FIRST-TIME FUNDRAISING BAROMETER

2018

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FOREWORD

The private equity fundraising market is extremely buoyant and, as a result, extremely competitive. According to data provider Preqin, in 2017 global fundraising exceeded US$450 billion, a record high and US$39 billion more than the previous year. The time taken to launch and raise a fund is now at just 13.4 months, the lowest since the financial crisis, and 30% of funds are taking six months or less to close.

It is, in short, a very competitive fundraising environment. Added to the mix is the wave of new firms and maiden funds that have set-up shop over the last five years or so. There has always been a healthy flow of new funds into the private equity market, even during the financial crisis, but rarely have there been so many firms, fresh-faced or old hands, vying for the attention of investors.

As such, anyone considering raising a private equity fund for the time, or those who have recently embarked on such an endeavour, will need some help. As the industry association, the BVCA has produced this publication to provide just that. But this is not a ‘guide’ in the traditional sense. There are a number of such publications already in existence. Rather, this aims to give you some insight into the latest market sentiments from both fund managers who have recently been through the process themselves, and the investors who ultimately hold the purse strings.

During December 2017 and January 2018, we polled 15 senior fund managers (General Partners) and 16 investors (Limited Partners and fund-of-funds) to get their opinion on some of the most important issues for first-time funds. The results of the survey presented here – accompanied by more detailed comments by some of the respondents – helps shed light on what it takes to launch your first fund, containing crucial insights and advice for any new manager.

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INTRODUCTION

Setting up a new business can be a scary exercise. Setting up a new investment management business can be even more frightening. But many take on the challenge and many are successful.

The world of private equity can be a mysterious place. In this guide we try to lift the curtain on some of the mystique and help new managers through some of the ‘do’s and don’ts’ of setting up a new fund. There is no fixed recipe for success – but gaining an understanding of how investors think, along with learning from other managers who have done it before, will, we hope, provide valuable insight to those thinking of going in on their own.

One of the key messages that must emerge from this work is ‘talk to as many people as you can’

Everyone wants to see new managers succeed – and everyone is happy to help. The world of private equity is relatively small, and professionals – administrators, lawyers, placement agents, auditors etc. – as well as investors are all more than happy to make a contribution and help. And in the case of the professionals – at least the first conversation is generally free!

The other message that must prevail is ‘don’t underestimate the time it will take’. It takes a lot of time and effort to put a team together (especially one that can work together, producing returns, for 15 years or more), develop the track record and develop the investment strategies that will catch the eye of potential investors. There will be pain along the way (which needs to be anticipated) and it goes without saying that the team needs to be well-funded to get through the costs of development and launch. It will be a while before management fees begin to flow in, and costs and expenses will soon mount up.

This survey is a snapshot of thoughts and suggestions from investors and GPs alike. And as a number of successful new GPs have suggested, it’s not just about money but wanting to do things differently. Our world is changing rapidly and it is imperative that our industry changes with the times. New managers refresh the industry. They challenge old practices and bring new ideas to old problems – and deliver on returns. New managers are welcomed by the industry as a whole and many are willing to help and support. Seek out that help and the chances of success will only increase.

Ian Kelly, Chief Executive Officer, Augentius

STARTING OUT

Launching a new venture is always difficult. Launching a fund, even for an established manager, is ever challenging. Combining the two is not for the faint-hearted. As one respondent to the survey said when asked, what pieces of advice they would give to new fund managers: "It will be harder than you think." Why then do so many do it?

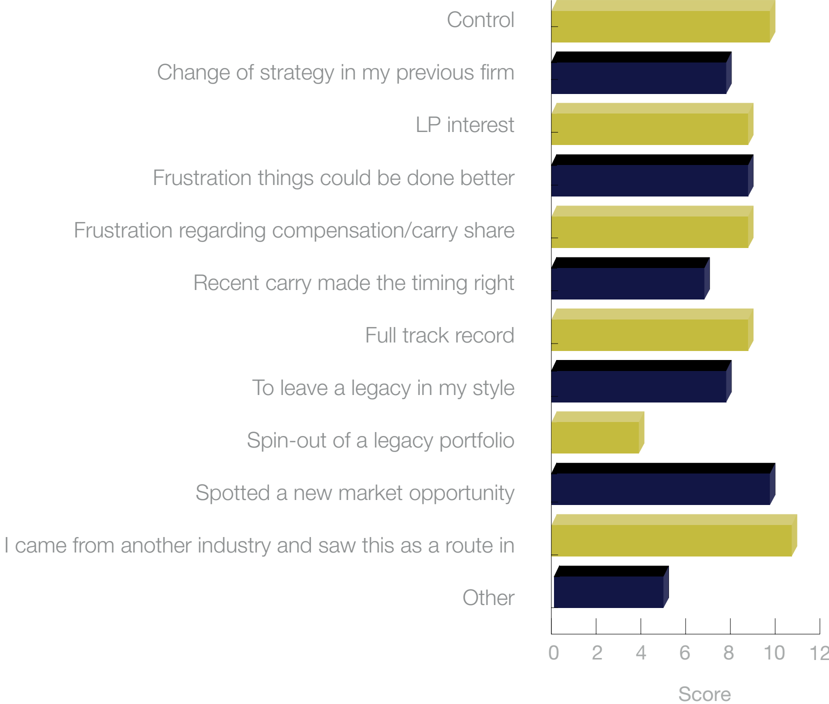
The results from our GP members suggest a mixture of wanting more control and a frustration that things could be done better and, that ever thorny problem, frustration over compensation and carry share.

Perhaps most interesting are those that responded came from another industry or spotted a new market opportunity. The former nicely ties in with the surprising result produced elsewhere in the survey that many new fund managers did not have a long, if any, relationship to their investors. Positive news for those coming from outside private equity and venture capital, that this industry is not a closed shop.

