# Buyouts

# Emerging Manager Report

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# Buyouts

# Emerging Manager Report

ISSN 1040-0990 • OCTOBER 2023

# Insight

## Buyouts Emerging Manager Survey 2023 **Appetite for promising debuts remains, despite macro jitters. Here are seven charts that tell the story of today's status quo**

Describing the current climate for private markets, the one word that managers aren't using is "easy," ***writes Rob Kotecki***. After a rough fundraising climate last year, for emerging managers it only got rougher this year. According to *Buyouts* data, first-time funds only raised $6 billion globally in the first quarter of 2023, after raising $67 billion all of last year. And GPs of all kinds are spending more time fundraising. They spent a new record average of 13.4 months on the road as they tried to close funds, according to *Buyouts* data.

That's the backdrop for the seventh annual *Buyouts Emerging Managers Survey* conducted in partnership with Gen II Fund Services LLC. LPs are raising the standards for emerging managers, but still willing to commit capital to those with the right mix of team, strategy and, above all, track record.

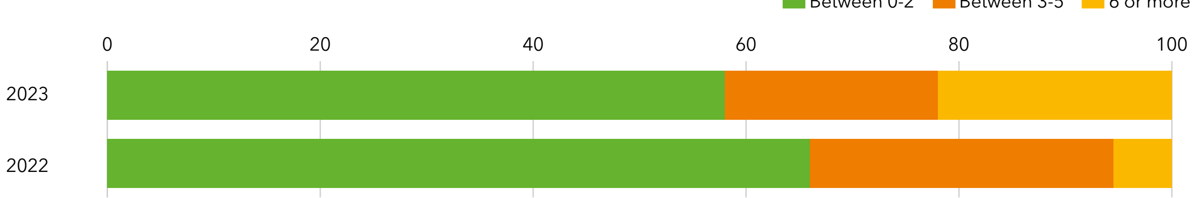
It's a complex picture, shaped by larger market forces, and no doubt recent regulatory moves by the SEC. However, plenty of GPs have made their names by "emerging" from forbidding economic conditions to become the next generation of marquee firms.

### Reality check

One of the primary purposes of this report is to dig past the headline fundraising tallies and discover what's behind the numbers. But it would be remiss not to acknowledge them.

Some respondents might be all doom and gloom, but in 2023, 22 percent of LP respondents said they backed 6 or more emerging managers, up from only 6 percent last year. But there were declines among LPs backing one to five managers. And that 22 percent does not indicate how many of those emerging managers featured a team-up of marquee players.

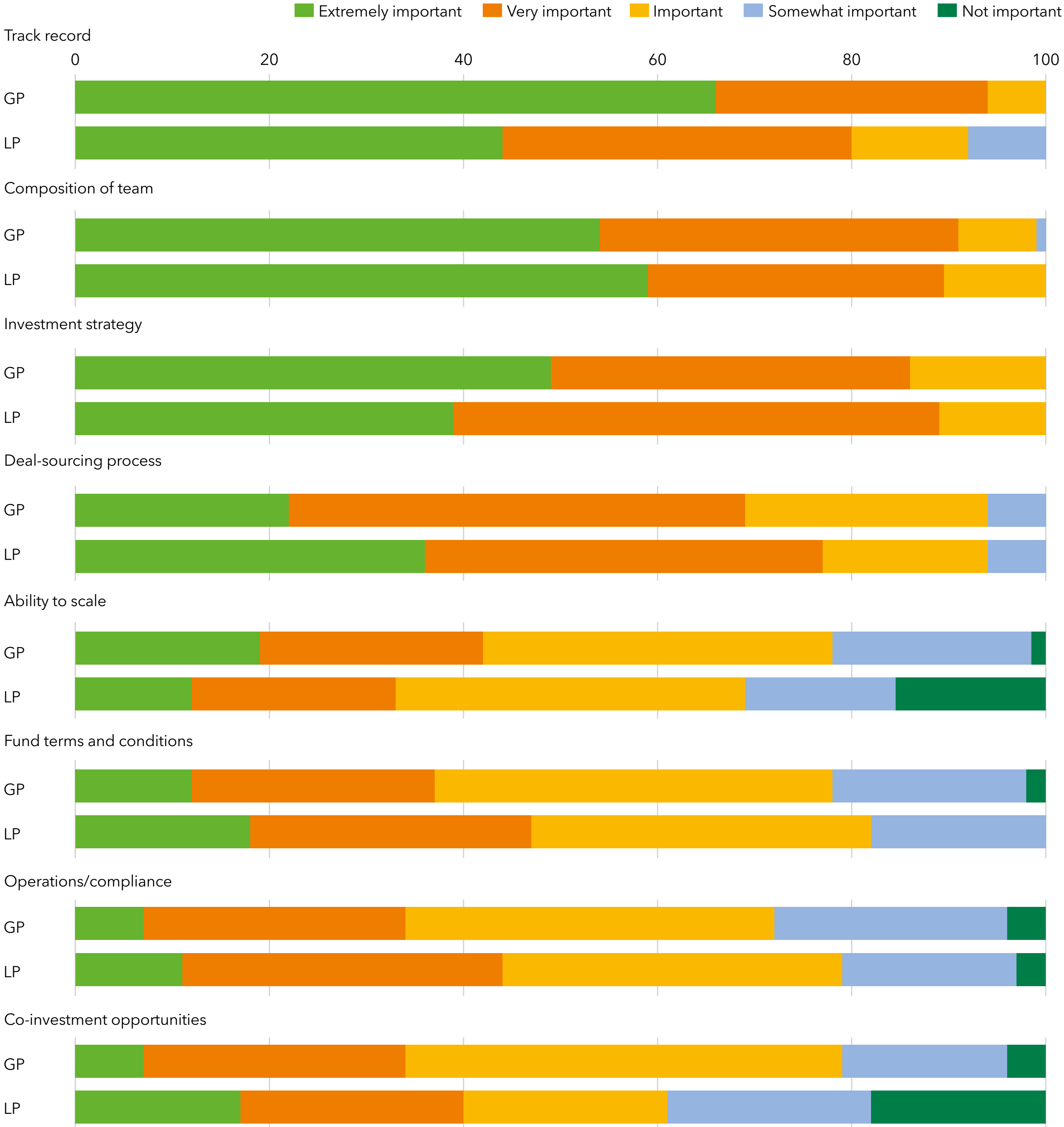
**How many emerging manager funds do you anticipate backing over the next year? (%)**



# Track record trumps all

As it turns out, GPs might be better at mind-reading than expected. LPs agree that track record and team composition are by the far the biggest factor in selecting emerging managers, with investment strategy again clocking in third, substantiating the idea that investor sentiment might be quite conservative these days. But will investment strategy climb up the agenda as market conditions improve?

**How important are the following factors when evaluating an emerging manager fund? (%)**



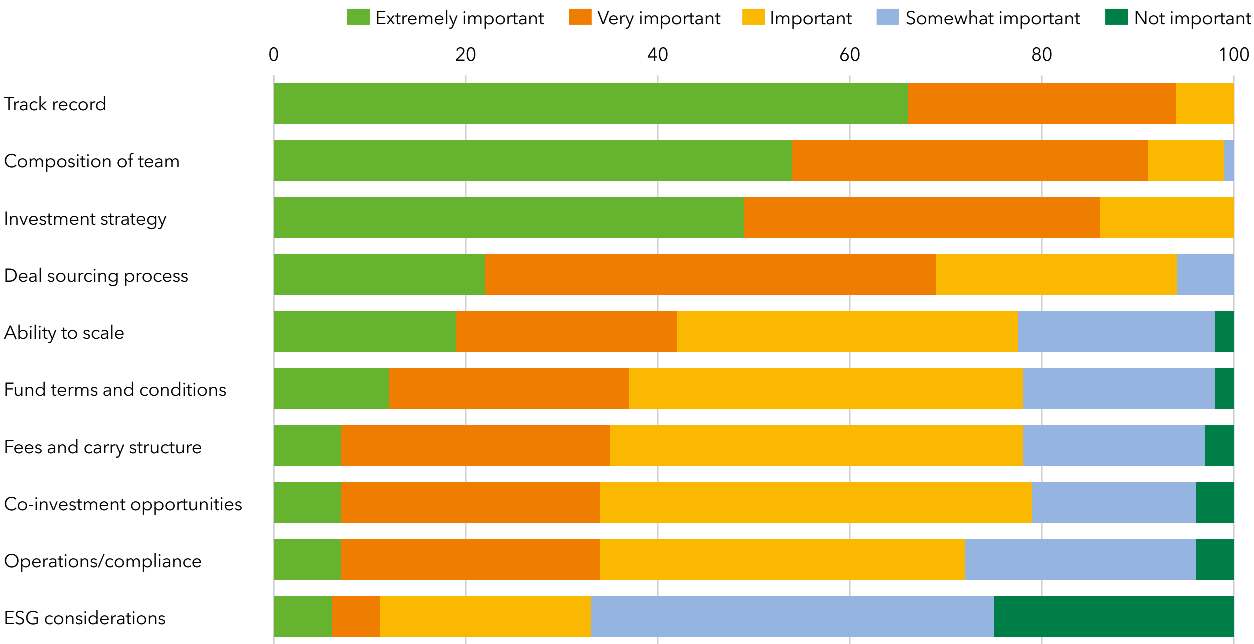

Source: Buyouts Emerging Manager Survey 2023

## Rationalizing commitments

When GPs discuss why an LP did or didn't invest, there will always be an element of guesswork. And if they did commit, it might not be because of a bulletproof PPM, but rather because the opportunity was the right fit.

Here we find that track record is cited as the most important factor, followed closely behind composition of the team, which is another way of gauging the track record of the individual partners. Meanwhile, investment strategy comes third, which argues that established managers do in fact have the edge.

**How important do you believe the following factors are for LPs evaluating your fund? (%)**




## The pressure cooker

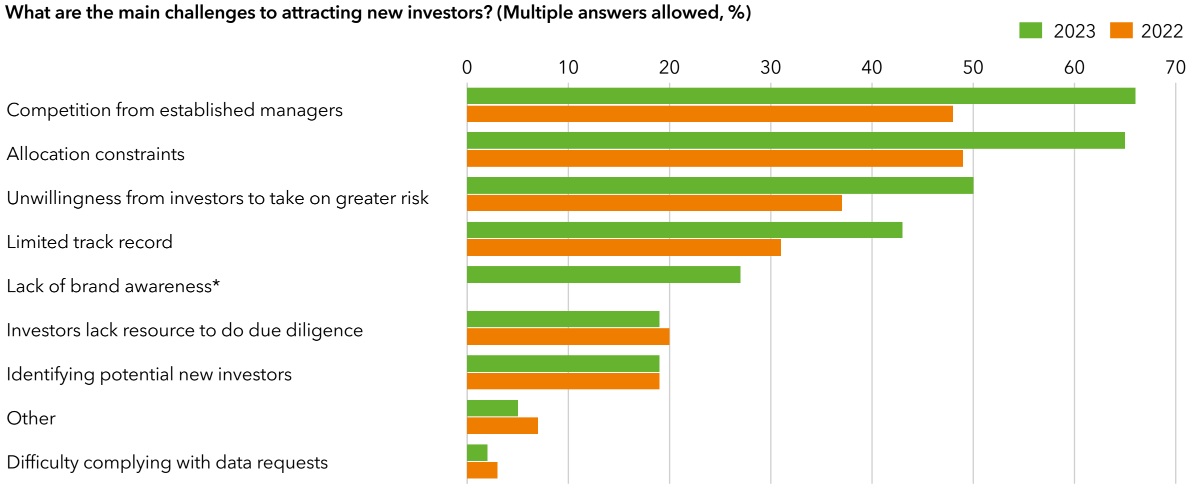
Macroeconomic volatility is the new normal, and GPs don't expect the climate to get any friendlier to investment performance, which is the biggest factor in the fate of any manager. Interest rate hikes, a recession in core markets and high inflation were the top three concerns, but stock market volatility and geopolitical uncertainty weren't that far behind. In short, respondents know what they don't know, and it's keeping them up at night.

**Which of the following factors do you think will have the greatest impact on private markets investment performance in the next 12 months? (Multiple answers allowed, %)**

## Emerging issues

When asked about the key challenges to raising a debut fund, emerging managers stayed consistent, citing competition with more experience managers as the number one issue, and that tally has to include a lack of track record, brand awareness and the unwillingness to take on additional risk, which LPs must consider when backing a younger, unknown group. However, it should be noted that few had any issue complying with data requests or finding LPs without sufficient resources for due diligence. So if anything, today's tech solutions might actually be helping folks do more with less.

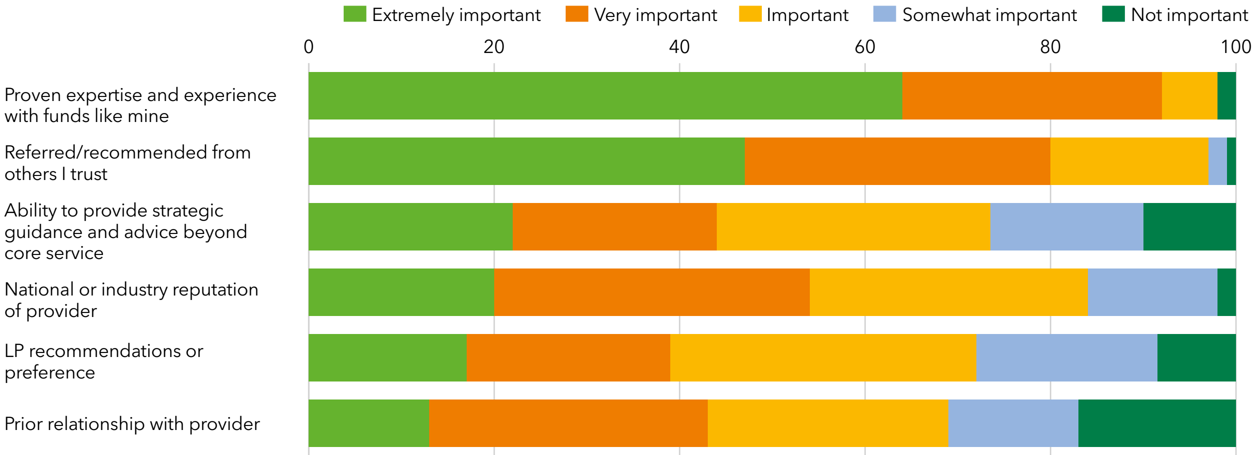
**What are the main challenges to attracting new investors? (Multiple answers allowed, %)**




## The need for expertise

When it comes to choosing a service provider, reputation and track record matter most. It's proven expertise with similar firms that emerging managers deem most important when selecting a service provider, followed by a recommendation from a trusted source. Also taken into account are the provision of strategic advice beyond the core offering, the endorsement of a national or industry group, LP preferences, and a prior relationship.

**How important are the following factors in choosing service providers? (%)**




*Answer option not included in 2022 survey
Source: Buyouts Emerging Manager Survey 2023

**22%**

**of LPs anticipate backing 6 or more emerging managers over the next year**

**40%**

**of LPs say investor sentiment around emerging managers is strong**

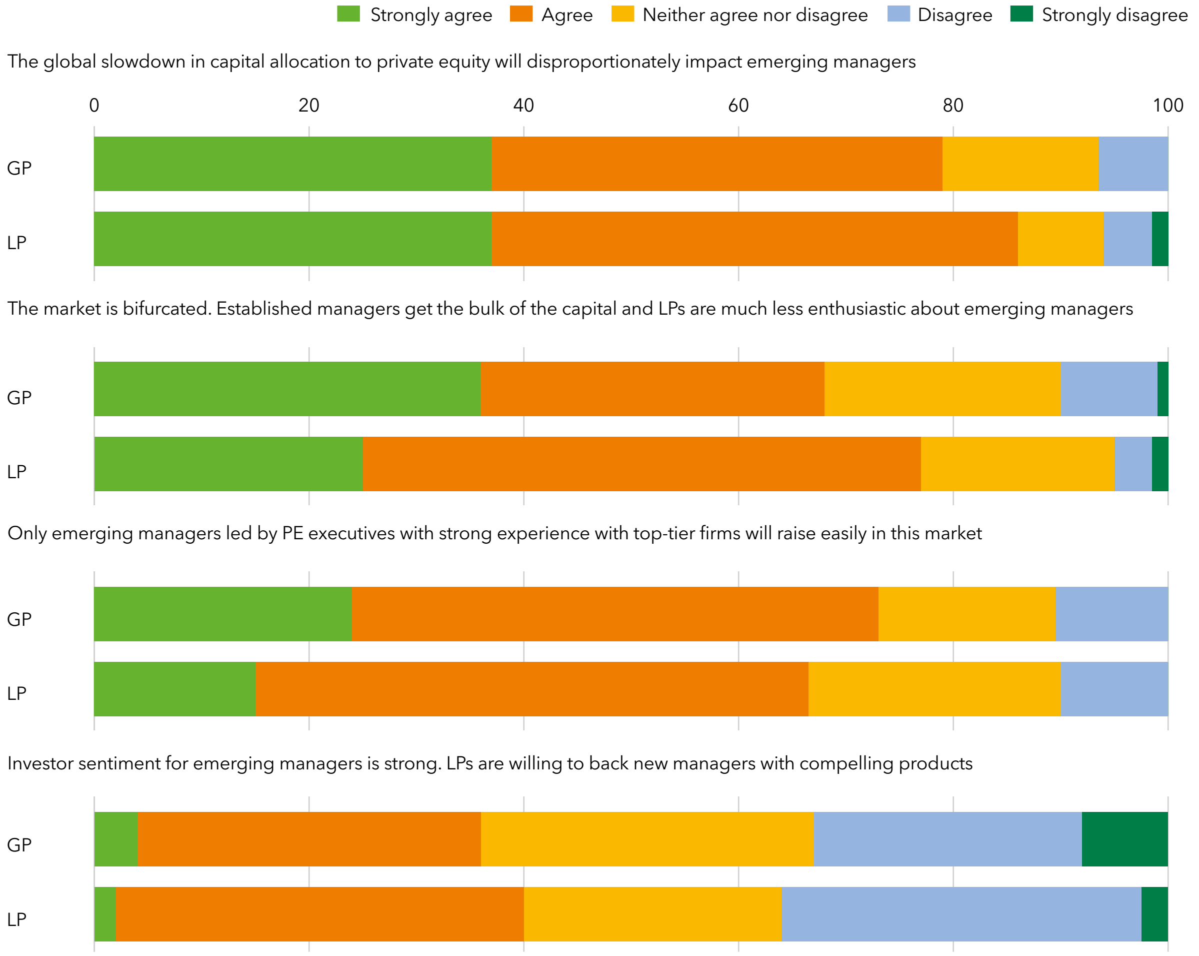
**67%**

**agreed that only emerging managers led by PE executives with top-tier experience will raise easily**

## The blessed few

Given the competition for funds out there, emerging managers may be right to be pessimistic. Established managers are well-positioned to win commitments even if they are raising their first fund outside of their marquee strategy. The global slowdown in fundraising appears most likely to hit emerging managers the hardest. Unfortunately, LPs don't have a rosier outlook. They maintain a similar view of a bifurcated market that has established managers easily raising their latest funds or launching new firms, and the rest of the field vying for what's left.

