with access to a targeted database. These databases are generally run by third-party operators and available to any accredited investor. Targeted database operators source their data directly from GPs as well as from public sources. eVestment Private Markets operates a targeted database called Profiles, available exclusively to accredited investors.

Where should my data be?

To maximize institutional-quality investors' awareness of your firm, you should work to build profiles for your firm and funds across as many databases as possible. But before jumping in, it's important to be thoughtful and deliberate in your approach to this process. Making conscious decisions about the level of data privacy you want to maintain and the viewer personas you want to reach should be top priorities. Consider questions like:

Who are the primary users of the database and do I want them to have access to my data?

This is one of the most important questions to consider to ensure you are getting the most value out of your profiles without compromising your competitive advantage or exposing your fund to unneeded risk.

Public databases are often eager to provide their data to any interested party and may be unscrupulous in vetting their users. If you decide to build profiles on public databases, you need to make certain they do not expose your fund to compliance risk for soliciting investment from non-accredited investors.

When considering private databases, it's important to decide whether you are prepared to take on the added layer of working with consultants in addition to LPs.

Are the reporting requirements burdensome?

After building an initial profile, databases need to be updated regularly to guarantee investors have the most current data available. Generally this means logging in to platforms or emailing performance reports on a quarterly basis to provide updated data. In an effort to facilitate participation from GPs, some databases will staff internal teams that handle the data entry portion of these process making it easier for you to maintain an updated profile.

Before committing to a profile, understand what each database needs from your firm on an ongoing basis and ensure it is not overly burdensome on you and your team.

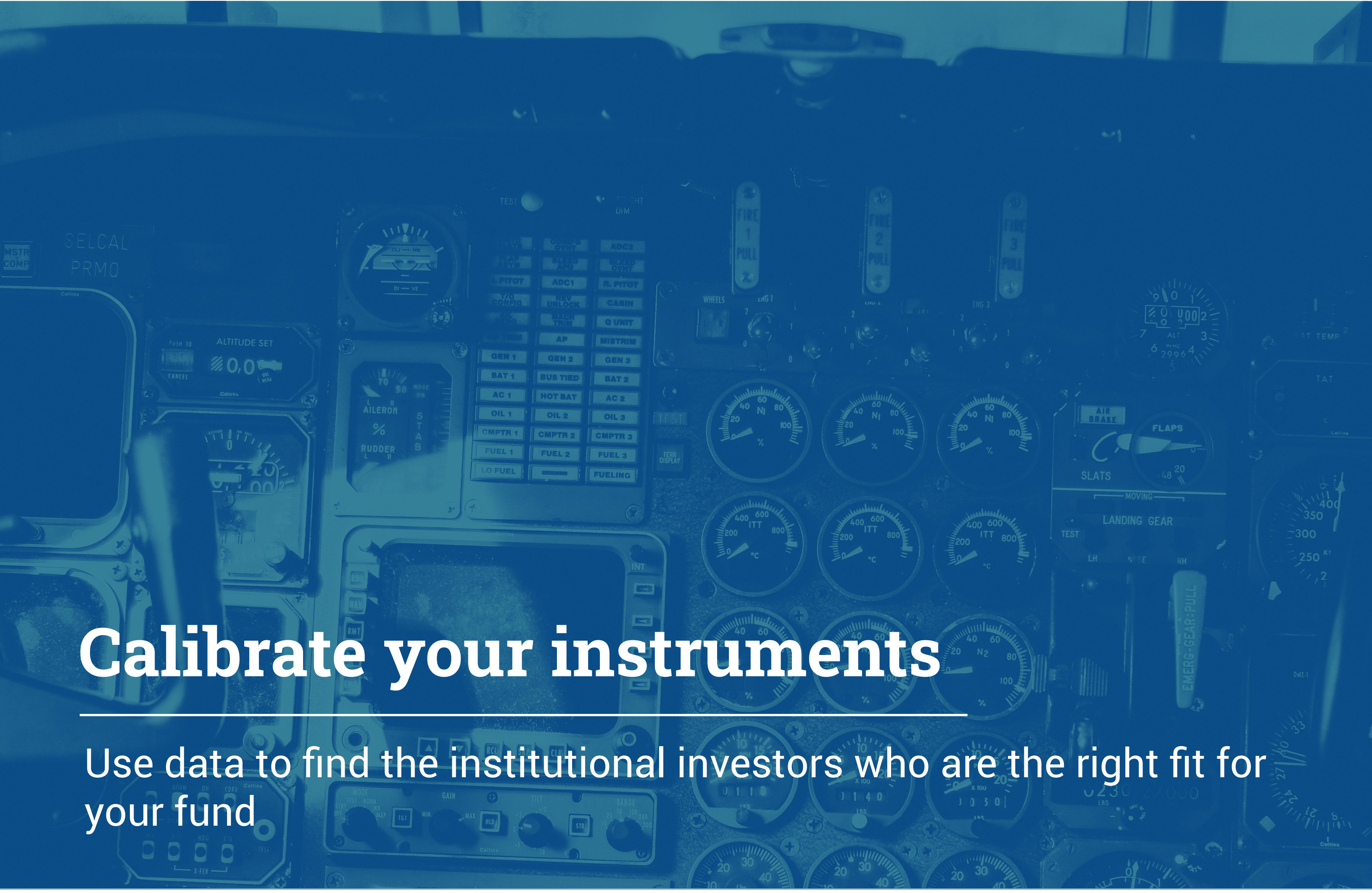
Will peers and competitors have access to my data?