As for the latter, market opportunity, finding a niche, or a differentiator, is very important in private equity. With the surfeit of firms in the market, offering something different has become one of the key trends over the course of the last decade or so. If you are planning to give it a shot, you need to make sure you have a distinct investment approach to stand out from the crowd.

GHO Capital is a specialist mid-market private equity house with a focus on European healthcare. Founder and Executive Partner Alan MacKay set up the firm in 2014. "For 10 years I was a sector-focused investor. Looking at the private equity landscape in 2014 we saw more than 20 mid-market healthcare funds in the US, but none in Europe, so we knew there was a long overdue opportunity. We decided to build a healthcare sector firm based in London. It was great that LPs globally agreed this diagnosis. On the same basis, amazingly, there are still more than a few industries where Europe has no dedicated sector specialist."

GP: WHAT WERE THE DRIVERS FOR YOU LAUNCHING A FIRST-TIME FUND? (IN ORDER OF PRIORITY)



OUT WITH THE OLD...

Everyone setting up a new firm and fund wants, ideally, to do things differently, and this is especially true for those who are coming out of a previous fund manager to set up shop on their own.

Dovetailing with the results from 'why set up a fund?', this set of responses reveals that, for many, remuneration is a significant difference between their current firm and their old one, whether it be dividing up the carried interest more equally amongst the partners or sharing the carry among a wider pool of people rather than just the most senior figures (who can also be the founders).

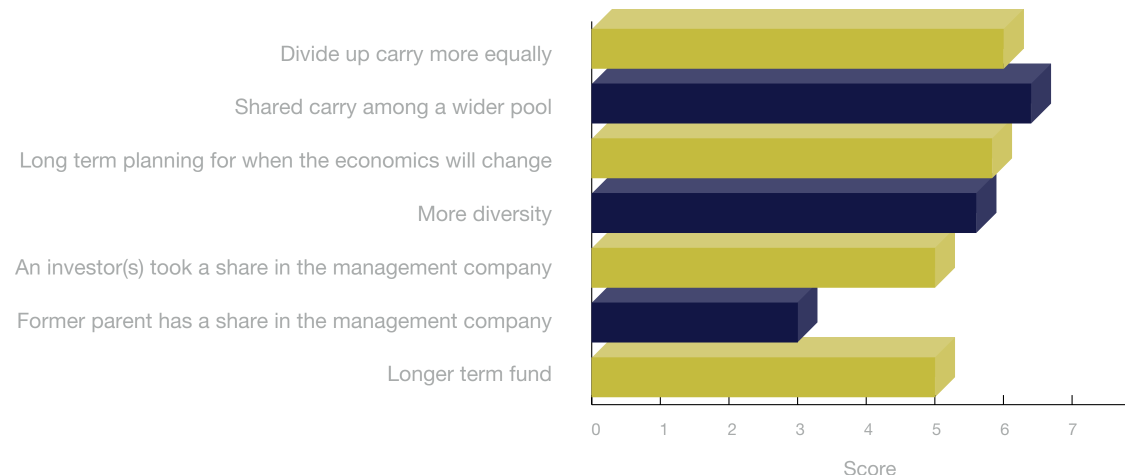
The results could indicate that the traditional carry model for private equity is becoming outdated - and there is some anecdotal evidence beyond this survey to suggest that is the case - and that there is a newer generation entering positions of seniority now who want a more equitable split, a more "democratic" model.

Frog Capital's Managing Partner Mike Reid believes it is more about ambition: "They just want to be the senior ones now and get a fair share. I don't think the model is changing that much, it's just about generational transition. If good people are good enough to start a new fund with their own name and their own team with more carry, why wouldn't they?"

Alan MacKay says the reason he started GHO Capital goes beyond money: "What we were able to do by designing a firm from a blank canvas was to engineer out many of the structural boundaries of older firms – not just around remuneration and carry but around career progression and future succession."

Given the current concerns around the lack of diversity within the business world, and in private equity and venture capital in particular, it is noteworthy that this was an explicit differentiator for many respondents from their previous employer, and bodes well for the future of the industry.

GP: WHAT HAVE YOU DONE DIFFERENTLY TO YOUR PREVIOUS EMPLOYER? IN ORDER OF PRIORITY:



"There has been discussion for a long time that traditional carry models are under pressure, and we've certainly seen approaches start to shift in many of the funds we advise on. If we accept that the first-time funds of today are the established funds of tomorrow, then it does seem we'll be looking at a different picture in terms of how carry is shared and how talent is attracted and retained in the years to come.

Diversity is an area the industry has tried hard in recent years to address. The fact that it is a high priority for first-time fund managers shows a dedication to attracting the very best talent, creating greater potential for stronger, more well-rounded firms with a breadth of competencies and experiences."

JOHN RIFE, PARTNER,
DEBEVOISE & PLIMPTON

SURPRISES

No matter how much effort you have put into your strategy, no matter how tirelessly you have worked to get the best people together, honed your investment strategy and polished your slide deck, something will, invariably, not go according to plan. There will always be something that you didn't account for, something unexpected or something you underestimated.

Raising a first-time fund can be immensely rewarding but it is also a task that is beset with difficulties, so it is always useful to look at how others have fared before embarking on your own journey into the (relative) unknown.

For our General Partner respondents, the extent of regulation came out on top with 40% of people stating this was one of their biggest surprises. The amount of paperwork required to start a firm and launch a fund certainly can be daunting, and if you haven't been involved in a fundraising process before you will quickly become familiar with a whole host of new acronyms – FCA, LPA, AIFMD to name just a few – but it is not insurmountable by any means and, whilst time-consuming, will likely not be your biggest challenge.