**How do you perceive market sentiment around emerging managers right now? (%)**




Source: Buyouts Emerging Manager Survey 2023

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**Buyouts**
Published 10 times a year by PEI Group. To find out more about PEI Group visit **pei.group**



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## Editor's letter

# Little room for rookies

Rob Kotecki
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On this, the seventh year of the *Buyouts Emerging Manager Report*, conducted in partnership with Gen II Fund Services LLC, it's safe to say that although inflation, and the resulting interest rate hikes, might be receding some, no one is expecting a return to the free money "daze" that greeted this decade.

Throughout the findings, one of the most common themes is the power of experience to beat the odds right now. The firms closing funds have decades investing in that industry, often in that subsector, and they are tapping long-term relationships with LPs to score anchor investments.

> **"One of the most common themes is the power of experience to beat the odds"**

Many are raising funds deal-by-deal until they have a strong enough track record to draw a crowd, but even that uphill effort requires enough of a reputation to raise money for those transactions.

And while everyone agrees the market for emerging managers has only gotten rougher, there's still an enormous amount of support for the idea of emerging managers. LPs want the next generation of star GPs and know that supporting them early helps ensure access as they mature into juggernauts. But they are cautious, with concerns around a global slowdown they sense will hit new firms the hardest. So there's a hunger to say "yes," even if it takes months more of deliberations to earn it.

Launching a debut fund has never been easy for someone without a substantial track record. Right now, that may be near impossible, as even veterans are struggling against one of the toughest markets in years.

**Rob Kotecki**

# The Gen II View **The going has gotten tougher, but demand is still there**

Expert analysis by **Jeff Gendel**, principal, Gen II Fund Services

Two years ago at this time, emerging managers seemed to have survived the challenges brought on by the pandemic and were finally poised to pick up where they had left off prior to the global shutdown. LPs were eager to make commitments to new managers, new entrants were coming into PE every day, and the fundraising market was robust.

It has been a very different story, however, in the time since. Significant and seemingly constant winds of change, led by the SEC's new rules for private funds approved in August 2023, have made an already difficult fundraising terrain that much more challenging for smaller and emerging managers. Investors tend to be less willing to allocate to newer managers in uncertain times, and the pressures emerging managers are facing are reflected in this year's survey results from both LPs and GPs, who clearly see the universe of private capital fundraising transforming right before their very eyes.

### Views on allocations and fundraising

Investors continue to make adjustments to their private market portfolios, with many still taking a more conservative approach to capital allocations and not establishing new relationships. This is being driven in part by both a slowdown in the velocity of capital flow and the ongoing trend of larger firms raising more and more of that available capital. With established firms coming back to market sooner and raising increasingly larger funds, re-ups are absorbing much of the bandwidth of investors. This is making it difficult for emerging managers not only to get their fair portion of the annual capital allocation pie but to even get in front of investors.

“The pressures emerging managers are facing are reflected in this year's survey results from both LPs and GPs, who clearly see the universe of private capital fundraising transforming right before their very eyes”

Investor allocations a year ago were stretched thin, but more than three-quarters of respondents (76 percent) continue to report that they have formal PE allocation programs. Investors have capitalized so far in 2023 on favorable buying conditions, enough so that the survey revealed an uptick in LPs' average annual PE/VC target allocations from 47 percent of their portfolios in 2022 to 50 percent in 2023.

Fundraising across the board is becoming more challenging, again compounded by the ramifications of the new SEC rules, and this is especially true for emerging managers. However, LPs are still deploying capital and in 2023, progress was made in terms of the length of time it takes to close on a commitment from start to finish.

In 2022, 65 percent of LPs reported that it took anywhere from one to four months from the date of first introduction to signed commitment; this grew significantly to 79 percent in the 2023 results. At the same time, the expectation of longer closing times fell as only 3 percent of LPs reported closing periods of 12 months or more, compared with 21 percent in the prior survey. The most common period, by far, continued to be five to nine months (57 percent).

The good news is that many investors are confident their allocations for new commitments to emerging managers will remain steady, but with a decline from 66 percent to 58 percent of respondents. The data also clearly shows that LPs are seeking to expand their emerging manager positions to drive more diversity through this segment of their portfolios. Those LPs reporting that they hold zero to five emerging managers fell from 61 percent in 2023 to 39 percent, while those with 16 or greater more than doubled year over year.

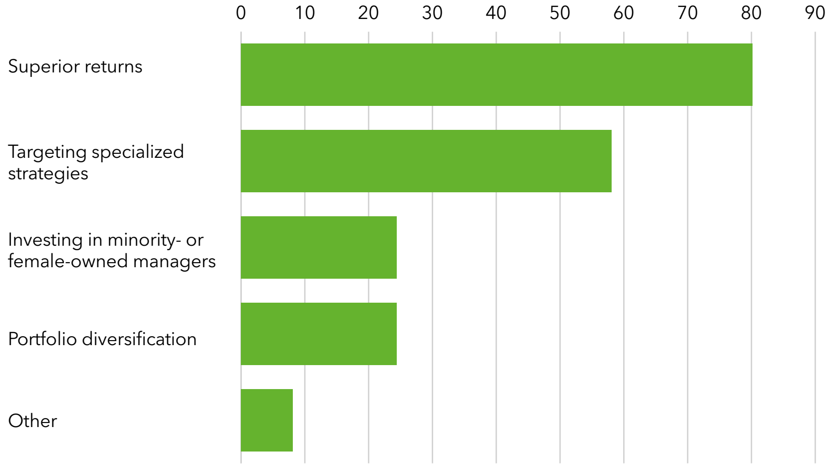
## The bar, as always, is set high

LPs are continuously looking to add new managers and want to invest with newly formed firms with genuine differentiation. Anecdotally, many believe GPs are "hungriest" to perform for funds with Roman numerals one through three. At the same time, they recognize the challenges emerging managers face, particularly, to not only source investments and create value but to stand up a back and middle office to meet their LPs' rigorous reporting and compliance demands. So, while there is still space for new players seeking capital, the bar is always set high.

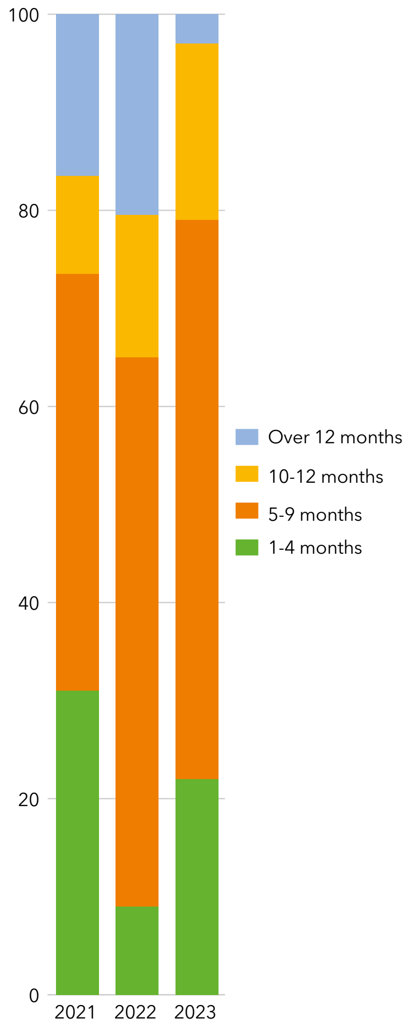
A large majority of investors – 80 percent compared with just over two-thirds in 2022 cited superior returns and portfolio diversification as the primary reasons for their emerging manager programs, and 92 percent – up from 79 percent in 2022 – said they are still most likely to invest in an emerging manager formed by a team spun out from a larger firm. At the same time, LPs continue to put increased pressure on emerging managers when negotiating terms. In particular, the number of LPs requesting access to co-investment opportunities grew from 45 percent to 60 percent, while LPAC participation was another common request, jumping to 72 percent from 63 percent.

Whether this is the right approach to position fledgling fund managers to thrive – because they're certainly not reducing their reporting demands – it underscores the pressures facing new managers. In this more risk-averse environment, which seems as if it's here to stay, it is even more important that emerging managers partner with the right service providers so they can focus on the mission-critical tasks of raising, investing, and growing capital without taking on the back- and middle-office responsibilities that might otherwise create a distraction.

**What is the primary purpose of your emerging managers program? (Multiple answers allowed, %)**




**How long does it typically take from first introduction to a signed commitment? (%)**




## Increased demand for real-time access to accurate, timely information

Given the significant levels of capital invested in the alternative investment space and a larger addressable market of investors, automation, accuracy, and transparency have never been more critical. In fact, the newly approved SEC rules for private funds – the most significant industry reforms in nearly 15 years – are aimed directly at increasing transparency for all investors.

In the private markets, implementing technology is a requirement to handle not only the increasing volume of investors but the growing complexity of the fund structures. Increased competition for emerging managers is driving next-generation technology to fill a critical role in the fund administration process for emerging managers.

Not only are LPs in the driver's seat when it comes to capital raising and negotiating terms, but they are also driving trends in fund operations. This is especially true around new technology, which is fast becoming table stakes to facilitate improved onboarding through electronic subscription documents, bespoke and more frequent reporting, and more depth and transparency around performance and attribution reporting as well as portfolio monitoring.

Technology is changing how GPs onboard investors by digitizing fund subscription, transforming it from a labor-intensive, error-prone paper process to one that is automated, while still being more accurate, reliable and customizable. Utilizing electronic subscription documents not only improves the LP experience, but it also gives fund managers immediate visibility into investor activity and fundraising analytics. This visibility is critical in an environment where the competition for capital is heightened.

As the asset class matures, there will be a sea change in reporting frequency, particularly to the extent managers welcome HNW and accredited retail investors. Historically, reporting is done on a quarterly basis. However, some LPs are starting to ask for more frequent reporting, seeking the same access to information that they have for their public market investments. The adoption of technology will likely be required to accommodate the acceleration in the timeliness and accuracy of information LPs are requesting.

Private equity sponsors are also embracing technology around portfolio monitoring. They're leveraging data and analytics for real-time insight into how they're generating returns and using these capabilities to optimize decision making. With the growth in private equity as an asset class, we are seeing much more demand for data and precision in analytics as sponsors realize that their data is a potential source of differentiation.

In today's investing climate especially, LPs want to know that the GP they're investing in works with a reliable operations partner. Specialist fund administrators like Gen II play a key role in helping emerging managers become stronger operationally, which in turn makes them more institutionally investable.

In terms of data capabilities, Gen II's tools give sponsors "corner office" analytics and insights into their portfolios and a performance analytics platform that offers both a 30,000-foot view of their enterprise or fund as well as granular details at the investment level. These capabilities allow emerging managers to offer best-in-class bespoke reporting for LPs that are increasingly demanding transparency, custom reporting requirements, and real-time access to details of their investments, performance attribution, management/performance fees paid, etc.

> "Those LPs reporting that they hold zero to five emerging managers fell from 61 percent in 2023 to 39 percent, while those with 16 or greater more than doubled year over year"

We believe that investing in technology and investing in people go hand in hand. We look for a balance and try to invest in technology in areas where we can scale, reduce cycle times and improve quality, but also maintain capabilities to ensure that we can administer and manage these complex structures or even enhance the "operational" alpha embedded within them.

**Working with the right partner is key**

Scalability, performance, and experience truly matter, and the majority of emerging managers start their life with an administrator relationship. Given the increased complexity of fund structures, escalating stakeholder expectations, and complex regulatory requirements, it is vital that emerging managers team up with a provider that can demonstrate relevant and specialized experience. Equally important considering the long-term nature of these relationships, is a commitment to technology investment, team continuity, and the ability to scale with clients.

For the remainder of 2023 and beyond, the survey reflects that while capital raising for emerging managers will continue to be challenging there will be opportunities for continued growth over the long term. However, lower capital allocations, economic uncertainty and hesitation to take on greater risk, are causing LPs to diversify their existing emerging manager positions and be more selective in the overall manager evaluation process.

A highly qualified set of professional service firms – fund administrators, auditors, placement agents, compliance consultants and attorneys – with deep experience supporting first-time funds will continue to be vital to the emerging manager's success. ■

# Veterans day for emerging managers

*In a market defined by hesitant LPs and harsh macroeconomic winds, emerging managers are betting their depth of experience will carry them to a successful close*

On first glance, there's an enormous amount of pessimism in the results of this year's Buyouts Emerging Manager Survey, conducted in partnership with Gen II Fund Services LLC. Respondents expect emerging managers to bear the brunt of macroeconomic challenges, the market is bifurcated with established managers scoring the bulk of the capital, while LPs remain lukewarm on newer groups.

And only emerging managers with executives boasting experience at top-tier firms will raise capital easily in this market.

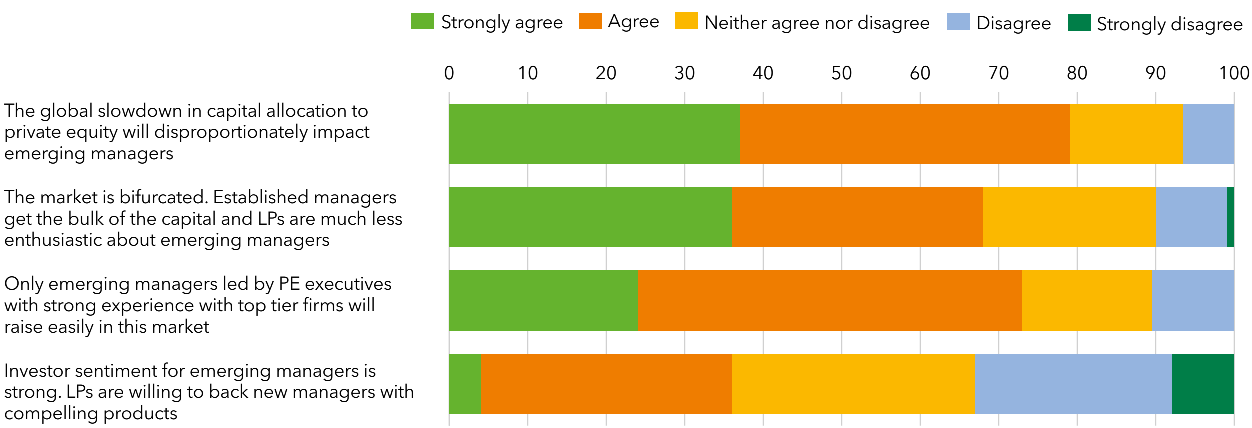
However, there's a ray of sunshine. As cynical as LPs and GPs can be about the market as a whole, their mood brightens as soon as the market is taken firm by firm. Emerging managers are still raising funds, and they cite their own years of experience as the factor that will help them beat the odds. Meanwhile, LPs are still backing emerging managers, albeit after longer bouts of deliberation.

The success stories, and the managers with the sunnier dispositions, are all built on a single factor: experience. Experience in a given sector, with a given size and style of investment, and with investors that have backed them in previous vehicles. Not all those vehicles were launched by top tier brands. Instead of an impossible climb to a close, it's an arduous one, but GPs are betting they have spent enough time on the mountains to know how to pivot on their way to the summit.

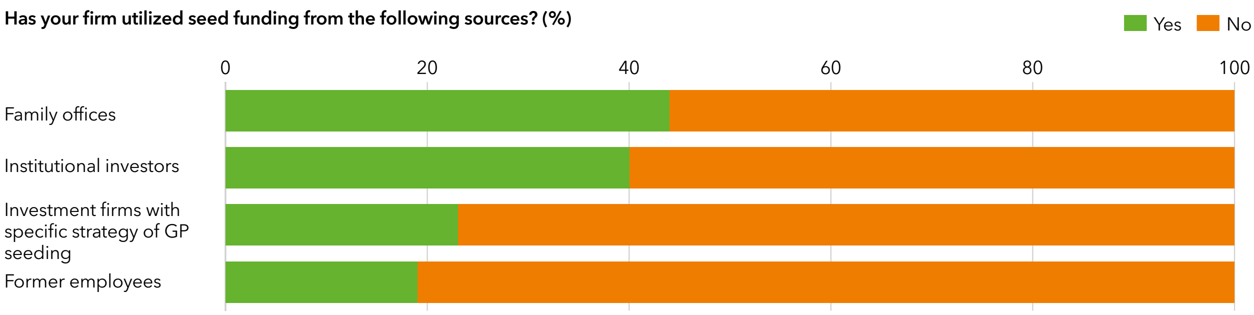
That doesn't mean the pessimism is rare or unwarranted. "Fund formation lawyers are finding fewer groups spinning out now that the fundraising environment is so challenging," says Sarah Sandstrom, a partner with the placement agent Campbell Lutyens. And it would be foolish to discount the impact of interest rates and the overall credit market.