The proliferation and growth of public databases has ushered in a “new normal” with regards to data transparency in the private markets. The open accessibility of public databases means that your firm’s data could be viewed by your peers and competitors.

Some of this is unavoidable as much of the data is sourced from public filings and through FOIA request to your LPs, but as you develop your database population approach, you need to consider your level of tolerance for other fund managers competing for the same assets being able to view your performance and information, and how that may impact your fundraising efforts.

Find the right balance and maintain a long-term view

Above all, your database population strategy is about finding the balance that is right for your firm and understanding that you likely will not see results overnight. It is important to remember that by submitting data and updating your various profiles on a quarterly basis, you are maximizing awareness and receiving essentially free, passive advertising to LPs for your firm and funds. Something that can make the difference when it comes time to fundraise.



Calibrate your instruments

Use data to find the institutional investors who are the right fit for your fund

Looking again at the eVestment Private Markets survey mentioned earlier, it also found that only one in four institutional LPs are looking to expand their roster of GP relationships.[5] As an emerging manager this statistic puts an even greater pressure on your fundraising efforts. With limited time and resources, you can't afford to focus on institutional LPs who have a low likelihood of committing to your fund. The opportunity costs are too large.

The instinct of some GPs is to chase down the CalPERS and Ontario Teachers of the institutional investing world, prominent and well-known, with large checkbooks. But in most cases going after these types of LPs is quixotic for an emerging manager. You are much better off targeting the right LPs – not the biggest and "best" LPs.

[5] *2019 eVestment Private Markets Due Diligence Survey*

Who are the right LPs?

The right LPs are those institutional investors who have a clearly defined need for a fund like yours within their portfolio. This may come in the form of a stated mandate for funds with a strategy and allocation size that matches your fund's profile, or simply a mandate that seeks out emerging mangers. Alternatively LP portfolio rebalancing events resulting from revised target allocations or the unwinding of existing manager relationships also present opportunities for emerging managers.

Taking a strategic and selective approach to finding LPs will improve your fundraising efficiency and minimize wasted time and effort during your capital raise period. But this is not to say that contacting and connecting with a large number of prospect investors will not be required in order to raise your fund. Industry research shows that GPs receive commitments from as few as 1 in 10 prospects.[6]

How do you identify the right LPs?

The first step is to be as data-driven as the institutional investors you are targeting. When thinking about what LPs to target, answering the following questions can help you narrow your search:

What is the investor's outlook?

How does the LP, and/or their consultant, view your strategy? What market trends have the potential to affect fundraising? These answers can help you understand the appetite for your strategy and the likelihood of securing a commitment.

Are you a size fit?

Does your fund size and target commitment amount match up to the LP's desired fund profile and commitment bite size or is your fund too small? If there is a fit, what is the amount you can expect to receive from the LP?

Do they have open slots?

How many commitment slots are available for the remainder of their financial year or through your intended fundraising period? Can you reasonably expect to receive a commitment from the LP within the relevant timeframe?

[6] https://www.perenews.com/emerging-managers-expected-grant-big-fee-breaks/

Who have they committed to?

Which other funds have they recently committed to? Does the LP have pre-existing relationships with any of your competitors and has their mandate for your strategy already been fulfilled?

Ultimately with this approach, emerging managers can minimize or completely eliminate time spent chasing prospective LPs who are not seeking new GP relationships or who have already filled their allocation to your fund's strategy with a competitor's fund. But perhaps most valuably, by understanding what investors are looking for and when they are looking to commit, you can target and tailor your pitch to speak to their exact needs, ultimately increasing your chances of earning a commitment.

Disappearing over the horizon

Technology and data have been areas of innovation that established players in the market are now starting to investigate, understand, and leverage for capital raising. As an emerging manager you have a huge opportunity to start your firm and fund off on a path to success and sustained “flight” by using technology to facilitate fundraising from institutional investors. Will you be getting onboard?

Get in touch with a member of our team and see how eVestment Private Markets can help your firm reach new heights.

Find out more

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