Mike Reid, Managing Partner at Frog Capital, called the regulatory issue "overblown". For him, "the real issue is getting people to first close when there is no incentive to do so".

Regulatory work is part and parcel of fundraising, much like the two joint-second from top answers: the number of meetings with LPs and the number of LPs who don't invest in first-time funds. You will have to meet a lot of investors and sometimes you will get knocked back but you have to go again. And, unfortunately, a number of investors do not invest in first-time funds. Often, this will be out of the hands of the individual or individuals you are engaging with but will be an explicit policy of the organisation. Many investors are simply not comfortable writing cheques for unproven fund managers.

For LPs, the surprises they encounter are varied but a lack of differentiation and deal flow opportunity come out comfortably on top. Richard Clarke-Jervoise, Head of the Stonehage Fleming Private Capital Investment team, says: "GPs need to be crystal clear on what they are offering that existing players cannot. Remember that most LPs will see something like 200 to 400 funds a year and so to get their attention you need to fulfil a real need and to stand-out from the pack."

The number of pitches is one of a number of pieces of advice from Ken Cooper, Managing Director of the British Business Bank: "Realise that LPs see more opportunities than they can fund. Put yourselves in their shoes and focus on an interesting and informative pitch. Some suggestions would be to make sure you don't pitch that you are better than another fund manager they have backed. It isn't a point in your favour, you probably haven't done the diligence and you are calling their judgement into question. Cover your own past achievements but don't exaggerate them - when you get found out it will sour the relationship. Do be open about the challenges but show how you meet them."

The composition of the fund management team is also important, and almost a third of LP respondents chose "team spread", or lack of, as their answer to what surprises them. This represents a move away from the early days of private equity where investors would subscribe to a fund almost purely on the basis of a star fund manager. Today, investors are much more interested in having a balanced team rather than a single figure running the show (if only because they want to be reassured the fund won't fall over if for whatever reason he or she leaves the firm). For investors, you need to be able to show that as well as investing, you are also able to run a business. A fund management team needs to have a good mix of skills and experience, from deal doers to fund raisers to analysts.

GP: WHAT SURPRISED YOU MOST ABOUT YOUR FUNDRAISE?

MOST APPLICABLE

1. The number of meetings with LPs
2. The number of LPs who don't invest in first-time funds
3. The extent of the regulatory work needed
4. The extent of LPs due diligence
5. The amount of GP competition
6. Pressure on fees
7. The investment required in infrastructure
8. Nothing about the fundraise surprised me

LEAST APPLICABLE

LP: WHAT SURPRISES YOU MOST ABOUT GPS RAISING A FIRST-TIME FUND?

MOST APPLICABLE

1. Lack of a differentiated strategy
2. Lack of evident deal flow opportunity
3. Lack of exit capability
4. Not a good team spread. Dominated by one person
5. Never worked together before
6. Difficult to see where decision-making lies
7. Slowness or inability to complete Due Diligence questionnaires
8. Inconsistencies in the track record
9. Misaligned economic interests
10. Lack of infrastructure
11. Lack of flexibility
12. Lack of long term planning

LEAST APPLICABLE

"You can't open the private equity trade press without reading about the increasingly complex regulatory environment for private funds. Since the global financial crisis, the sector and its investors have been faced with a healthy number of fresh regulatory hurdles.

While this is no secret, there's still a perception gap amongst many first-time fund managers; something these figures help to shed light on.

The causes are multiple. We've found some first-time fund managers with a background at bigger shops simply underestimated the volume of work their old compliance colleagues were doing. Others are aware of the big areas, such as AIFMD, but are not so prepared for less well known areas of compliance, such as data protection requirements and MIFID II.

Whatever the reason, this continues to be a significant challenge for first-time fund managers. And there's no real short-cut to solving it. The best advice is to start thinking of your regulatory crunch points as early as possible to minimise impact down the line."

PATRICIA VOLHARD, PARTNER, DEBEVOISE & PLIMPTON

A LONG-TERM RELATIONSHIP

Received wisdom tells us that private equity and venture capital fundraising is built upon relationships, specifically between the fund manager and their investors. With an established fund, this is obviously less of an issue. If you're a General Partner (GP) raising your fourth or fifth fund you will know your LPs, your firm has a track record of generating healthy returns, your investors will be comfortable with your investment strategy and you communicate with them regularly.

With a first-time fund, and especially if you are new to private equity, this situation becomes more challenging. You have no track record as a firm – although you and your team may have one – or you may not even know any institutional investors at all. On initial impression, this is a significant barrier to raising a fund.

The survey results, however, completely dispel that notion. Over 30% of LPs had known their new fund managers for a year or less. The same amount did not even know them at all. Half of GP respondents said they had no relationship with LPs before leaving their previous firm.

Good news for first-time funds, but how to explain a result which would, on the surface at least, appear rather surprising?

Mike Reid, Managing Partner at Frog Capital, which launched in 2009, says there is an appetite for fresh faces: "It's very tough to raise a new fund but investors are looking for new, hungry managers. Many of their existing managers are getting on, are extremely wealthy and aren't quite as hungry and innovative as before."