"Given how much bank lending has retreated, many private equity

**How do you perceive market sentiment around emerging managers right now? (%)**




Source: Buyouts Emerging Manager Survey 2023



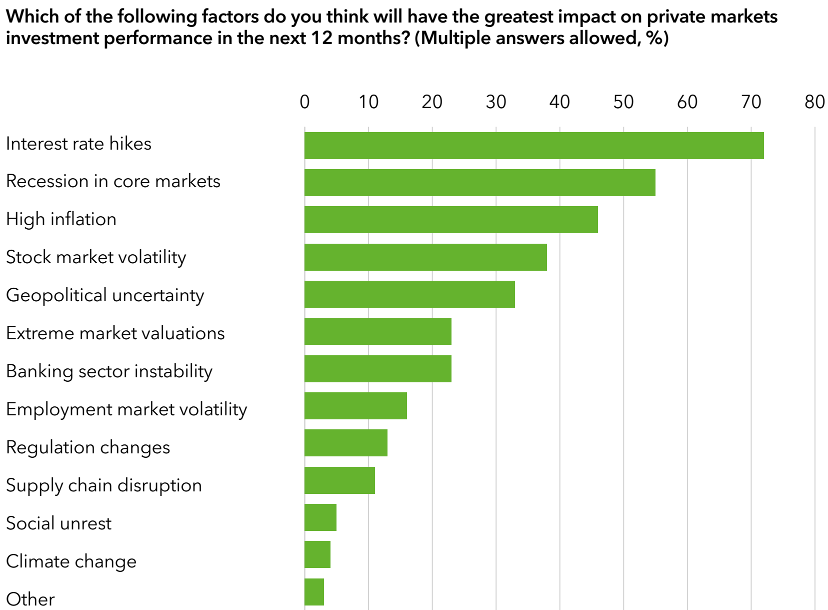

managers are going straight to private credit providers to finance deals," says Patricia Zollar, a managing director of Neuberger Berman, who leads the firm's emerging manager private investment practice. "And high-interest rates are increasing the cost and access to the capital that emerging managers need to fund portfolio M&A, which is an integral part of any private equity firm's toolbox."

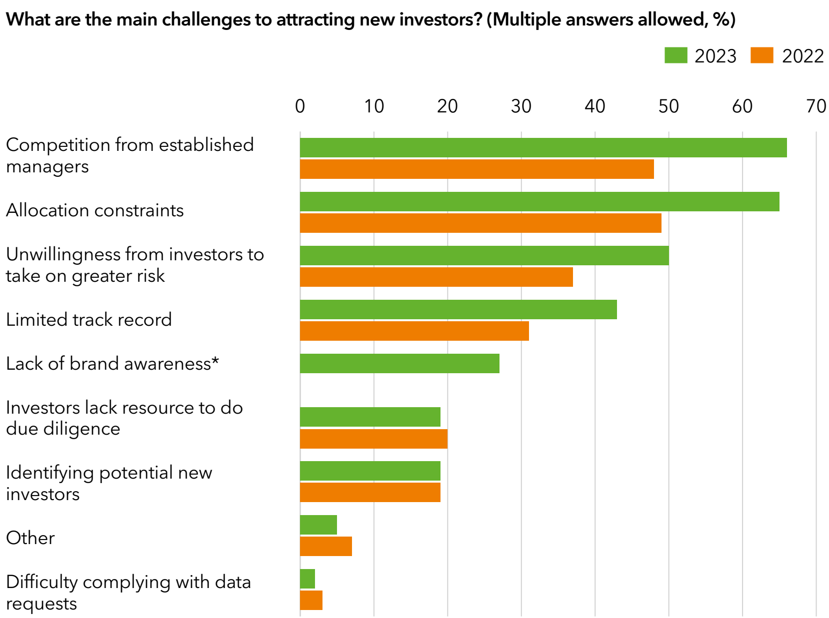
One of the other drags on the space is the sheer number of emerging managers in the market. "There's a ton of supply as we've seen a lot of emerging managers spin out over the last 12 to 18 months," says Natalie Walker, partner at Stepstone Group, which focuses on US small-market managers. "Although many of those fundraising efforts were in motion prior to the current volatility. But I have to say, in general, the quality of emerging managers today is the best that I've ever seen in my career."

And that is the contradiction at the heart of the emerging manager market today. There are good quality managers, and LPs see the value in emerging manager exposure, but there are market forces making the fundraising a slog. But again, it is difficult, not impossible.

## Sticking the landing

In the case of Princeton Equity Partners, it was able to raise its $575 million hard-cap for its sophomore fund by addressing LPs concerns about the strategy's resiliency in a recession. "We were able to move through the market quickly, in part because of our focus on the highly attractive franchisor business




*answer option not included in 2022 survey

**72%**

**GPs who say that interest rate hikes will have the greatest impact on performance**

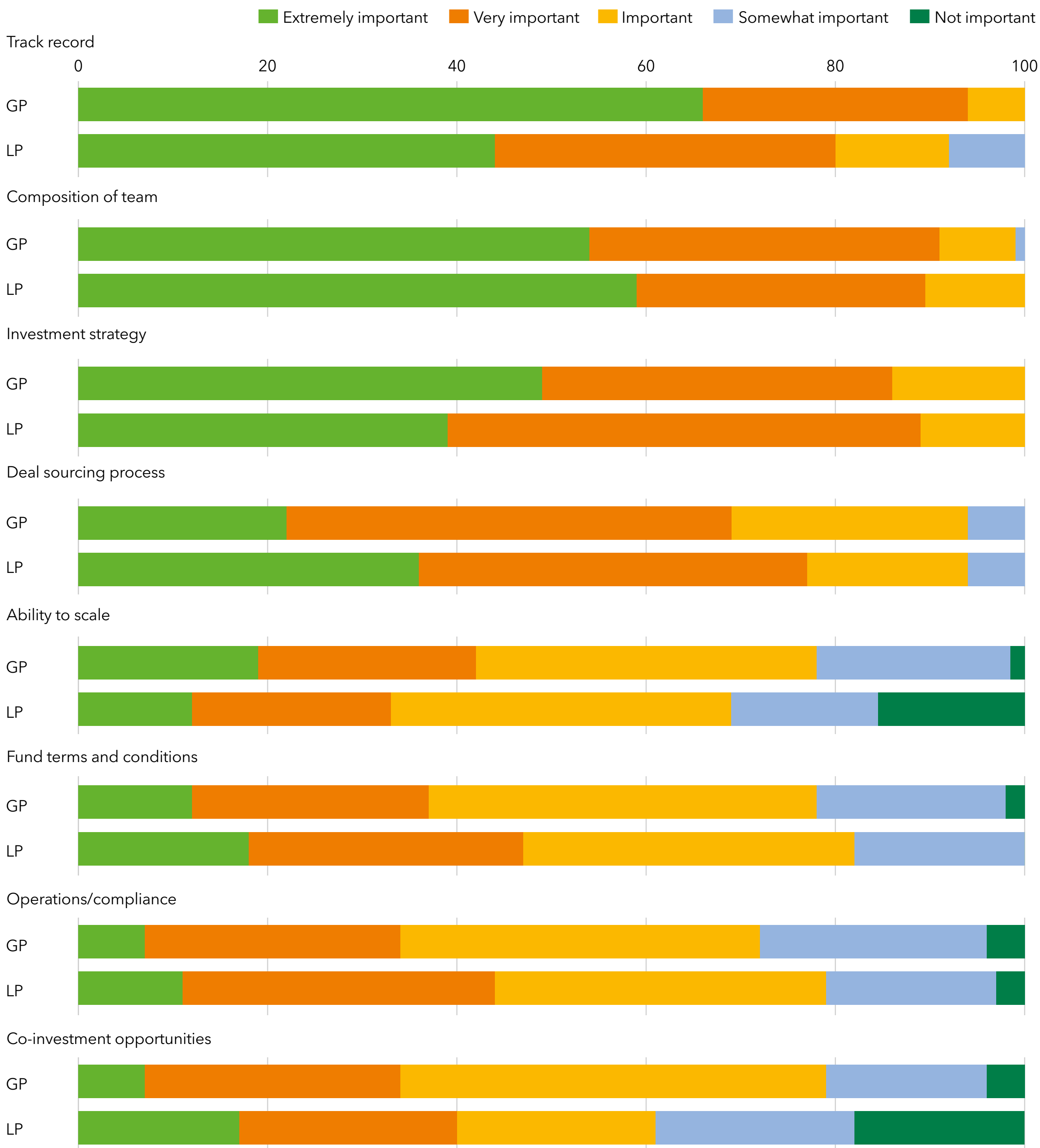
**70%**

**LPs who say they look for ESG considerations in an emerging manager**

**40%**

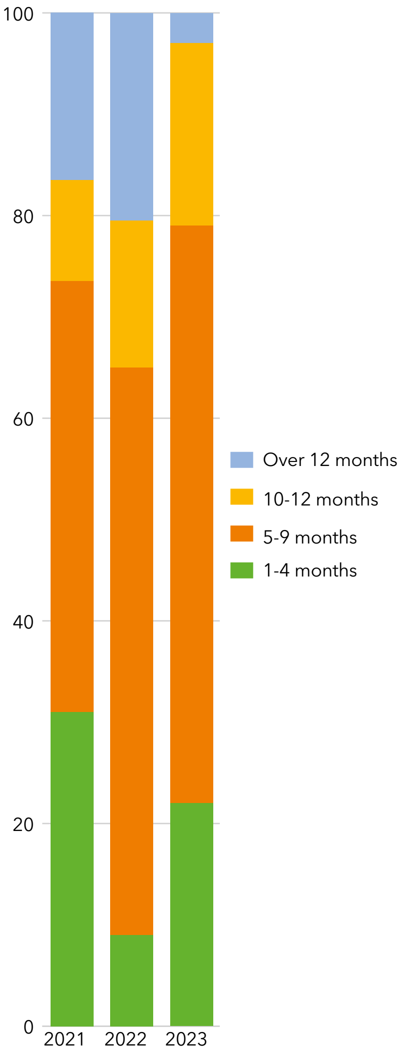
**LPs who say that co-investment opportunities are extremely or very important**

**How important are the following factors when evaluating an emerging manager fund? (%)**



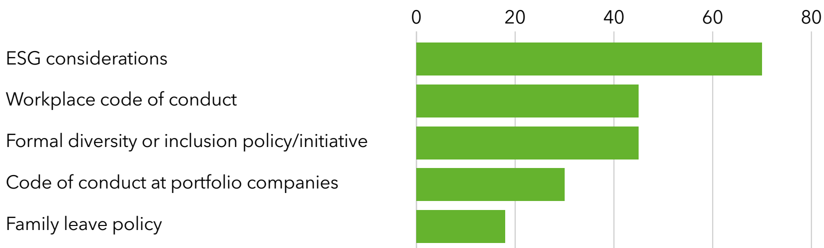
## LPs

**How long does it typically take from first introduction to a signed commitment? (%)**

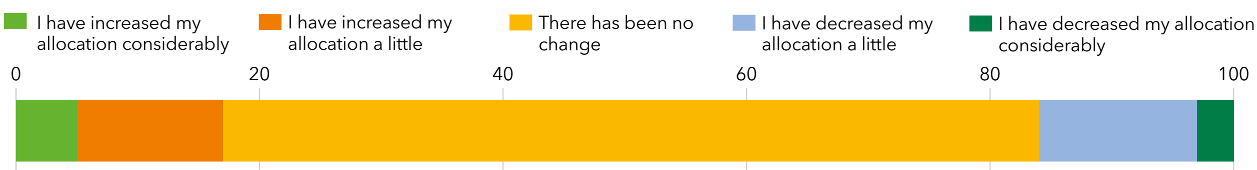



**Which of the following factors do you think will have the greatest impact on private markets investment performance in the next 12 months? (Multiple answers allowed, %)**

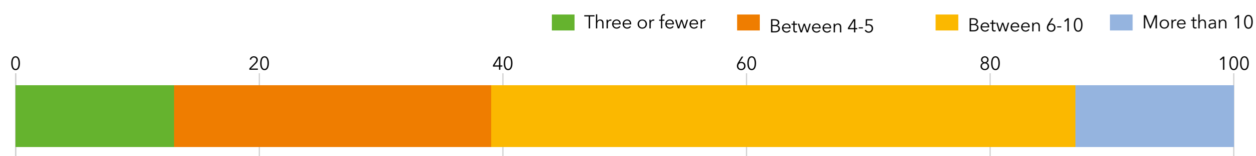

**Do you look for any of the following in an emerging manager? (Multiple answers allowed, %)**



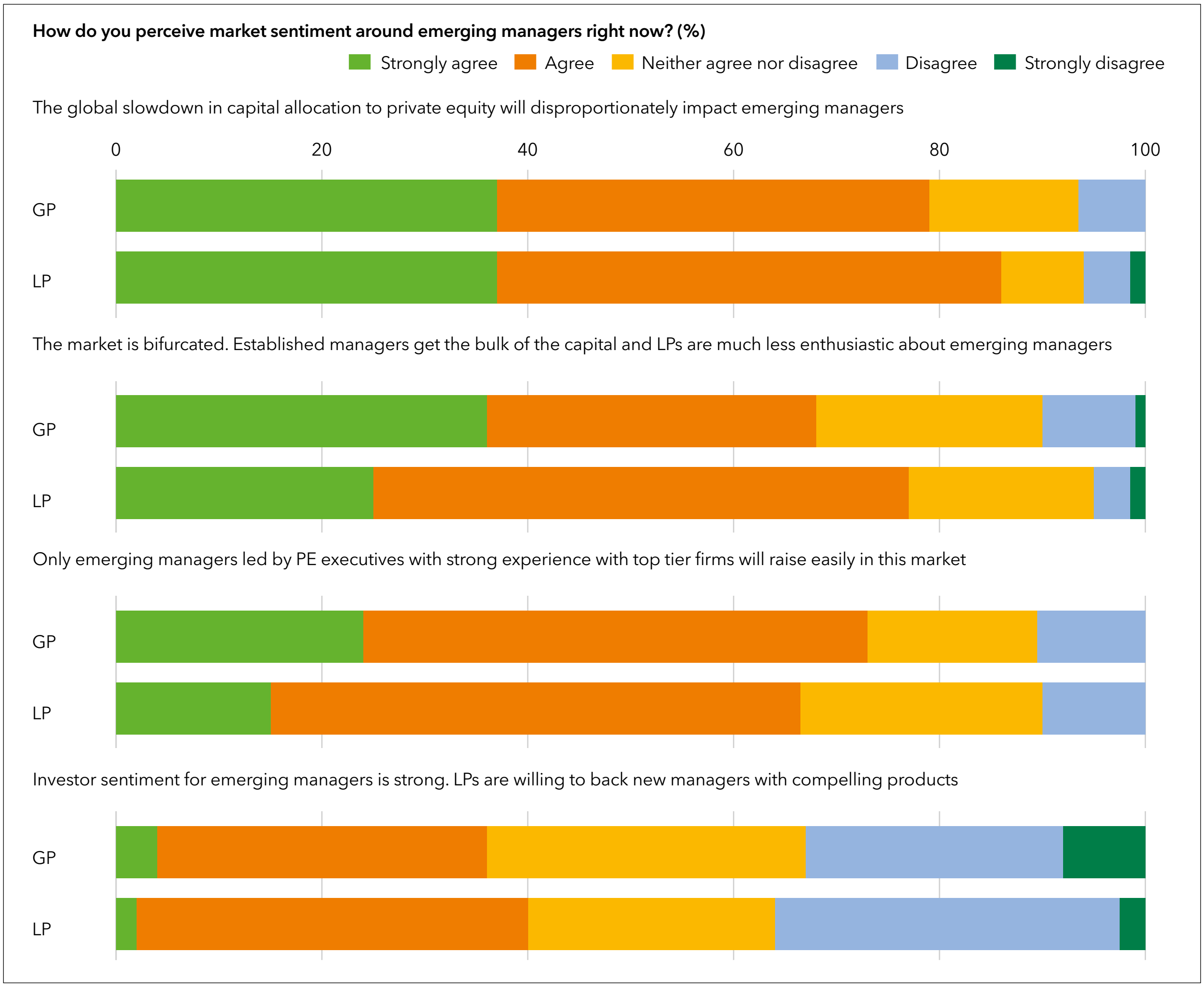

**How have recent market conditions (rising interest rates, high inflation, etc) affected your allocation to emerging managers? (%)**




**How many meetings, including conference calls, would you expect to have with an emerging manager before making a commitment? (%)**




Source: Buyouts Emerging Manager Survey 2023




model, which tends to perform well in most economic environments, and the high organic growth rates of our businesses, which reduces our need to financially engineer a return," says Jim Waskovich, co-founder and managing partner at Princeton Equity.

But Princeton Equity already had the benefit of its debut fund's strong performance, and importantly, the group had more than 14 years of investing in franchisors – with a track record of backing 30 concepts – that began well before the firm was founded.

Experience played a starring role in Braemont Capital's $575 million debut close. "We went out with a story that we're doing what we've done for over two decades, which is an opportunistic approach to investing in growth companies with low leverage, and very durable balance sheets," says Robert Covington, Braemont's founder and managing partner. "People always want to own growth companies that can generate good returns regardless of the state of debt markets."

## Deal by deal

Even experienced managers need time to raise funds. A tactic that has been winning over LPs of late is acting as an independent sponsor, raising money deal by deal, to build a track record for that specific fund. Lisa Melchior pulled this off and ended up with a C$300 million ($222 million) close for Toronto-based Vertu Capital. So how did she convince those first few investors?

"These were LPs that knew me for years, given that I'd been an investor in this asset class for over two decades, which gave them the confidence to support me at the very start," says Melchior. This path isn't for the faint-hearted, though, considering "acting as an independent sponsor" was one of the most common challenges cited by emerging managers in the survey.

The degree to which this year's survey results mirrored those of last year suggests a "new normal", even if it is one marked by instability. "We can't expect to return to the days of 2019, or so, when interest rates were so low, the money was practically free," says Zollar. "Capital is going to be harder to access and more expensive for the foreseeable future."

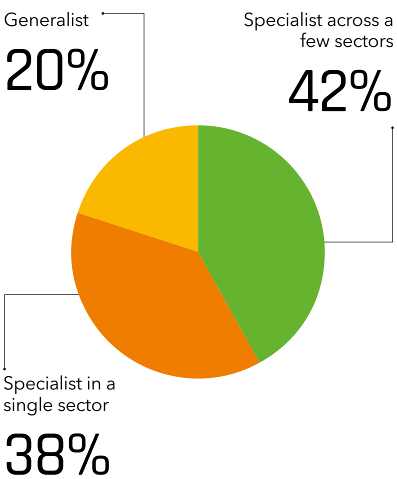
# Methodology

*More than 80 institutional investors and 130 fund managers contributed to the 2023 Buyouts Emerging Manager Report, produced in partnership with Gen II Fund Services LLC*

Field work for the seventh annual *Buyouts Emerging Manager Survey*, conducted in partnership with Gen II Fund Services LLC, was carried out between June 9 and July 19, 2023. A total of 130 managers self-selected as "emerging managers" were surveyed. The initial list was narrowed down to managers that have fundraised or are in the process of fundraising their third fund or fewer.

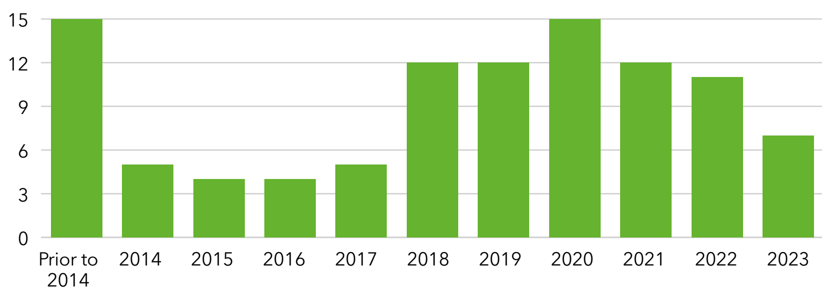
A total of 87 institutional investors with a self-identified appetite for emerging managers were surveyed. Incomplete fund manager and investor surveys were reviewed for inclusion in the sample on a respondent-by-respondent basis.

**Would you consider your firm to be a…**

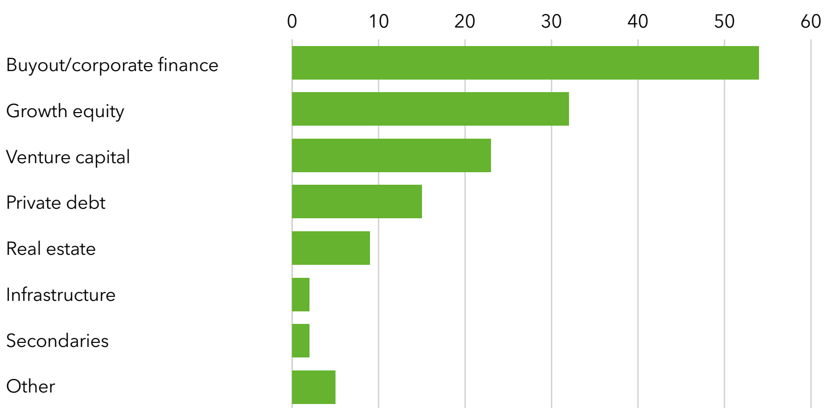



Source: Buyouts Emerging Manager Survey 2023

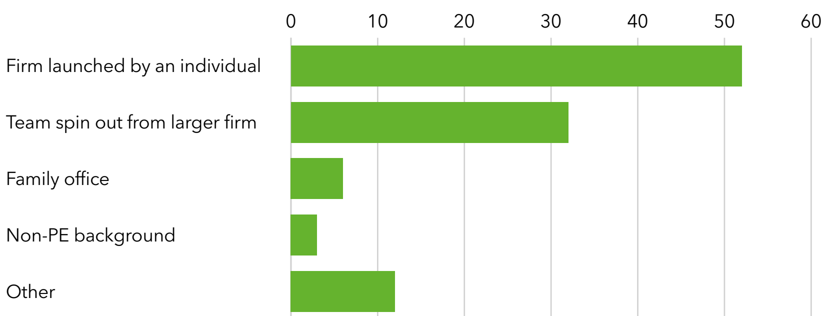
**What year was your firm founded? (%)**




**What kind of investment strategy does your firm pursue? (Multiple answers allowed, %)**

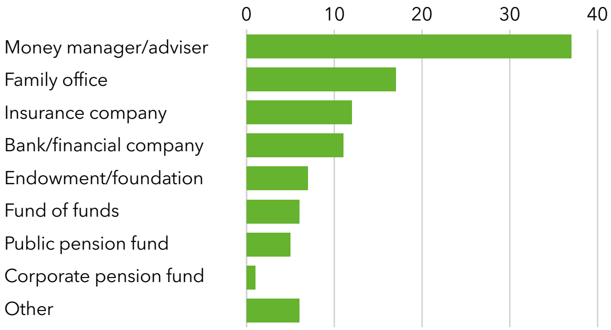



**What is your firm's heritage? (Multiple answers allowed, %)**

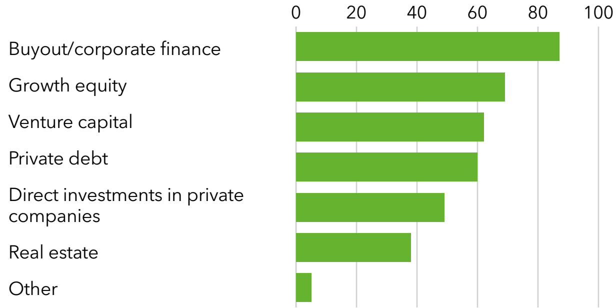


# LPs

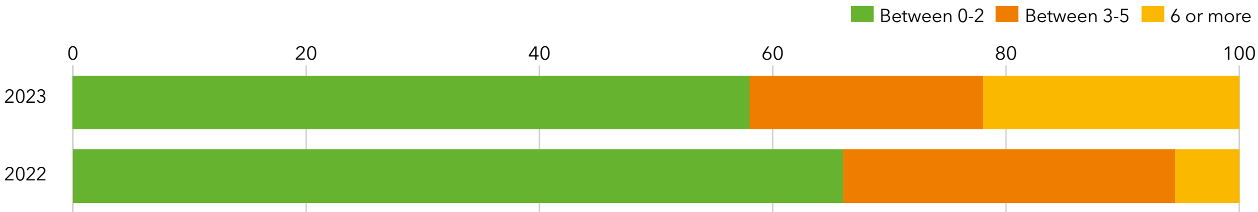
**What kind of institution do you work for? (%)**



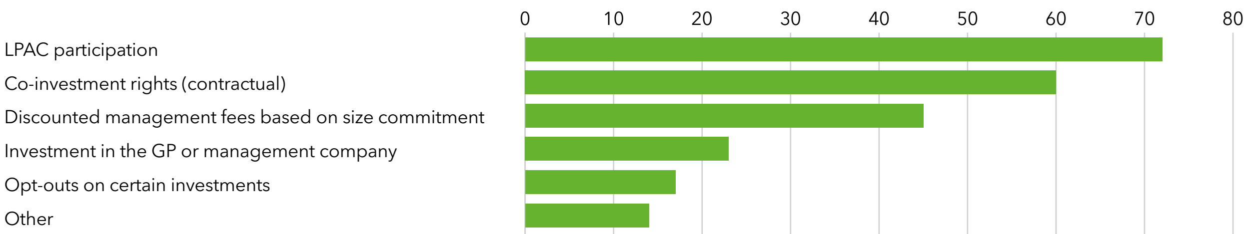

**.What kind of alternative investment strategies do you invest in? (Multiple answers allowed, %)**



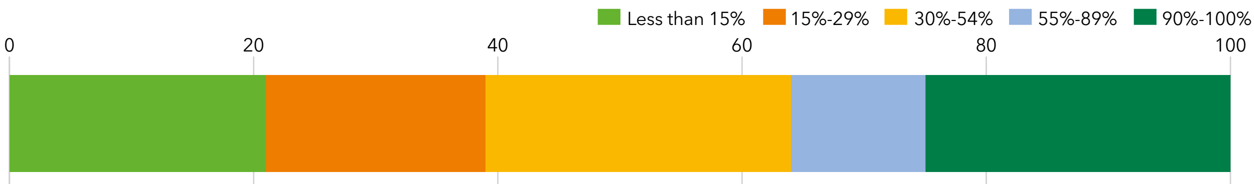

**How many emerging manager funds do you anticipate backing over the next year? (%)**



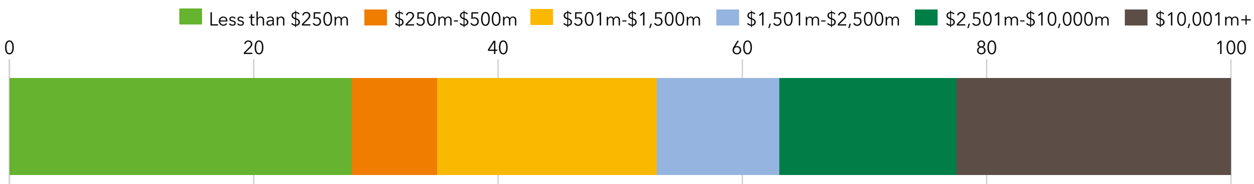

**What kind of terms do you try to negotiate with emerging managers? (Multiple answers allowed, %)**



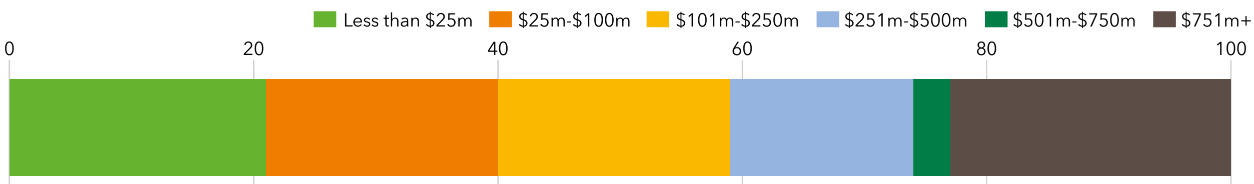

**What is your target allocation to PE/VC, as a percentage of your overall portfolio? (%)**




**LP35.What is the value of your overall PE/VC portfolio? (%)**




**LP36.How much capital do you commit to PE/VC funds of all types per year on average? (%)**



# Cloudy with a chance of commitments

*Even as the fundraising trail gets harder to trek, emerging managers are still finding creative ways to close funds*

In an era defined by volatility and uncertainty, no one disputes that it's hard for emerging managers to raise funds right now. LPs are doing their best to ride out the downturn in distributions, knowing that private equity pays off in the long term, but it's made them far more conservative in their allocations. And that means they're holding emerging manager groups to higher standards before committing their first dollar.

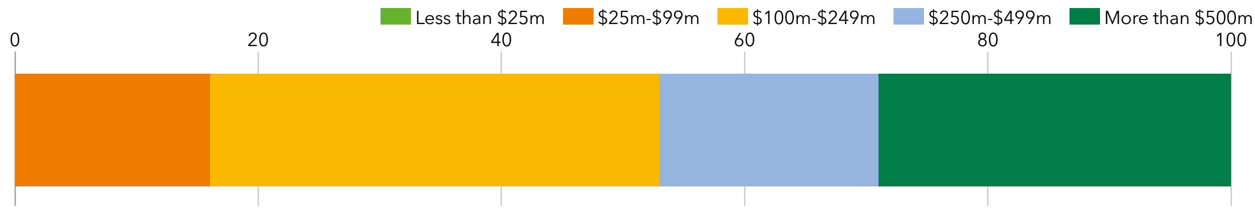
And according to our latest *Buyouts Emerging Manager Survey*, conducted in partnership with Gen II Fund Services LLC, emerging managers are doing their best to meet those standards. The new firms closing their debut funds these days boast rock solid track records, great teams from brand name GPs and novel strategies that aren't mimicking their older, larger peers. Anchor investors matter all the more in the current environment, not only conferring legitimacy, but also helping to rally other investors to a vehicle. And some aren't even waiting for the first close to begin investing deal by deal, building a track record even as they raise a fund.

Yet even that doesn't guarantee a successful close for emerging managers. "Arguably, this is one of the worst fundraising periods we've had in private equity for almost a decade," says Patricia Zollar, managing director of Neuberger Berman, who leads the firm's emerging manager private investment practice. Both GPs and LPs made it clear that covid, recent inflation and interest rate hikes all eroded the appetite for private equity, no matter the vintage. That's meant longer fundraising efforts.

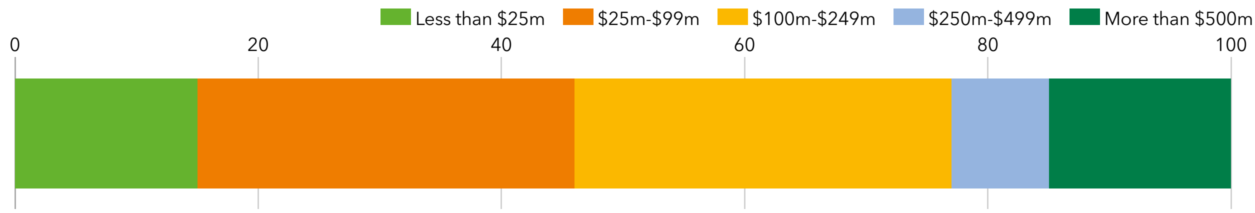
## The marathon era

For the past decade, it's been fashionable to say that GPs never stop fundraising, but that's never meant that it took them forever to reach that first close. The average time taken between

**What is the target of the fund you are currently raising? (%)**




**What is the size of your most recently closed fund? (%)**




Source: Buyouts Emerging Manager Survey 2023

first and final close was 14.3 months in our 2023 survey, up from 10.3 in 2022.

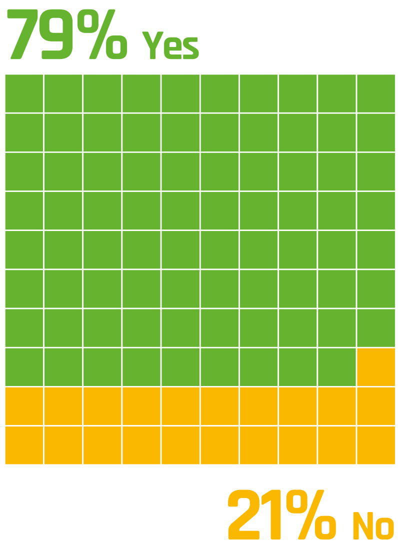
But here the stats can be misleading. “The average fundraising time is not representative of most emerging managers’ experience,” says Sarah Sandstrom, a partner with the placement agent Campbell Lutyens. “There’s been a barbelling, with a few groups grabbing the imagination of the market and closing very quickly, while other groups are taking 18 months to two years.”

Zollar suggests that emerging managers should use 18 months as the base case expectation for fundraising at the moment.

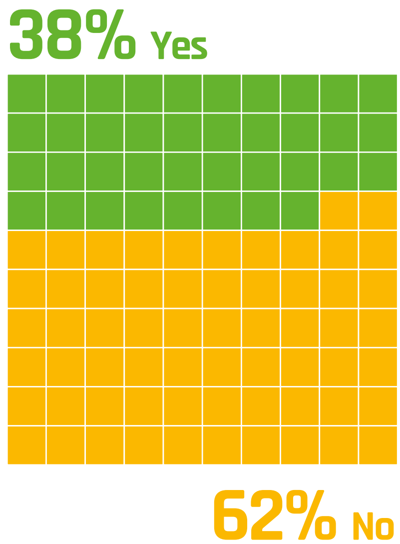
The going might be rougher and slower these days, but what is making the difference between the managers that reach a close, and those that don’t? Prysm Capital closed a maiden fund at $305 million for their strategy around growth equity primarily in the tech and consumer sectors. They credit their success to not only a strong track record but also a good reputation as a partner to the founders and CEOs that lead their portfolio companies.

“Reputation matters. LPs do their due diligence. They call our CEOs and founders and verify that we operate the way we say we do,” says Jay Park, co-founder and managing partner at the firm.

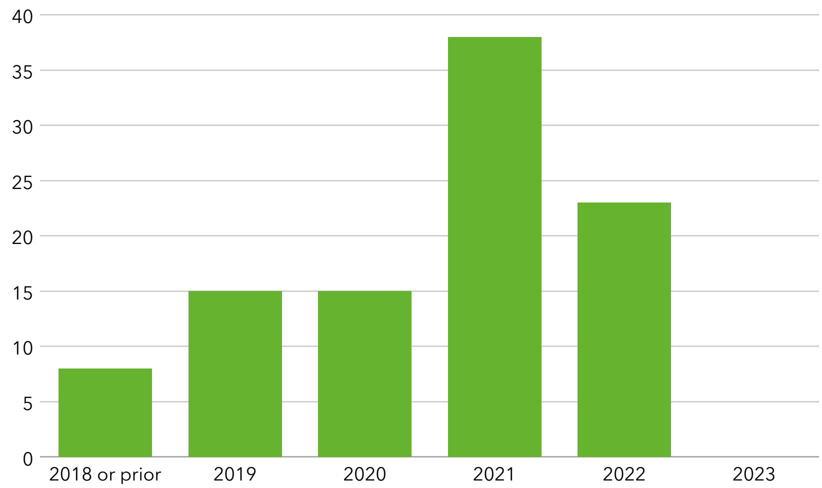
**Are you currently fundraising?**



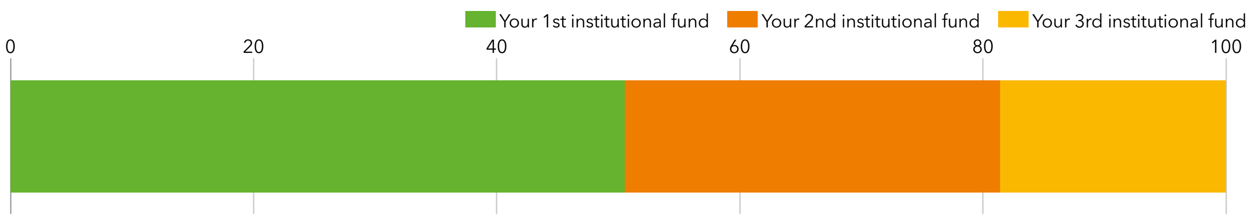

**Are you using a placement agent?**



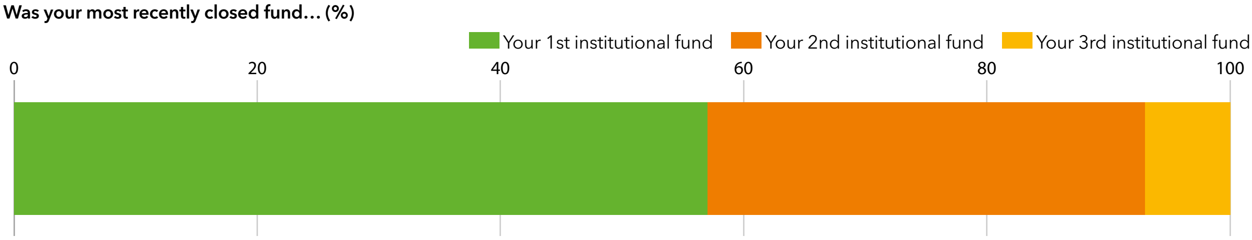

**When did you launch marketing for the fund? (%)**




**Are you currently raising… (%)**




**Was your most recently closed fund… (%)**



## What was the most challenging aspect of the fundraise?


Source: Buyouts Emerging Manager Survey 2023

However, "track record is always core," says Joncarlo Mark, the former chairman of ILPA and CalPERS' senior portfolio manager, now the founding partner at LP advisory firm Upwelling Capital. "But attribution is critical, as the manager has to demonstrate which transactions they can call their own."