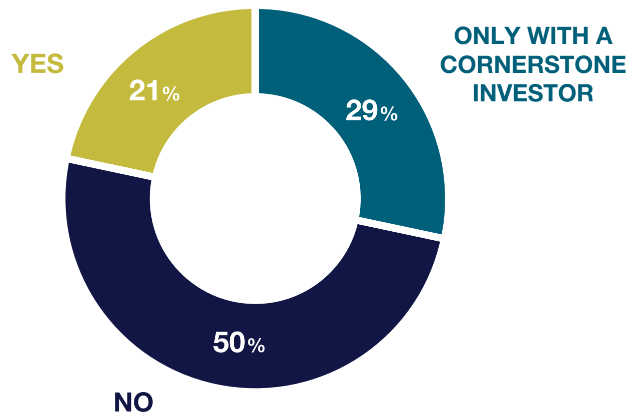
The track record is key. Alan MacKay, Founder and Executive Partner at GHO Capital, which closed its first fund in 2016, says: "Relationships can be an important 'corroborator' factor. It is, however, track record and team that receive most focus, while for most LPs an attractive strategy is *sine qua non*."

Ken Cooper, Managing Director at the British Business Bank, concurs: "This may well be a function of current market conditions, with fundraising appearing easier than in recent history. But it is true that a good (and verifiable) track record will trump any length of previous history. More important for us is that the fund manager team knows each other well and have the potential to stick out the 12+ years. The long-term relationship comes in funds two, three and four."

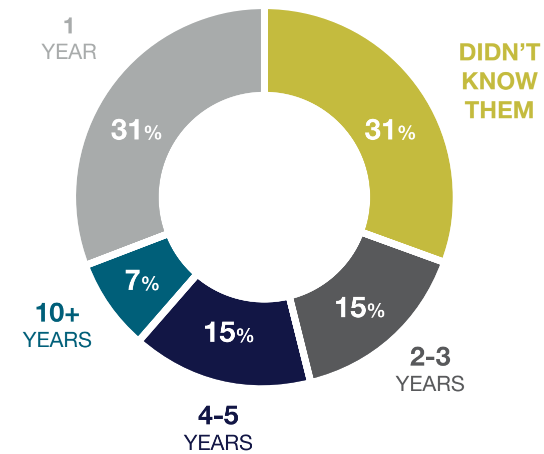
Some respondents also suggest that whilst direct relationships may not necessarily be important, connections through your network are. Simon Faure, a Director at M&G Investments, says: "Many LPs will look to other LPs that do know the manager for comfort that they are good and own the track record. If half of them were to know a GP, that may account for half or more of the fund and so create sufficient endorsement or momentum for the rest of the market."

Ultimately, having some kind of relationship or connection with investors is important, but as the survey suggests, it is not the be all and end all, you also need the right skills in place at your firm. Reid says: "These results are good to share as new managers know that others have succeeded despite not having all the money set up. It is also key that the teamwork and skills in the team are broad enough to become great at fundraising, not just stick to your comfort zone of investing."

GP: DID YOU HAVE STRONG RELATIONSHIPS WITH LPS BEFORE LEAVING YOUR PREVIOUS FIRM?



LP: IF YOU HAVE INVESTED IN FIRST-TIME FUNDS, HOW LONG DID YOU KNOW THE MANAGERS BEFORE THEY BEGAN FUNDRAISING?



"Without the need for previous relationships, it's the new managers with strong teams and new ideas that often succeed. Not only are relationships with investors important but so are the relationships between the team. You are likely to spend many hours together in airports and stations, and being good investment managers and able to identify good deals is one thing but being able to live together through the successes and failures is almost more important. It's something investors will want to test you on - you are, after all, likely to spending more time with your business partners than anyone else!"

J.P. HARROP, GROUP HEAD OF SALES, AUGENTIUS

THE FIRST-TIME ADVANTAGE

The investors responding to the survey saw numerous advantages of investing in first-time funds, with just two responding they didn't see any.

Chief among these was that they are often more entrepreneurial, closely followed by a heightened motivation. This desire to create something new and dynamic is of course also one of the main motivating factors for creating a new business, and it is this vision that investors will be backing as much as they will be your fund. The ability to spot new market opportunities and react quickly to developments is one of the primary reasons first-time funds are attractive to investors. The ambition and hunger of a new private equity fund manager should be no different to the most entrepreneurial tech start-up.

Richard Clarke-Jervoise, Head of the Stonehage Fleming Private Capital Investment team, says: "I think the most compelling first-time funds are those that show a commitment to building a firm right from the outset. This will mean demonstrating that they aim to be on a par with the best across all areas of their business rather than just focusing on investment performance."

Ken Cooper, Managing Director of the British Business Bank, agrees: "First-time managers are usually hungry for success, they don't carry the baggage of earlier funds so tend to be fully-focused on making a success. If that balances out the lack of experience then we see good results."

Launching a new fund gives you an opportunity to offer something genuinely new – whether that be targeting an emerging sector, using new deal or fund structures, finding new ways of sourcing deals or working with investee companies.

Clarke-Jervoise adds: "It's also a good thing to be able to offer something extra on top of positioning, track record, etc. This might involve a ware-housed portfolio, shorter duration fund, more favourable terms, etc, or a combination of all of these."

Ultimately, of course, generating a return for your investors is what you will be judged on. It would appear, therefore, to be good news for any new or aspiring first-time fund manager (and their investors) that of the LPs we surveyed, 40% have had better returns from their first-time fund managers and 60% had about the same as existing funds, i.e. none had experienced worse returns.

These results should be taken with a mild health warning, however. Speaking to investors, it is where you go from here that the challenge really starts. As Simon Faure, Director at M&G Private Funds Management, says: "They have outperformed. The more difficult fund to get right is the second fund."

Clarke-Jervoise expands on this: "Stats are pretty categorical that top-quartile first-time funds tend to generate a real premium to later funds. However, the dispersion of returns between funds is far higher and the fourth quarter shows a real risk of loss of capital compared to existing funds – particularly in the event that the team dynamics don't work out."