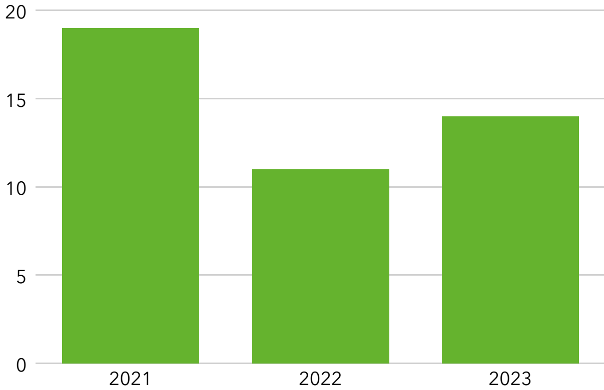
### The right kind of attribution

It's not merely attribution to successful transactions, but relevant ones as well. "A strong body of work matters, but it has to be relevant in terms of deal size and strategy to the new vehicle as well," says Sandstrom. "The LPs have to believe that the team is uniquely well-equipped to drive returns through the new firm's strategy."

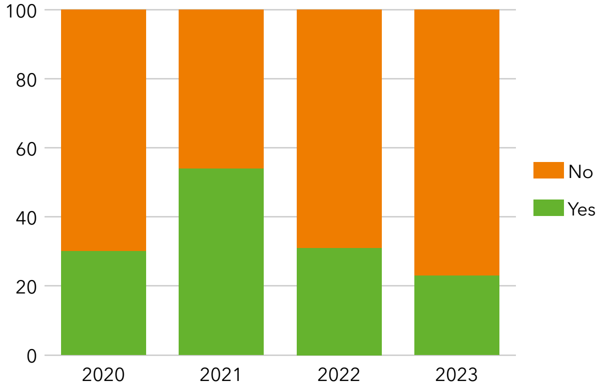
Teams matter, but the consensus appeared to be that "team" means a combination of track record and experience working together. Three superstar managers are compelling, but not as compelling as three superstars who have previously worked together on successful transactions.

Strategy is the next consideration, but, given that every LP has their own priorities, it's harder to determine the themes that resonate most with investors. Sector specialization is still popular, and only getting more focused with subsectors allowing GPs to argue they can own that particular slice of the market. This can also help win over LPs who lack exposure to that specific part of an industry.

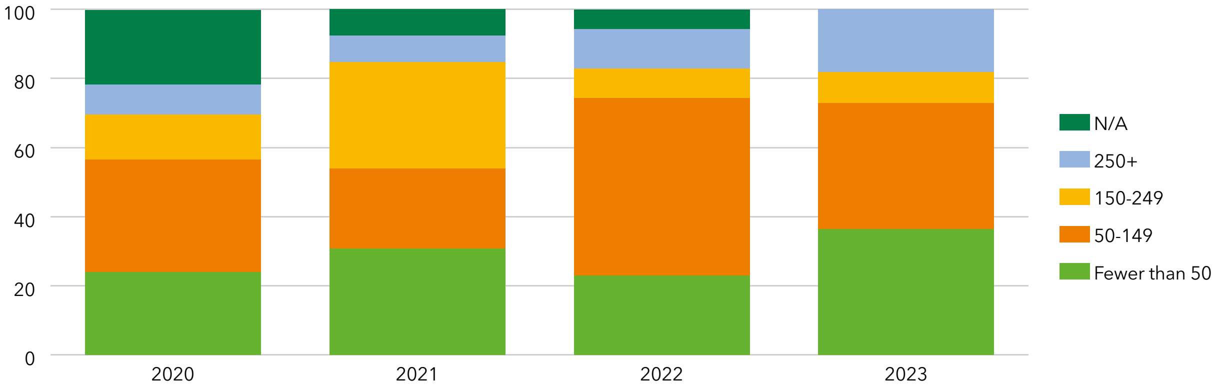
What was the length of time between first and final closing? (Months)



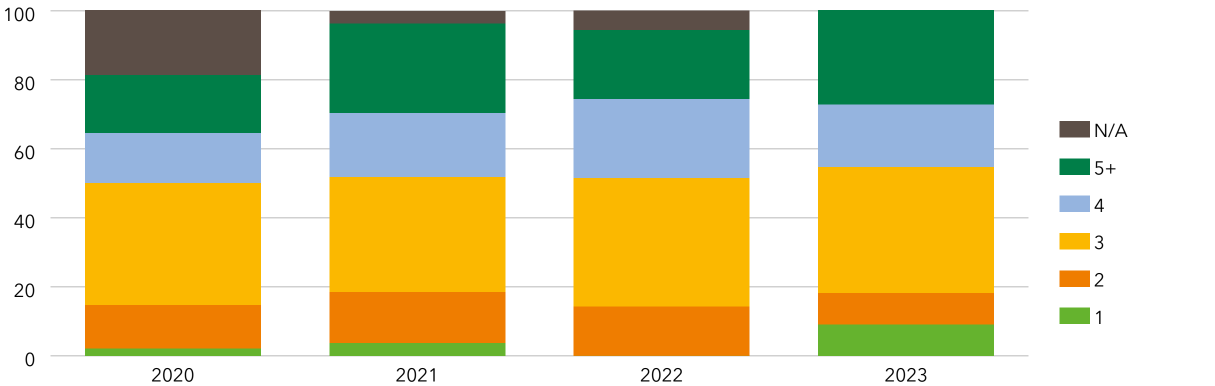

Did you use a placement agent? (%)



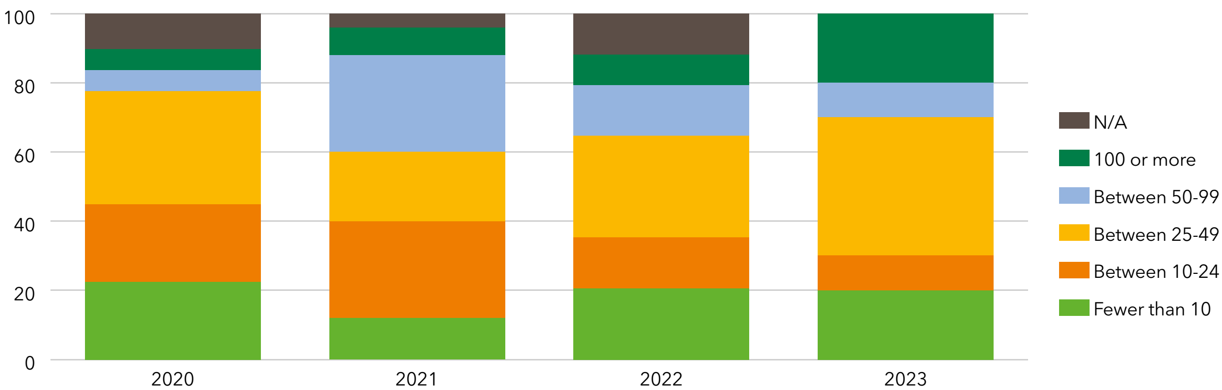

How many prospective investors did you meet with? (%)

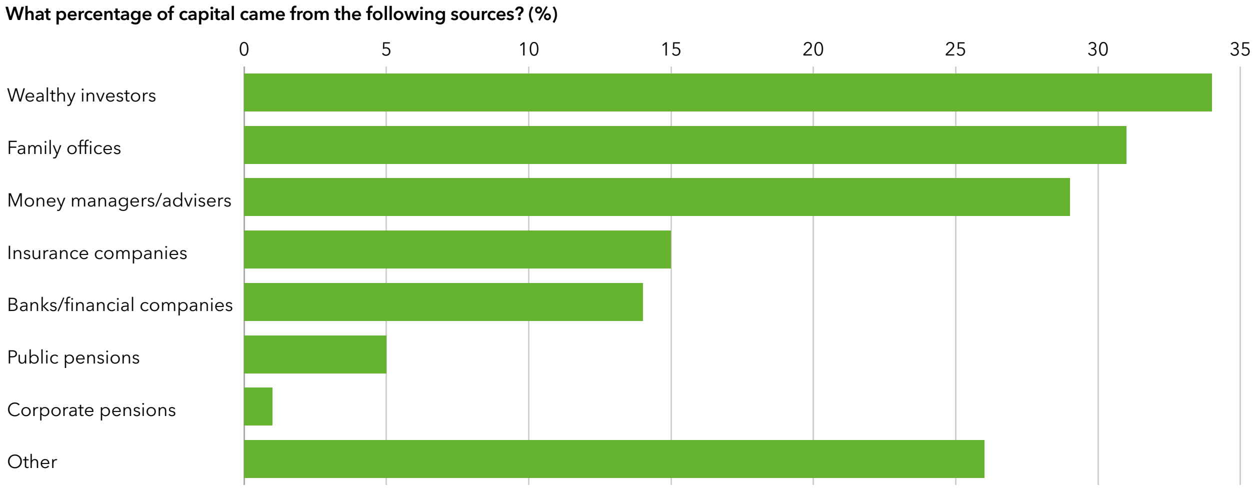


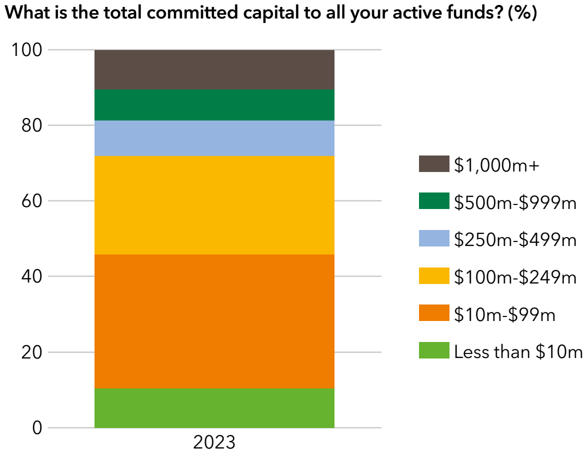

For investors who ultimately committed, how many meetings (including conference calls) did you have with them on average? (%)

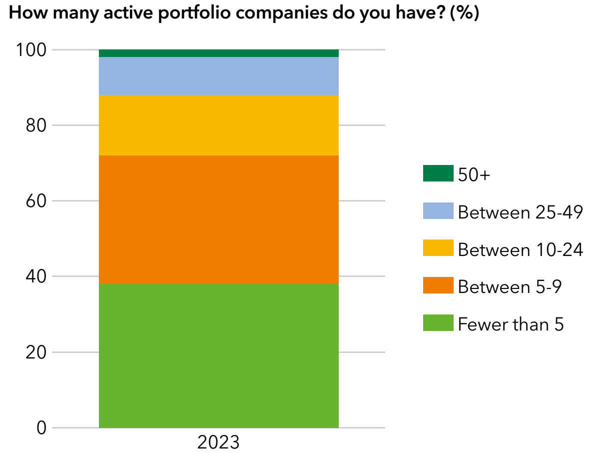


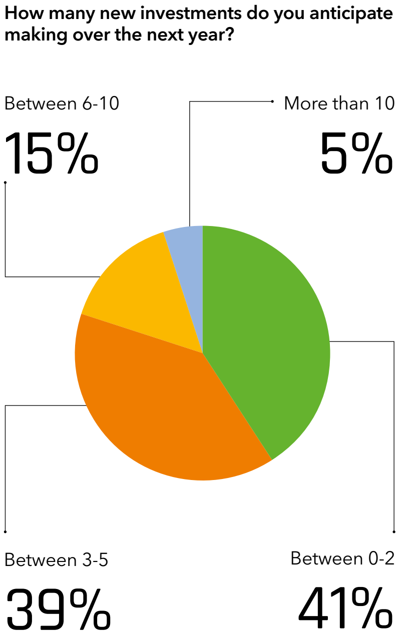

How many limited partners do you have in your most recent fund? (%)






"Let's say an LP has exposure to healthcare provider services in their current portfolio, but an emerging manager shows up with a strategy devoted to healthcare products," says Natalie Walker, partner at Stepstone Group, who focuses on US small-market managers. "Now that emerging manager offers a chance to invest in a complementary angle of the market that they don't have yet. That can be attractive enough to win a commitment."

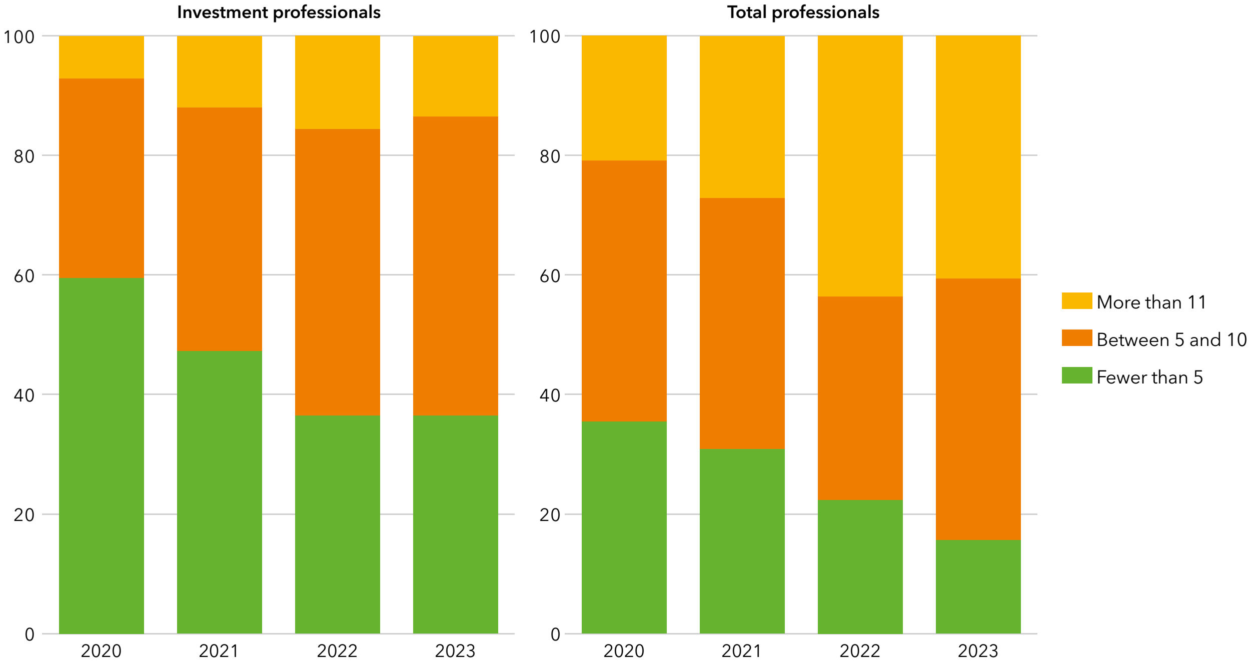
## Anchors away

That doesn't take into consideration how many LPs might fall in the category of needing precisely that subsector strategy. Even for managers with a magnetic strategy and the track record to prove they've made it work before, the market can still prove daunting, which is why anchor investors have become a vital asset for emerging managers at the moment.

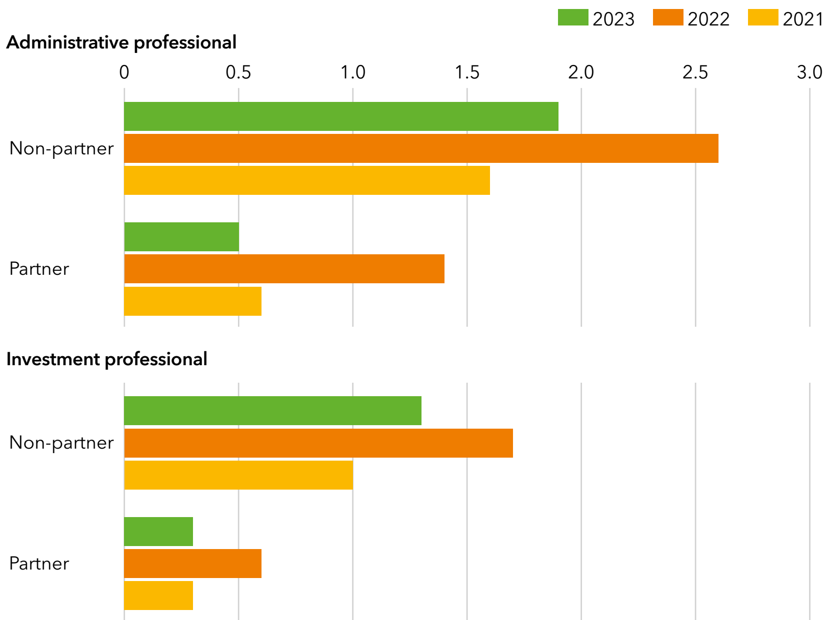
"Coming out of the gate with zero dollars can be hard at the moment, so an anchor investor or two can make a huge difference," says Mark. "Anchor investors validate the strategy and provide sufficient resources to keep the lights on as the manager is looking to round the fund out."

Robert Covington's Braemont Capital closed a $525 million fund this year, and it was a key group of early investors that played a big role in that win. "Early in the fundraising process, an anchor group of families wrote sizable checks, and that changed

**How many investment and total professionals work for your firm? (%)**




**How many staff do you plan to add at the following levels and roles over the next year?**




Source All Charts: Buyouts Emerging Manager Survey 2023

everything," says Covington. "They said, 'We like what you're doing and believe in it.' And then we were able to bring in more families with the same shared goals."

Many managers that can't woo such a star anchor are choosing to build that same validation deal by deal, investing before the first close, which appears to be tremendously popular with LPs at the moment.