The British Business Bank acknowledges that things do not always go according to plan. Managing Director Ken Cooper explains: "We have a programme that is ideally suited to emerging managers and have backed quite a few. Our experience has been generally positive with some really strong performance although we have had to be quite active as an LP as a result of the one or two that go through rocky patches.

I think it helps if a first-time manager can have experienced LPs. We often help teams get to terms with the less exciting but crucial aspects of fund management – structuring investment activities, investor relations, reporting and issues like considering dry powder and investment rates."

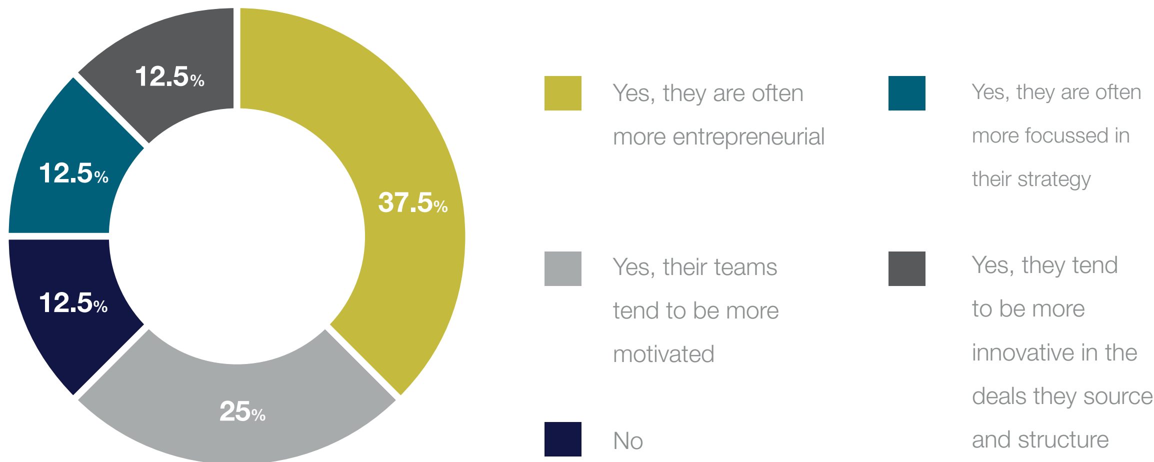
LP: WHAT SORT OF RETURNS HAVE YOU SEEN FIRST-TIME FUND MANAGERS DELIVER?

0% **WORSE** THAN EXISTING FUNDS

40% **BETTER** THAN EXISTING FUNDS

60% ABOUT THE **SAME** AS EXISTING FUNDS

LP: DO YOU THINK FIRST-TIME FUNDS HAVE ANY ADVANTAGES OVER MORE ESTABLISHED FUNDS?



"There is no doubt that everyone wants to see first-time managers succeed. Managers are hungry to deliver returns and investors want those returns. New ideas and new strategies are welcomed – but they also have to be pragmatic and deliverable.

Probably the most refreshing observation is how enthusiastic everyone is to see that success and how everyone will help new managers to achieve their objectives. Managers themselves of course need to be open to that help and guidance from others. Investors, advisors, administrators alike – we have seen much of it before and can help and guide through the difficult times as well as the good times. Resources are there to be used and those that trust their advisors are more able to focus on the investment job in hand – alleviating some of the routine and allowing for the focus on returns."

DAVID DOREY, DIRECTOR, AUGENTIUS GUERNSEY

PAST PERFORMANCE AND FUTURE SUCCESS

This is the big one. If you want to successfully raise a fund, it is imperative to know what your potential investors are looking for. Ultimately, investors want to be confident that you are going to generate a return for them on their capital committed to your fund, and comfortable with your strategy, team dynamics and alignment of interests.

Track record is crucial, even if there was no direct relationship with them from their previous firm. Yet different investors will place a different level of importance on the track record. Richard Clarke-Jervoise, Head of the Stonehage Fleming Private Capital Investment team, says: "Broadly, more institutional investors will rely heavily on track record. A GP with no track-record will be a red flag for most institutions. This is likely to be different for family offices where, I suspect, the key criteria will be the market opportunity and the trust/relationship with the GP."

Simon Faure, a Director at M&G Private Funds Management, agrees: "We only do it to get access to the best 'deal doers' so their personal track records are paramount. But there may be particular investment strategies that some LPs want to add, such as renewables or impact investment for example, where track records may be slightly less relevant."

There is also a difference between personal and team performance, as Ken Cooper, Managing Director at the British Business Bank, explains: "There is a distinction between a team's track record and that of individuals. It is unusual to have a team that is completely new to investing – and we haven't ever backed such a team. More likely there will be one or two members who have shown success in a previous career or undertaking and can bring operational experience as part of a team which also has investment experience. Sometimes these individuals may also have some business angel investing experience. For those individuals within a team who don't have investment experience we will look at how their experience matches the strategy of the fund and if they can add value to investee companies."

The answers from LPs chime nicely with those from the fund managers surveyed, albeit with strategy edging out track record for top spot.

If there is one major theme that emerges from the results of this entire survey, it is ensuring you are offering something which differentiates you from other funds in the market, fist-time or not.

Alan MacKay, Founder and Executive Partner of GHO Capital, said: "We offered a strategy nobody else had offered before. That could work two ways – some LPs said if nobody else doing it was possibly flawed – other LPs thought it was about time and signed up. More generally, no strategy works for all or even most LPs so the art and science is to find the right LPs – just like finding 20 needles in a global haystack."

Mike Reid, Managing Partner at Frog Capital, has this advice for new fund managers looking to stand out from the crowd: "You are good at what you are good at. You can't really change that. So it is more about analysing what funds are getting traction near your area, drawing in the common themes as well as differentiating, and then finding the best need that draws someone to your strategy. Too many people meet too many LPs who will never invest in their fund. Qualify, qualify, qualify."

GP: WHAT DO YOU THINK INVESTORS LIKED/VALUED MOST ABOUT YOUR FUND?

IN ORDER OF PRIORITY

1. Track record
2. Strategy
3. Market opportunity
4. The team has worked together before
5. The blessing of the former employer with strong references
6. Team dynamics are cohesive for the long term
7. Operational capabilities
8. Alignment of economic interests
9. Fit with portfolio
10. A sweetener (e.g. existing assets are rolled into the fund)

LP: WHAT DO YOU LOOK FOR MOST IN A FIRST-TIME FUND MANAGER?

IN ORDER OF PRIORITY

1. Track record
2. Strategy
3. Market opportunity
4. Team dynamics
5. Operational capabilities
6. Alignment of economic interest
7. Fit with portfolio

BACKING THE FIRST-TIMERS

Given the positive attitude towards first-time funds shown in this survey, it may appear almost self-evident why investors want to commit their capital to maiden funds. In the constant quest for returns in this low-yield environment, the performance record of first-time funds would appear to make them an obvious choice for LPs.

Alas, this is not necessarily the case. For a multitude of reasons, a number of LPs do not invest in first-time funds. The risk is higher, the amount of due diligence required is generally higher than for an established fund, relationships have to be forged; add it all up and some LPs are simply ill-equipped or uncomfortable backing a new manager.

The important thing is to do your research. As some of the LPs featured here have indicated, some investors will see hundreds of funds a year. In order to make the process efficient, find out as much information as you can in advance before you make an approach: what area of the market are they interested in (e.g. venture, growth, buyouts), what geographical preferences they have or sectors they are particularly interested in, who else they are invested in, how much capital they typically allocate and, of course, whether they invest in first-time funds.

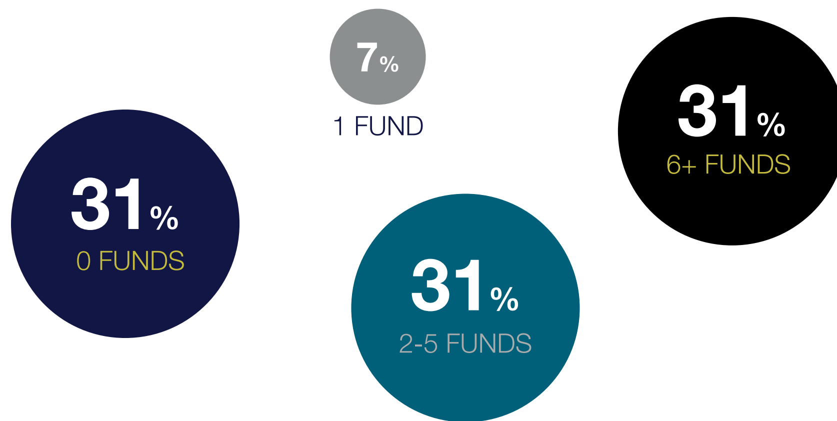
Almost a third of respondents in our survey have never invested in first-time funds, whilst the remaining number have invested in at least one and some in six or more. As the results from the other question show – and interestingly all of the respondents answered this, even those that have not invested in a first-timer – three quarters take an opportunistic approach. That is to say they will judge each fund manager on their merits, such as track record, strategy and other areas as previously discussed.

Other LPs – a quarter on this survey – will also have an explicit mandate to back new fund managers. This includes the British Business Bank. Managing Director Ken Cooper says: “The performance of first-time funds has been good so it isn’t surprising there are now a number of LPs open to investing on an opportunity basis. Our mandate is about making finance markets work better for small businesses but we see this as both mandate and opportunity. We don’t have a ‘lower bar’ for first-time teams but we do have the time to work with them.”

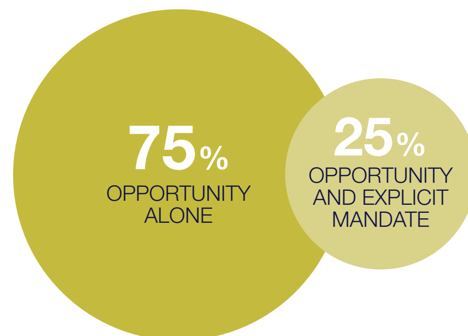
The time factor is an important one. Due to the aforementioned due diligence required, many investors simply will not have the time and manpower to undertake the necessary and additional work involved in backing a new firm. Larger institutions are more likely to back first-time managers because they will have this resource in-house, and they will also have a portfolio large enough to mitigate the risks associated with investing in a new fund.

As such, knowing what will make an investor see you as an ‘opportunity’ worth backing is vital. Simon Faure, Director at M&G Private Funds Management, says: “GPs need to be able to show what is going on in a sector or segment that is undercapitalised (from a private equity point of view) or that the space has been somewhat abandoned by peers (them moving up or disappearing). Another option is to attack existing competition in a new way by being more focussed and ‘aggressive’ in-sourcing, structuring, etc.”

LP: HOW MANY FIRST-TIME FUNDS HAVE YOU INVESTED IN?



LP: IS YOUR DECISION TO INVEST IN FIRST-TIME FUNDS BASED ON THE OPPORTUNITY ALONE, OR AN EXPLICIT MANDATE?



"Tackling the risk factor is paramount for first-time funds. That means doing everything possible to show prospective investors that you know what you are doing, have a clear strategy, and can be trusted to deliver returns. The regulatory aspect again pops up as a factor here. If investors can't trust that the manager has a keen grasp of regulatory hurdles, and has done everything possible to mitigate them for the investor, they simply won't invest."