"Given the difficult fundraising environment, there is a greater opportunity to invest in funded primaries, which can answer so many underlying questions an LP may have about the potential of the group," says Zollar. "Often, a prospective LP can see the value accretion at those companies already, and so it's much easier to commit to that partially funded portfolio."

That doesn't make it easy, as the *Buyouts Emerging Manager Survey* found that acting as an "independent sponsor" was one of the most challenging parts of raising funds. And Mark warns that as much as early investors might like co-investing opportunities in those first few deals, they run the risk that the manager doesn't reach their target, leaving them with an incredibly concentrated portfolio.

That appears to be a risk that managers are willing to take given the market out there, says Sandstrom. "Looking at this maturation of private fund capital raising where limited partners have so many choices and getting that capital is so competitive, the balance of power has certainly shifted towards investors."

# ESG: Evolution over revolution

*Beyond the headlines, ESG isn't driving commitments or scaring them away. Instead, LPs are asking emerging GPs to define their policies*

Today's ESG programs seem to have few fans on either side of the political divide. Conservatives fret that profit considerations are tossed aside for political agendas, and liberals complain ESG is simply granting cover to those profit considerations. But out on the fundraising trail, there's a far less shrill perspective at work. One that understands the need to manage ESG risks, along with the best way to do that early in the life of a firm.

The *Buyouts Emerging Manager Survey*, conducted in partnership with Gen II Fund Services LLC, found that ESG concerns have rarely caused LPs to pass up on an investment opportunity, and only 40 percent of LPs expect emerging managers to have an ESG policy in place. Both GPs and LPs are evenly split if ESG has a positive impact on investment performance. But few people are pretending that ESG can be ignored.

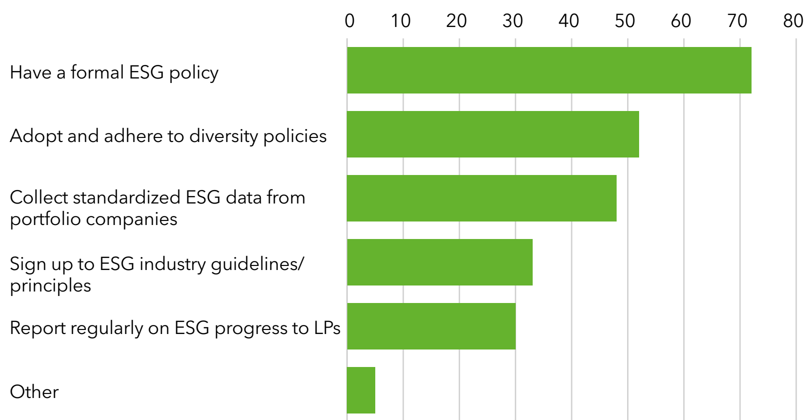
"Emerging managers should have a very defensible set of ESG practices and procedures, however they define it, that constitute a real framework for operating," says Joncarlo Mark, the former chairman of ILPA and CalPERS' senior portfolio manager, now the founding partner at LP advisory firm Upwelling Capital.

But what constitutes a defensible framework for ESG?

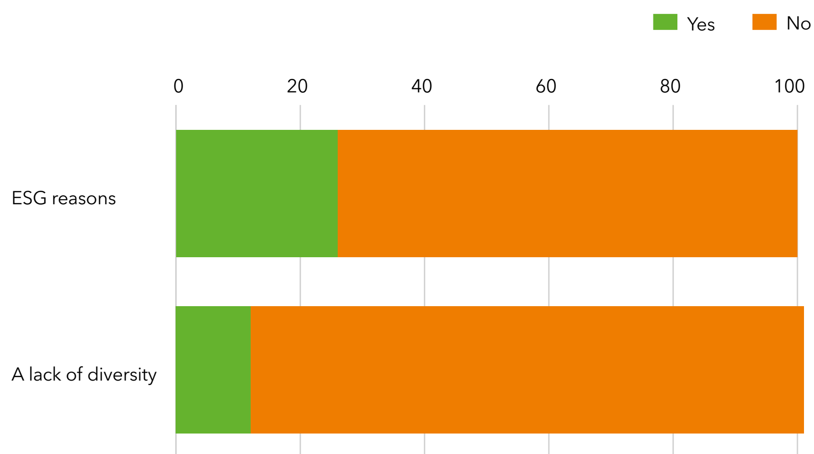
"LPs want ESG integrated into what managers do," says Patricia Zollar, managing director of Neuberger Berman who leads the firm's emerging manager private investment practice. She cautions against treating ESG policy as a separate set of considerations that get dragged out once a year for a report. But LPs do temper their expectations, especially when it comes to launching a tracking system for ESG issues.

"I had a manager explain that they often struggle to get an accurate balance sheet from the small enterprises they target, let alone ESG metrics,"

**On ESG issues, do you... (Multiple answers allowed, %)**




**Has your institution ever refused an investment opportunity from an emerging manager based on... (%)**




Source: Buyouts Emerging Manager Survey 2023

says Sarah Sandstrom, a partner with placement agent Campbell Lutyens. "So it really is a question of how one's going to address ESG concerns and drive positive change within the constraints of an emerging manager, and that often boils down to having a strategy about how ESG is applied to one's investment process and then tracking the data to support this value creation."

## Looking for diversity

Culling environmental metrics might be a tall ask for a new group, but the 'S' of ESG does factor into a new firm when it comes to team DE&I. "A lot of groups have been self-reflective in terms of the lack of diversity in their own portfolios," says Natalie Walker, partner at Stepstone Group, who focuses on US small-market managers. "And so groups like public pension funds, endowments and foundations are looking to add diverse managers to the roster and that can certainly set a new fund apart from the competition."

For some, it's about communicating how good investing practices organically address ESG concerns. "The whole idea of private equity is to install good governance," says Mark. "For example, this is how they turn family businesses into institutions. They establish appropriate financial reporting protocols, [and] work with management to create shared objectives and economic alignment.

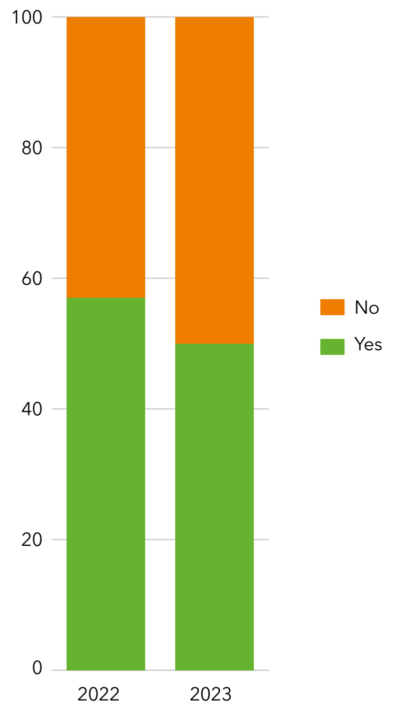
"The most successful PE firms seek to properly compensate and motivate employees while improving workforce safety, thus minimizing turnover. For industrial businesses, PE needs to care about environmental issues. If they don't get this right, how does the firm expect to sell a company for maximum value if, for instance, the company hasn't increased its efficiency and reduced emissions?"

For some, ESG is essentially a set of principles that drives better performance. Lisa Melchior is the managing partner of Toronto-based Vertu Capital, which recently closed its C$300 million ($222 million) debut fund, and she built her team with a diversity of backgrounds in mind. "When you have a fresh sheet of paper, you want to build the kind of team you always wanted to work with, and for me, that meant people with very different backgrounds and experiences.

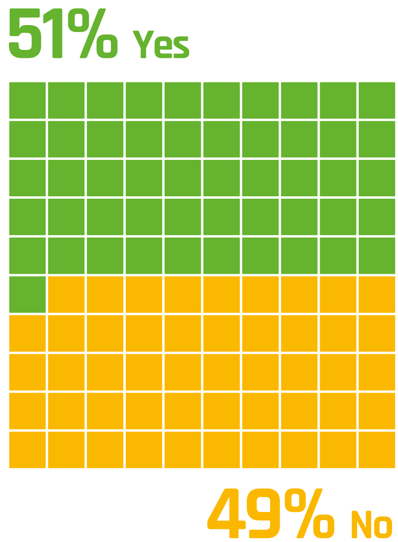
"I believe in having an extremely open and collaborative environment, so when you bring people together from different points of view and truly listen to each other, you can come up with best answers."

This is not arguing that emerging managers can skip crafting a formal ESG policy by assuring LPs they will tackle such concerns by investing well. "We spend a lot of time educating emerging managers on the best industry-wide ESG practices, so they understand the level of tracking and documentation taking place at the larger end of the market, and can aspire to those practices," says Walker.

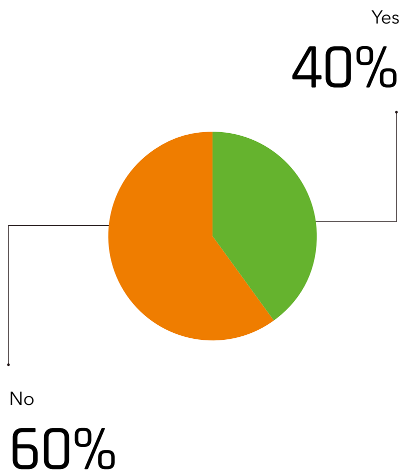
**Do you believe a commitment to ESG principles positively impacts performance? (%)**




**Do you believe there is a positive impact between ESG and investment performance in emerging managers?**




**Do you expect emerging managers to have a formal ESG policy in place before considering an investment?**




But why devote the energy to ESG if most LPs aren't rejecting teams over ESG concerns?

GPs, placement agents, LP advisers and marker observers all agree that to completely disregard the issue is an unnecessary risk in this hyper-competitive market. A small percentage of LPs do care enough about these issues, and these days no one can afford to alienate an investor who might be the anchor that launches the whole firm.

# Q&A

*Hidden River Strategic Capital's close of its debut fund on $245m in June is a testament to a focused game plan rooted in its experience in the lower mid-market, says partner Steve Gord*

**Q What was the elevator pitch for the firm's debut fund?**

A We sit in a space between a mezzanine debt fund and a growth equity fund, and the reason is that we found over the course of our careers that many smaller private businesses may need to raise $10 million-$25 million but aren't really sure if that should be debt or equity. In addition, the proposals they might get from a mezzanine fund are overly restrictive and "credit-y," while those they receive from growth equity are dilutive and invasive from a governance standpoint.

Companies typically use our capital to fund an acquisition or redeem an inactive shareholder, and these raises can often fall through the cracks, since there aren't a lot of folks executing these minority stake, debt/equity deals. We aren't the only one doing them, but there's a lot less competition.

> *"It was still hard to win commitments for a first-time fund"*

**Q Why aren't these kind of deals winning the attention of more of your peers?**

A First, it's hard to raise a fund like ours. Institutional investors want the story to line up pretty cleanly with their investment mandate. They might, for example, want to put 20 percent of their assets in alternatives, with a specific sub-portion of that into buyout firms, into venture capital, into credit and so on. So, when we pitch them on this in-between kind of product, we get the reaction that it sounds good, but they aren't sure where to place it in terms of their allocation.

The second reason is there's a very specific check size "sweet spot" in structured capital investing from a risk/reward standpoint, which we think is between $10 million and $30 million. That means a sub-$350 million fund, which precludes a lot of people from jumping in as well. We feel it's far better to work at a small fund than to chase a more well-worn strategy and be lumped in with the hundreds and hundreds of other funds that have been doing this for 20 years or more.

**Q Given the successful close, that assumption was correct. What are the other factors that contributed to you hitting your target?**

A The three founding partners here have an extensive, solid track record in this exact type of investing. It helped a lot to have a long list of successful deals to make our case. I should also mention that we're a SBIC fund, which automatically rules out about 95 percent of institutional investors. However, the good news is that leaves a short list of those that do, so it's easy to get to know the relevant players.

If we were a traditional buyouts shop, we might have a list of 5,000 different LP prospects, but without knowing who might be the most willing to make a commitment. And lots of LPs are happy to take meetings, simply to stay informed, with little intent to invest, so having a short list helped us close this in roughly nine months.

Even so, it was still hard to win commitments for a first-time fund. There's no escaping the fact that when raising any debut vehicle, 97 percent of the meetings are going to end with a "no." But typically, the remaining 3 percent are more than enough to cross the finish line. You have to bear that in mind, because it can be easy to get discouraged. ■

# LPs remain committed to first-time funds

*Investors might be trimming their allocations to private equity, but they remain committed to the asset class, and still recognize the unique value of emerging managers to their long-term prosperity*

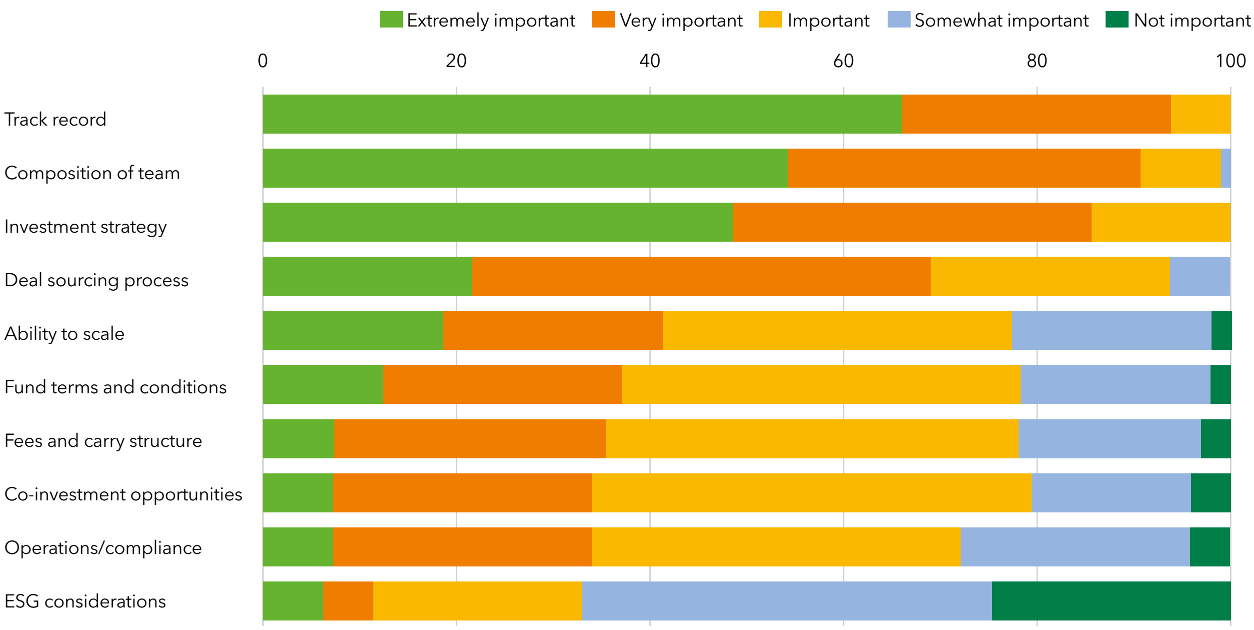
Today's volatile market has left LPs in a conundrum. On one hand, inflation, and the resulting interest rate hikes, has toughened the market for even the most illustrious firms to finance deals. A moribund IPO market has closed off a major path for exits, and distributions have been dwindling for some time, even if there are flickers of hope. All of this makes an argument for a serious retreat from the asset class, and a wait-and-see approach to new commitments.

On the other hand, LPs know that PE firms have proven time and time again that they thrive as a market climbs out of a ditch, taking advantage of lower prices and using their own operational value creation acumen to execute turnarounds and consolidate industries. It's been the recipe for some of the private equity's biggest windfalls.

And there's always a risk in retreating from emerging managers, many of whom become the next generation of superstars. How can they afford to miss out getting in on the ground floor of the next Blackstone or Carlyle? And in many ways, an emerging manager might offer the perfect complement to their existing portfolio, with some niche strategy and an expertly skilled team to pursue it.

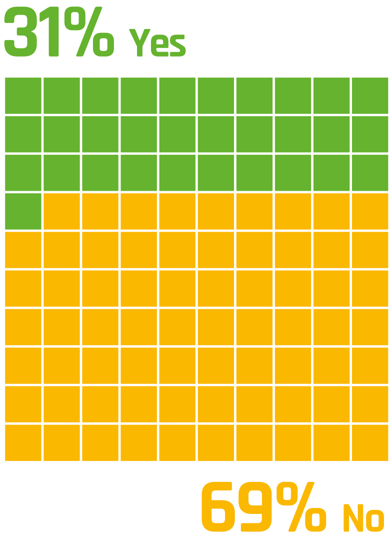
According to this year's *Buyouts*

**How important do you believe the following factors are for LPs evaluating your fund? (%)**

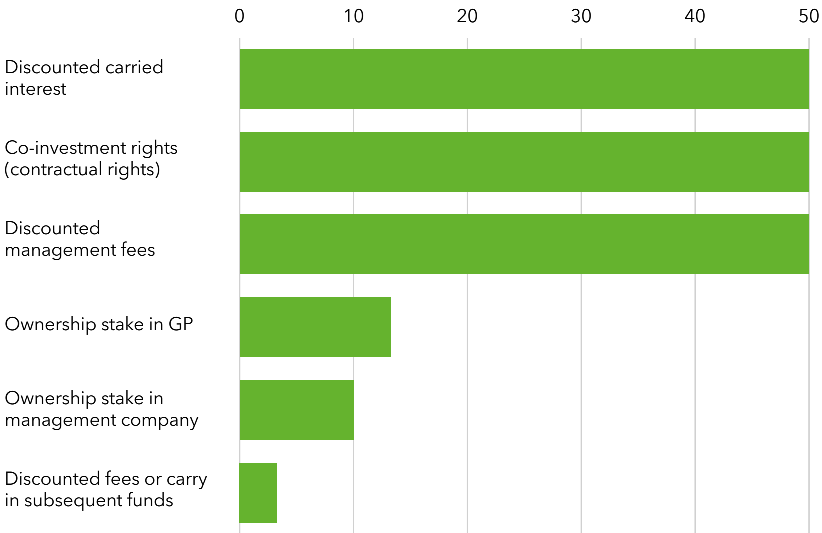



Source: Buyouts Emerging Manager Survey 2023

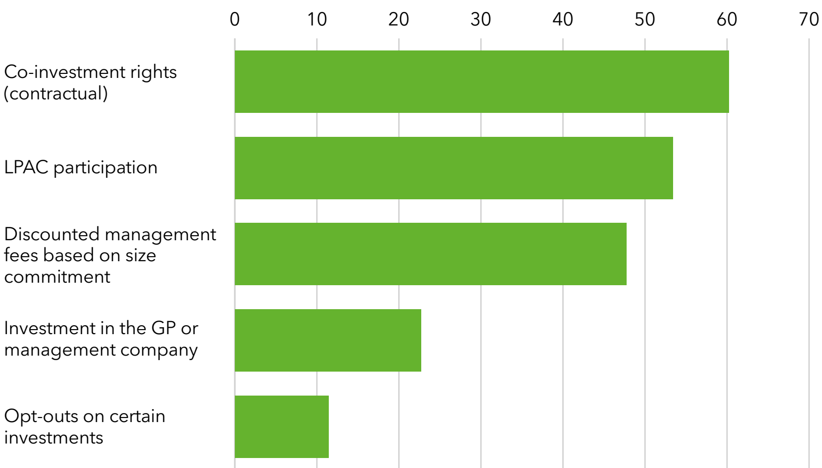
Did you have an anchor investor with more favorable economic terms?