PATRICIA VOLHARD,
PARTNER,
DEBEVOISE & PLIMPTON

"Similarly, using professional advisors to take on some of the day-to-day roles reassures investors that they can rely on the basics being done really well. They can be reassured that the books and records will be kept in good order and that they will receive their regular reporting in a timely manner and in a professional format, thereby freeing up the time and resources of the manager to allow for the proper focus on the investment strategy."

GARETH DAVIES,
HEAD OF UK CLIENT SERVICES,
AUGENTIUS

DEAL-BY-DEAL

Whether to start doing deals before you raise your fund is a common dilemma for those starting out in the world of investing. For some, it can be a good way to prove yourself and build up a track record to show investors. For others, it is a distraction.

Mike Reid, Managing Partner and Frog Capital, says: “Is deal-by-deal a stepping stone to fundraising success or never ending conveyor belt to insecurity? If you see deal-by-deal as a stepping stone to setting up a longer term, classic fund, then really ask yourself why investors won’t commit now (there may be a reason you don’t wish to hear).”

The results from the survey are pretty evenly split on both questions so ultimately it will come down to how comfortable you are with deal-doing and fundraising at the same time. Deal-by-deal certainly has its merits, proving not only to your investors but also to yourself and the team that you can actually do it - it can act as a “proof of concept” as one respondent said. It gives you experience, leads and improves your network, all invaluable when it comes to securing investment from an LP.

Alternatively, it is another thing to worry about. It is “challenging as you are always in fundraising mode” said one GP. “It wastes time when you should be closing a fund,” said another. As the survey indicates, opinion is split.

Whether you decide to go deal-by-deal whilst fundraising will in part be determined by your relationship with investors. Alan MacKay, Founder and Executive Partner at GHO Capital, says: “We did not invest on a deal-by-deal basis as we were fortunate to have a significant cornerstone investor and enough fast-follower LPs to have an early first close of our fund. A significant cornerstone can be invaluable.”

GP: DID YOU INVEST ON A DEAL-BY-DEAL BASIS BEFORE RAISING YOUR FUND?

GP: IF **YES**, WOULD YOU RECOMMEND THIS APPROACH?

WHY?

- Proof of concept
- Builds track record and team build up
- Builds confidence with your LPs
- Builds leads and network and experience

WHY?

- Wastes time closing the fund
- It's a distraction
- Too challenging in fundraising mode

“Deal-by-deal activity appears to be on the rise, but it’s not for everyone.

We see two basic models of first-time fund managers: teams that have spun out of existing fund sponsors, and teams that are largely coming together for the first time.

In the first model, the team’s ability to execute deals is already substantially proven. They are more likely to have a form of collective track record from the firm they spun out of, or at least a history of working together that prospective investors can to some extent diligence. That type of team, which may also have a continuing advisory fee or similar income related to the legacy portfolio of its prior employer, is more likely to go full-steam ahead on fundraising without feeling tempted or compelled to engage in deal-by-deal activity when weighed against the cost of delaying its fundraising.

In the second model, where it is a new team assembling itself, the more immediate concern involves showing the broader investor market that the team can operate as a well-functioning and effective group notwithstanding its ‘first-time’ status. Deal-by-deal fundraising and investment can serve as a useful showcase of the team’s ability to source, structure, negotiate, sign and close investment opportunities before hitting the traditional fundraising trail in earnest.

Of course, these are generalisations that mask the more subtle nuances that are factored into the objectives and timing of each firm as it evolves. However, broadly speaking, deal-by-deal activity is most appropriate as a credibility enhancer for first-time groups that are in their purest form – experienced, capable individuals newly presenting themselves to the market as a collection of talent where the whole exceeds the sum of the parts.”

GEOFFREY KITTREDGE, PARTNER,
DEBEVOISE & PLIMPTON

THE PLACEMENT AGENT QUESTION

Like going deal-by-deal, the decision over whether to use a placement agent is also a long-standing one for first-time fund managers. In the pro column, they have a network which you might not possess, they have experience of fundraising, and the time and resources to dedicate to fundraising which you might not have as you pull together the other strands required to build and run a business.

On the other hand, they do cost money, money which many first-timers may not, and often will not, have.

Mike Reid, Managing Partner at Frog Capital, says: "Agents are extremely expensive and the good ones make the most money and take less risk by serving bigger funds. So I still think that it is better to build the skills in-house and comes across more genuine to LPs if you do the pitching yourself."

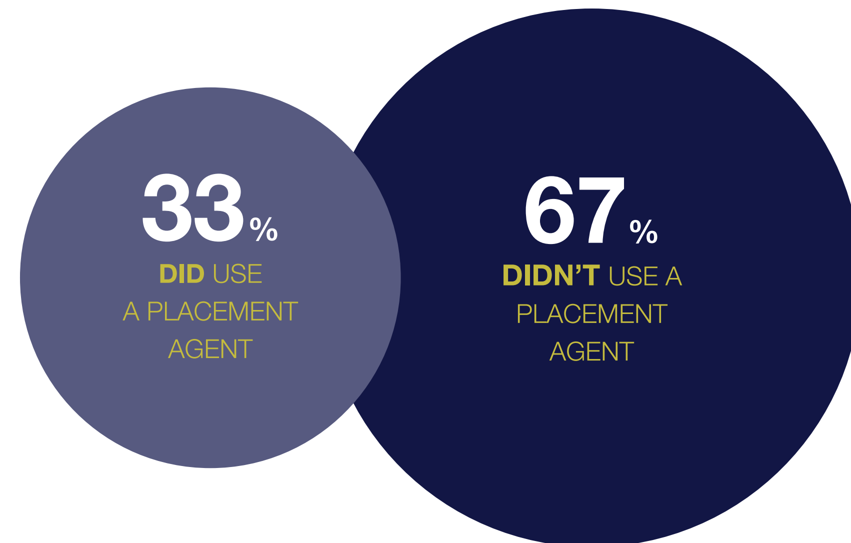
The fund size point is an important one. As one respondent said: "They certainly have their advantages, they have a different skillset, however at the small end it is not practical". Another simply said: "They are worth it if the fund size is over £100 million."