If so, what terms did the anchor investor receive? (Multiple answers allowed, %)




Which of the following terms did you offer/provide to investors? (Multiple answers allowed, %)




Source: Buyouts Emerging Manager Survey 2023

*Emerging Managers Survey*, conducted in partnership with Gen II Fund Services LLC, while LPs might be taking longer to commit to firms, and being more selective in choosing a few emerging managers, they are still bullish on the asset class, and even the newest players on the field.

The survey found that GPs understood LP's priorities for making commitments to emerging managers, with both sides citing track record, team and strategy as the highest priority qualities for a new firm. But that agreement, and even LPs' goodwill towards new managers, has not resulted in a friendlier fundraising climate. Commitments arrive, but sometimes not until a manager has already landed a few attractive deals as an independent sponsor.

The reality is that LPs are attempting to solve that conundrum, with one eye on the near-term volatility that has moved from macroeconomic concerns to fretting over a dearth of distributions, and another eye on the future, when the economy rebounds and new private equity kings will be crowned for ably managing such a difficult time. No LP wants to miss out on a genuinely promising team because they first came knocking in a rainstorm.

And even more to the point, some emerging managers are the perfect antidote to teams that were constructed in the sunny days of the long boom. In many ways, today's new teams are being built to withstand the shocks that are the new normal.

## Dwindling distributions

That does not mean that any LPs are getting comfortable with this status quo, and in some ways they are more concerned than they were last year. Placement agents and LP advisers agree that while a year ago investors were fretting about inflation and interest rates, their core worry now is around the lack of distributions, which hits home.

"A year ago, investors were mindful of what sustained high-interest rates would do to debt financing," says Sarah Sandstrom, a partner with the placement agent Campbell Lutyens.

"But over the last several months, there is additional rising anxiety around the lack of upcoming distributions. Our data shows that there's been quite significant net negative liquidity in the system for the last few quarters. So far in 2023, it's been tough out there: sales are not getting done, mergers aren't going through, and debt financing has dried up for a big segment of the market. That's making new commitments harder to make when LPs aren't generating the returns they expected."

Joncarlo Mark, the former chairman of ILPA and CalPERS' senior portfolio manager, now the founding partner at the LP advisory firm, Upwelling Capital, says: "Most LPs are thinking about liquidity right now. They're talking to their existing managers and saying, 'I'm going to cut you back by half to two-thirds.' At the same time, they're hoping that they can protect future allocation because there is competition from other LPs who may not be over-allocated and are ready to swoop up the additional capacity."

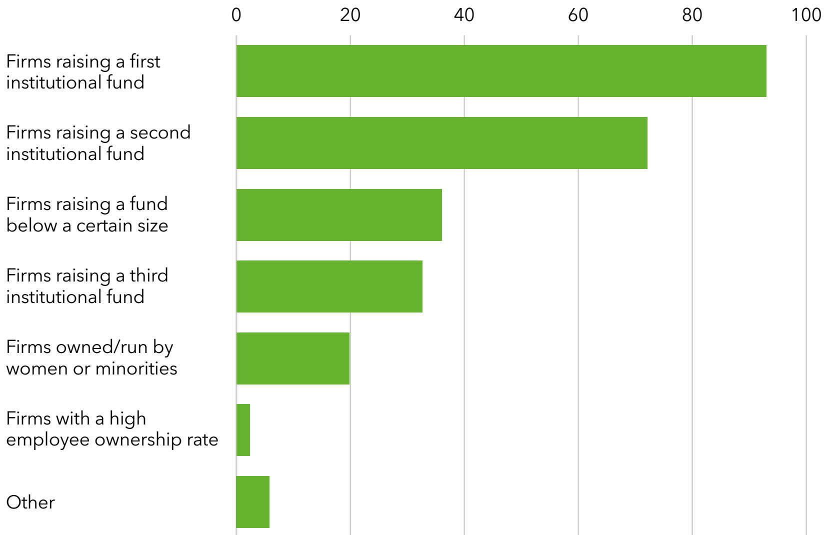
Still, there's a layer of optimism, as some LPs take solace in the green shoots that suggest distributions might be returning. "We're seeing strategies come back, maybe before some of the financial buyers, and there are tiny signs that the market could be picking up steam as we move into the autumn, and the new year," says Sandstrom.

But traces of a recovery won't necessarily loosen up purse strings anytime soon, especially for emerging managers. "The reality is that people are more inclined to re-up with their existing managers than give new people money," says Mark. "Which is a tough deal because some of the existing managers have lots of legacy issues. LPs may be better off backing a proven investor seeking to start a new shop or a spinout team from an existing firm with lots of experience."

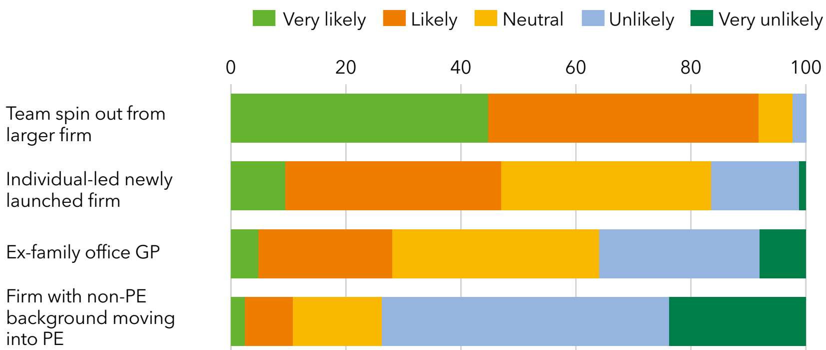
And at times, there are structural forces that prevent investors from committing to that many emerging managers. "Sometimes, the LP has too small of a team to review all the emerging managers that might be appealing, given the burden of diligence into brand new teams," says Patricia Zollar, managing director at Neuberger Berman and head of the firm's emerging

## LPs

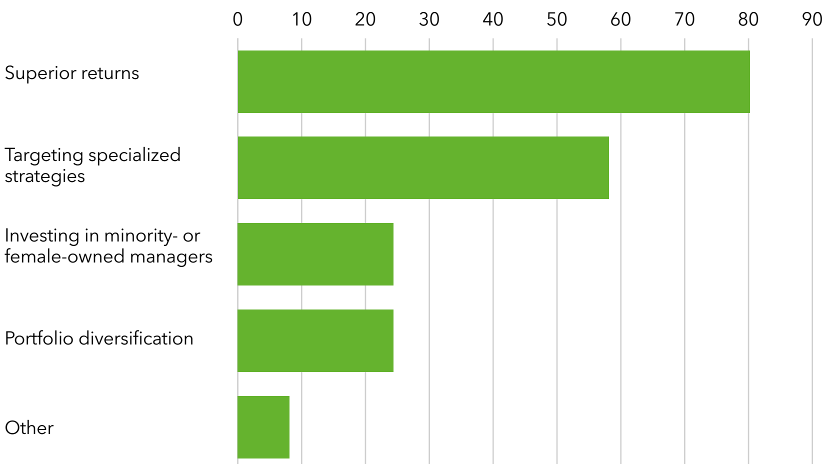
**How do you define the term 'emerging manager' when it comes to PE/VC? (Multiple answers allowed, %)**



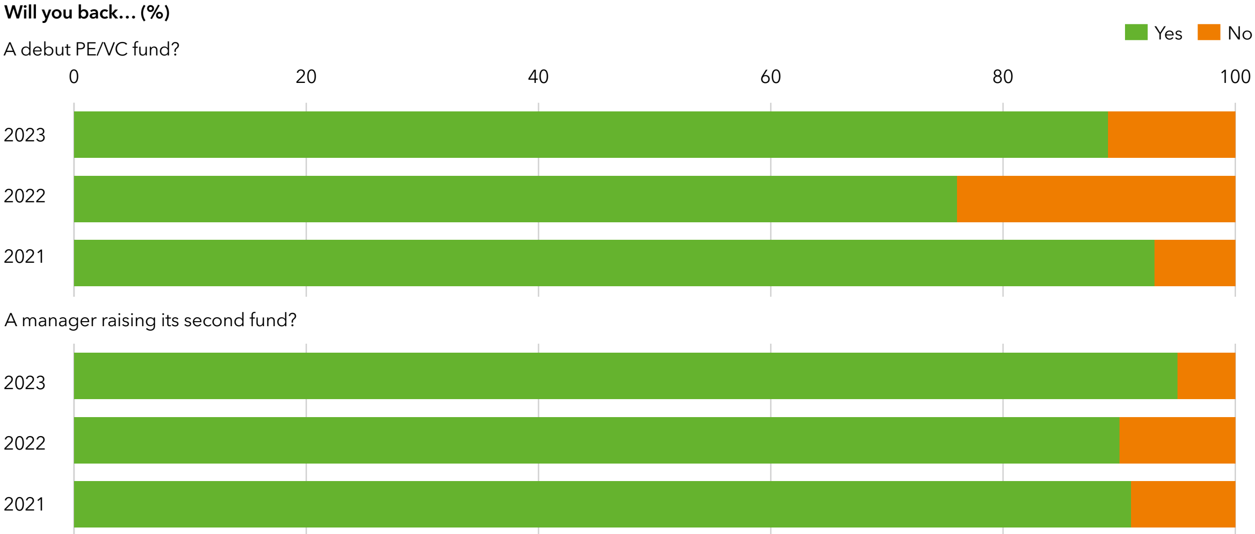

**How likely are you to invest in the following types of emerging managers? (%)**



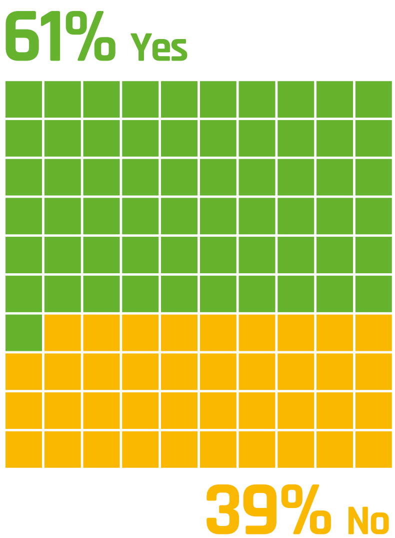

**What is the primary purpose of your emerging managers program? (Multiple answers allowed, %)**



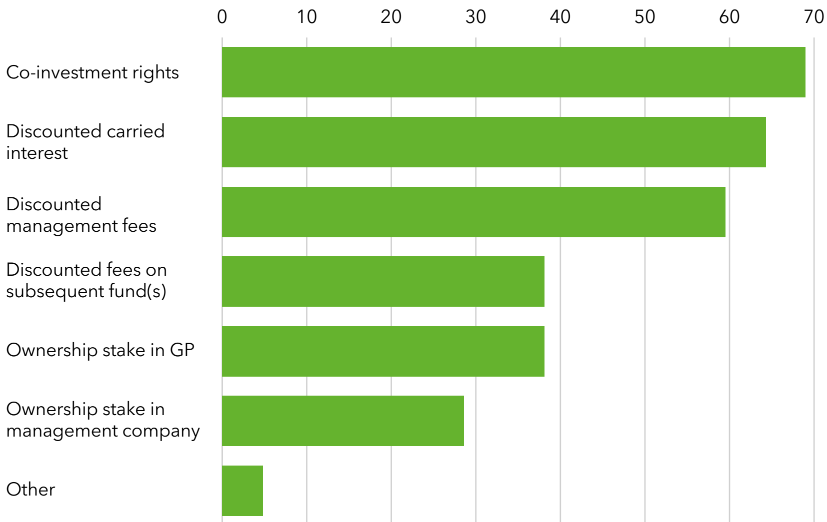
**Will you back… (%)**




**Would you make an anchor commitment to an emerging manager?**




**If you were to make an anchor commitment, what special terms would you seek? (Multiple answers allowed, %)**




manager private investment practice.

Zollar also notes on the other side of the spectrum, the check size for that emerging manager might be too small to be efficient for that LP.

### Hunting for next gen stars

Yet, there are structural forces working in favor of emerging firms as well. "If an LP allocates a certain amount to emerging managers as part of its overall strategy, eventually those emerging managers graduate out of that category," says Sandstrom. "And so that means the LP has to refill their portfolio." And LPs continue to make room for that category.

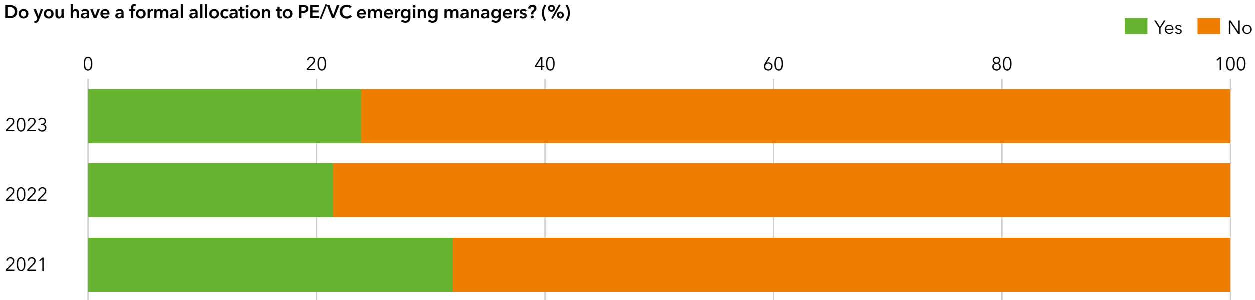
In some cases, the emerging managers can present themselves as an alternative to established teams that might have hit a hiccup, or three, in the face of such an unforgiving environment.

"New teams might avoid any 'softness' in their track record, for the simple reason that their new investments can be attractive without the expectation of delivering returns just yet," says Natalie Walker, partner at Stepstone Group, who focuses on US small-market managers.

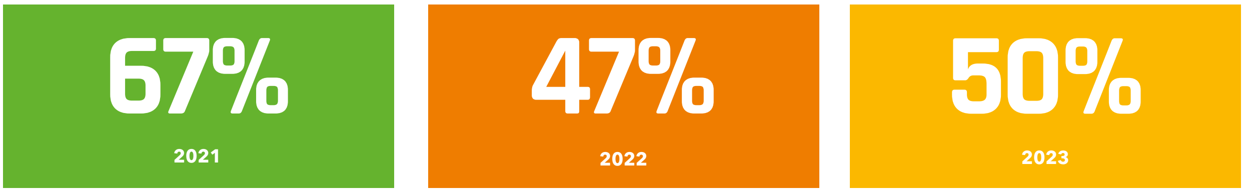
LPs understand if a GP hasn't exited a particular portfolio company after two years, but an underwhelming IRR for an investment that spent seven years in the portfolio might linger in the minds of an LP who's deciding between re-upping with that firm or betting on a promising new manager.

"Institutional investors understand emerging managers are a vital part of the PE ecosystem," says Zollar. "Meaning: if you're not investing in these managers early, it's tough to build a high-performing private equity portfolio over time. These managers can offer niche

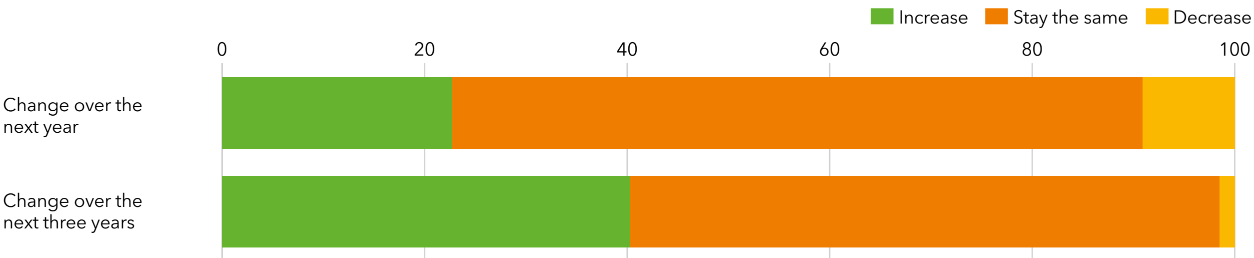
**Do you have a formal allocation to PE/VC emerging managers? (%)**



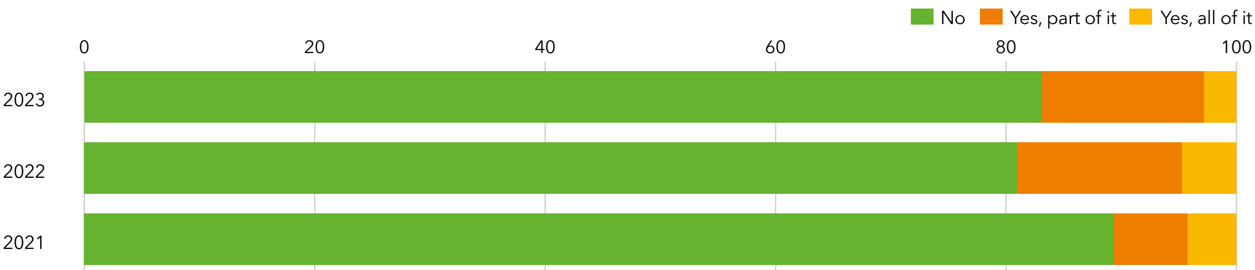

**If yes, what is the allocation target as a percentage of your total PE/VC portfolio?**




**How do you anticipate your allocation to emerging managers changing over the next year and over the next three years? (%)**




**Do you outsource at least a portion of your emerging manager program to a third-party adviser? (%)**




Source: Buyouts Emerging Manager Survey 2023

specializations, talent, an alignment of interest and commitment, all of which actually can create a better risk-adjusted return over the long term."