This is not to say that a smaller fund should necessarily avoid using a placement agent, but the financial implications of using one are more pertinent for those looking to raise smaller amounts of capital.

The results of the survey are themselves illuminating. Whilst only a third of our respondents actually used a placement agent, almost two-thirds would recommend doing so. Clearly, then, they have their advantages. One GP said: "I think a placement agent could have kept us more focused on fund management rather than fundraising."

For Alan MacKay, Founder and Executive Partner at GHO Capital, it was a no-brainer: "As a first-time manager with a first-time fund for a first-time strategy (mid-market healthcare Europe) we never even for one minute contemplated launching without a placement advisor. We searched for an advisor with proven 'first-time fund' track record, selected them, and they delivered."

GP: DID YOU FUNDRAISE YOURSELVES OR USE A PLACEMENT AGENT?



GP: WOULD YOU RECOMMEND USING A PLACEMENT AGENT FOR A FIRST-TIME FUND?

64%

RECOMMEND USING A PLACEMENT AGENT FOR A FIRST-TIME FUND

- Adds a different skillset
- Allows you to run your own business at the same time
- Allows you to get raised quicker
- Open doors, rubber stamping
- Keeps focus on fund management rather than fundraising
- They know the market
- Saves time and money

36%

DO NOT RECOMMEND USING A PLACEMENT AGENT FOR A FIRST-TIME FUND

- You are the best at selling your strategy
- You can get access to LPs if you take on the right resource
- It's not practical at the small end
- Pointless to re-invent the wheel
- If fund size is over £100m
- Cost
- Too small to matter to a good placement agent
- Better done through knowledge and own contacts

"Placement agents are the experts in fundraising. Every manager should at least consider using one and every group should talk to placement agents. They know what the market wants, they will review what you have to offer – and if they decide to work with you, you know you will have a good chance of raising a fund.

Whether you decide to work with placements agents or try to do the fundraising on your own is a different matter. Just remember that getting to the first close is hard, and getting the third close done when you have by this time started investing could be even harder. Running a portfolio and fundraising creates real conflicts on time."

DUNCAN SMITH, DIRECTOR, AUGENTIUS LUXEMBOURG

WORDS OF WISDOM

We also asked our GP respondents for three pieces of advice they would give to those considering launching a first-time fund.

Here are some of their responses:

It will be harder than you imagine

Prepare

Be patient

Be persistent

Treasure relationships

Prepare to be exhausted pitching

Know your LP audience

Align interests with LPs

Ensure you can market why you are different very clearly and convincingly

Focus on getting a meaningful cornerstone investor over all other conversations

Make sure you commit 5-10% yourself as well

Have a track record

Build a strong team

Prove with deal-by-deal

Know and test your weaknesses, and take tough decisions very early

Pick a placement agent with first-time fund experience

Invest in admin and IT - do not underestimate these issues

Prepare to enjoy first close

Don’t raise too much

It is worth it

Go for it!

“The quality of their work and their extraordinary access are what sets them apart.”

The private funds industry in the UK is mature, innovative and forward thinking. Debevoise has been at the centre of that industry for decades, with a team that helps our clients at every stage of the fund’s lifecycle.

The team is one of very few practices to have senior English, U.S. and locally qualified corporate, fund formation and tax practitioners based in Europe.

This strength has led to consistent praise from the legal directories, with Chambers UK reporting “the quality of their work and their extraordinary access are what sets them apart.”

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CONCLUSION

It is tempting to make some assumptions about the first-time funds part of the market, such as:

- **It is driven, on the whole, by a generation of younger investment professionals aspiring to become fund managers;**
- **It is challenged by the imperative of gaining the confidence of large institutional investors; and**
- **They can display a level of nimbleness and innovation that larger, more established platforms cannot always match.**

This survey sheds light on some elements of the market that are less well known, and questions some of the widely held assumptions about first-time funds.

For example, more than 30% of investors in the survey did not know the manager before investing in a first-time fund, and 50% of fund managers in the survey did not have any strong LP relationships before starting up. That runs contrary to conventional wisdom that starting off with existing LP relationships is the key to success.

Another notable finding — one third of first-time fund groups in the survey reported using a placement agent while almost two thirds recommended using a placement agent, indicating strong demand for fundraising advisory services in a market where the substantial majority of first-time funds manage to get raised without that type of support.

The results also confirmed certain aspects of first-time funds from the investor perspective. First, a sizeable majority of the investors responding in the survey believe that first-time funds are either more 'entrepreneurial', 'motivated' or 'innovative' than more established funds; and second, track record and a clear strategy continue to be what investors prioritise when looking at first-time funds.

The survey results paint a picture of a market that is continuing to change shape, but not radically transforming. Evolution rather than revolution.

Looking at the results, we can draw one clear lesson, and one clear note of optimism for managers considering launching their first fund.

The lesson: doing your homework before starting out is critical. That may sound like a truism, but the survey shows high numbers of first-time fund managers are still encountering surprises during their fundraise, often in basic areas, such as the nature of the regulatory challenge or the time they need to invest in meeting potential investors.

And the note of optimism: we're living in a receptive era for first-time funds. Every investor participating in the survey said the investment returns they see from first-time funds match or exceed the returns they see from established funds. The future looks bright.

Geoffrey Kittredge, Partner, Debevoise & Plimpton

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