That all sounds compelling, but in the face of unpleasant economic winds, it can hard to bet on an untested vessel.

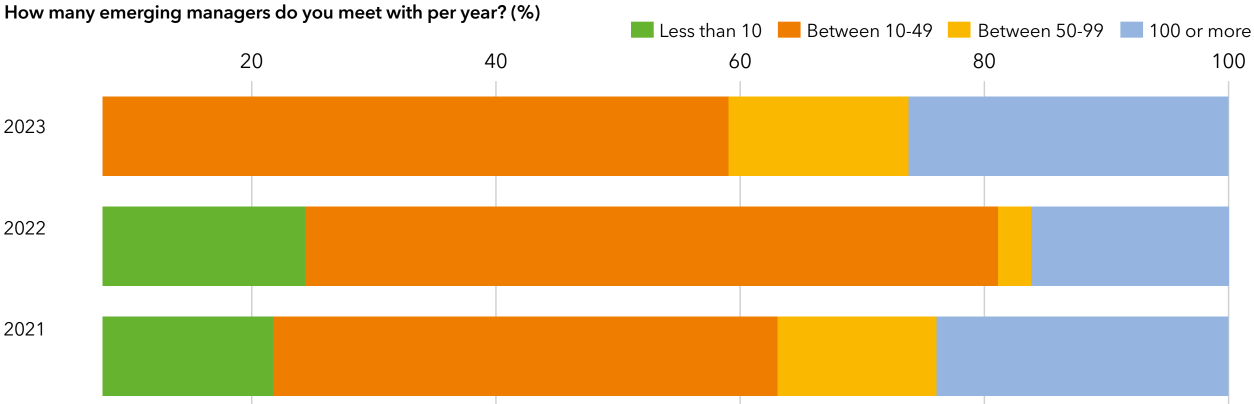
## Small, but resilient?

However, tough times can argue on behalf of those smaller, emerging managers as well. "Inflation, interest rates, labor shortages, productivity issues, and all those other macroeconomic pressures can be harder on small companies versus larger, more established companies," says Walker. "But does that lead to more volatility at the lower end? Our research would say that, no, in fact, that the lower end of the buyout market is actually less volatile than you'd expect."

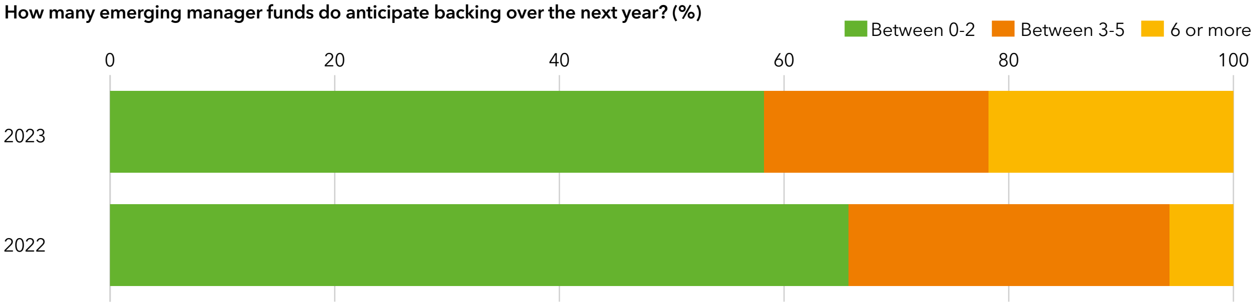
Walker explains that in times of market distress, small buyout opportunities become more attractive. "For a number of reasons, these small buyouts don't tend to cycle up as much in good times, but they don't cycle down as much in bad times, so it creates this idea of whether now's the time to move more into the small-cap space, while also factoring in the inherent risk of backing an emerging manager."

For new managers that decide to launch turnaround and distressed vehicles, this might be the time to shine, since so many LPs have perhaps

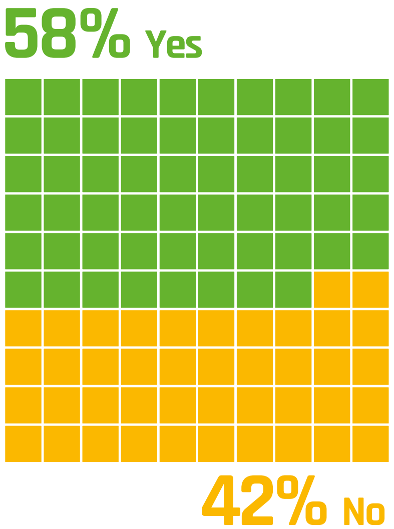
How many emerging managers do you meet with per year? (%)




How many emerging manager funds do anticipate backing over the next year? (%)




Do you have the same framework for selecting emerging and established managers?




Source: Buyouts Emerging Manager Survey 2023

over-committed to growth opportunities, simply because there were so many during the market's long boom. "Now LPs are finding that they have sacrificed value-oriented commitments for growth ones, and are looking to correct that," says Walker.

The other strategic element that is helping convince LPs to take the risk on a new firm is a focus on value creation, especially given the high cost of leverage at the moment. "A manager that is more operating-centric is generally going to fare better than one that's deploying a purely financial buyer model right now," says Mark. That said, it's been two decades or more of GPs touting operational skills in PPMs, with the caveat that some firms make more of an effort to live up to that promise.

## Ever faithful

But not all LPs need the hard sell to commit to emerging managers, even now. "It's been so gratifying to see groups stepping up and putting debut funds and young firms front and center," says Zollar. "Some are even deciding to commit less to their larger, more established funds, to free up capital for emerging managers with the idea that longer term, they deliver real value."

Some of them are even hiring the likes of Neuberger Berman to act as an extension of the team in reviewing emerging manager opportunities, especially given the additional diligence required for choosing a new kid on the block.

However, those champions do not represent a majority of investors today. Several placement agents and LP advisers have stressed that by and large, investors are holding back on commitments, even if they are still taking meetings and reviewing documents. And the consensus appears to be that LPs' hesitancy will continue into the new year.

"Liquidity needs to get unlocked for LPs," says John McCormick, partner at the Monument Group. "Some sort of rationalization in valuations has to occur to open up deal activity, even with the secondary market emerging as an alternative solution. And finally, investors need to get comfortable with their re-ups and overall allocation strategy. But there's no avoiding the fact that the market needs time to recover."

So, for the time being, patience might be a superpower for today's emerging managers, as it's simply a matter of waiting for LPs to feel confident enough to get off the sidelines.

# Operational care

*LPs' primary priority for service providers is ensuring operational excellence*

The constellation of law firms, fund administrators, compliance consultants and IT gurus that services today's private capital managers have long since proven their value, especially for first time funds that don't have the resources to bring such expertise in-house.

Investors understand this, and their operational due diligence is centered not on how a manager services their operational needs, but whether they are sufficiently servicing them and have someone internally responsible for those tasks.

"It's perfectly fine if the manager decides to outsource or insource their operational functions," says Natalie Walker, partner at Stepstone Group, who focuses on US small-market managers. "So long as there is a distribution of operational responsibilities among the team. We've seen partners divvy up the various duties so one partner may be the primary liaison for the fund administrator, another for compliance, and so on."

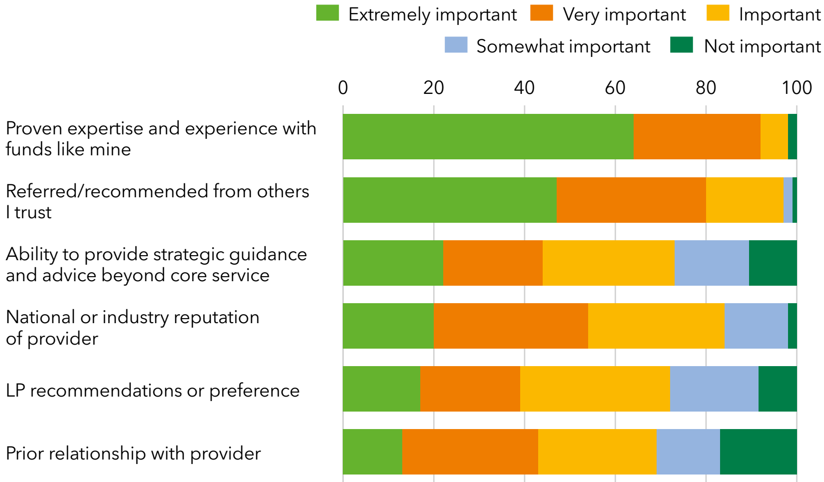
But several placement agents and LP advisers noted there's an inflection point where it makes sense to bring aboard a CFO to help manage the accounting burden, and that tends to be between $250 million and $500 million in AUM.

"There's no doubt that using outsourced providers, such as fund administrators, is a great way to build out certain sophisticated functions," says Sarah Sandstrom, a partner with the placement agent Campbell Lutyens.

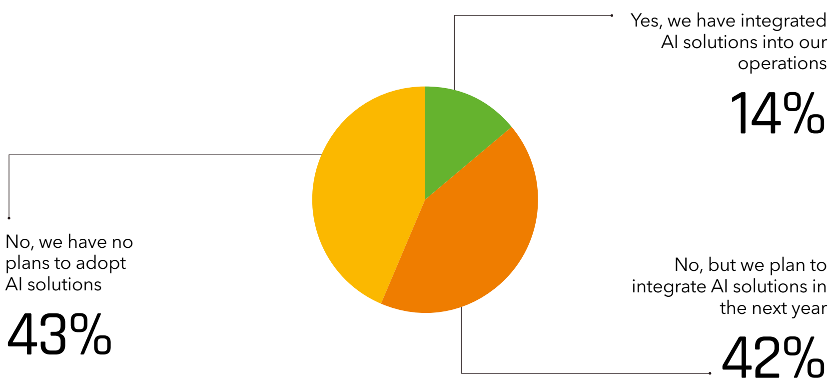
"But they can't replace an internal employee who's losing sleep if that investor doesn't get the information they need. The buck needs to stop at the firm, not the service provider."

**On average, how many months in advance of the first closing did you engage with (or do you anticipate engaging with) the following professional services firms?**


**How important are the following factors in choosing service providers? (%)**




**Have you integrated any AI-based solutions into your operations?**




Source: Buyouts Emerging Manager Survey 2023

# LPs in driving seat over fees and expenses

*LPs appreciate that emerging managers need their management fee to keep the lights on, but GPs should aim for maximum transparency*

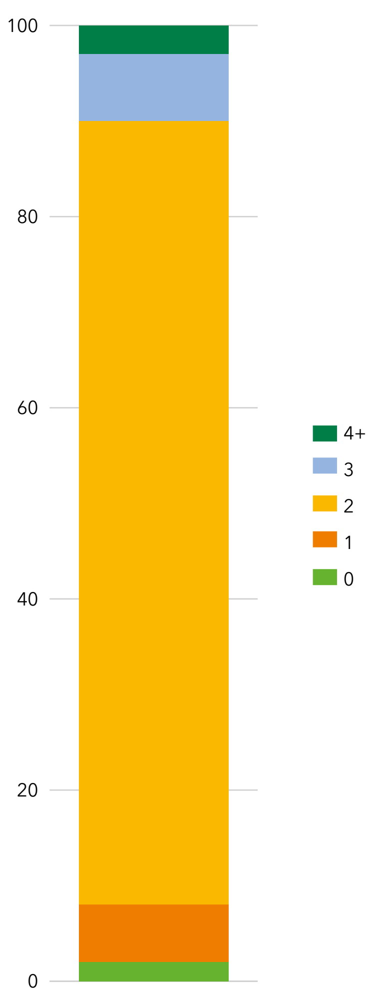
Fees and expenses have been a flashpoint for LPs and regulators for so long it's hard to feel the controversy will ever be muted. But even during the long boom in private capital, the standard manager certainly aimed at transparency and consistency. Naturally any consideration given to the LP by an established manager will be seen as table stakes for an emerging manager hoping to close their first fund. So first time funds are eager to prove themselves on par with their more veteran peers.

But are LPs asking for more of a break on fees and expenses from new managers? One of the most consistent themes of the *Buyouts Emerging Manager Survey*, conducted in partnership with Gen II Fund Services LLC, was that LPs are in the driver's seat these days, especially for newbie funds.

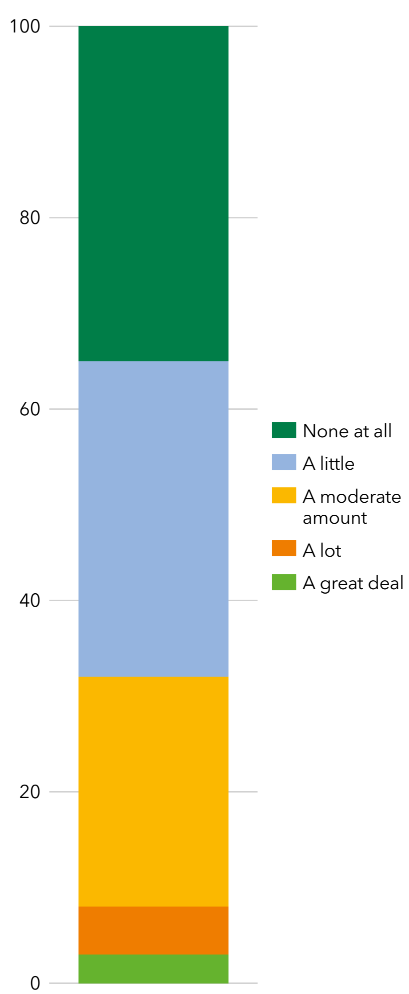
However, these investors are savvy enough to know new managers are in the most need of their management fees to fund their operations and the 2 percent fee remains the industry standard, according to survey respondents.

Emerging GPs are not reporting tough negotiations on the topic of fees and expenses, with the vast majority saying they get some pushback on fees, but few referring to it as "a

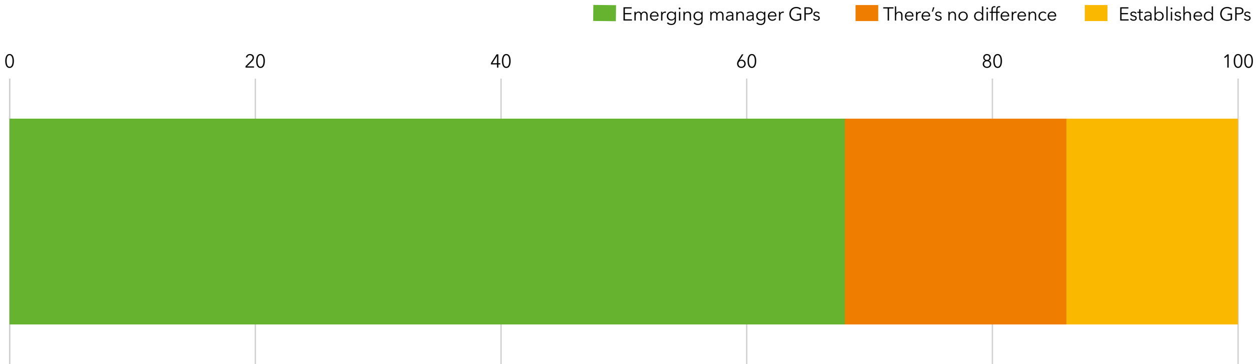
**What management fee as a percentage have you asked for in your fund? (%)**




**Do you receive pressure from investors regarding fees? (%)**



When negotiating fees, do you believe LPs generally negotiate harder with… (%)




Source: Buyouts Emerging Manager Survey 2023

lot." However, of the LP respondents, 68 percent admitted that they negotiate harder with emerging managers over fees than their longer-term relationships, a stat that was as high as 74 percent in 2021, and only sank to 61 percent in 2022. Some market participants argue that LPs are simply asking tougher questions of new, unknown managers to ensure that those standards of consistency and transparency are met.

For new managers uncertain about what those standards are, there's a great resource probably on hand to answer that question. "The best fund formation law firms have at their fingertips an incredible amount of data on the market," says Sarah Sandstrom, a partner with the placement agent Campbell Lutyens. "Many of them are active on the LP side as well, so they're looking at funds even if they're not representing them, and privy to those terms and conditions. So, I'd suggest heeding their counsel on the guidelines."

And what the counsel appears to be is aim for the highest level of transparency, as many placement agents and LP advisers stress that it's not about a particular fee or expense, but transparency. Investors understand that GPs need to invest in their own operations but want them to keep an eye on costs. One LP adviser cautions GPs that hiring the most prestigious law firm, fund administrator and other counsel can sometimes make a manager look like a spendthrift. It's important to right-size the budget for the firm's current stage. The manager looking to raise their first $150 million fund might not warrant a retainer with the likes of Simpson Thacher & Bartlett.

> *"Emerging managers should at least run parallel with ILPA's guidance, with zero ambiguity around what's a GP expense and what's a partnership expense"*
>
> **JONCARLO MARK**
> **Upwelling Capital**

### Follow ILPA's format

At this point, that highest standard for treating fees and expenses isn't a secret. ILPA has long had a set of guidelines that could form the basis of an approach that keeps GPs in the good graces of potential investors.

"Emerging managers should at least run parallel with ILPA's guidance, with zero ambiguity around what's a GP expense and what's a partnership expense," says Joncarlo Mark, the former chairman of ILPA and CalPERS' senior portfolio manager, now the founding partner at the LP advisory firm, Upwelling Capital. "Later in the life of a firm, those terms might evolve, but why would anyone risk their fund by playing coy around fees and expenses?"

It's a good question, but given the current climate for fundraising, especially for new managers, it's hard to imagine any GP hesitating to open up their books and letting any potential investor see for themselves that every dollar spent is a dedicated to delivering on the promise in their PPM.

# The power of proximity

*Co-investment opportunities aren't just a viable carrot for emerging managers to dangle in front of potential LPs, but a tool that could forge closer bonds with early investors*

By now, the nature of the current fundraising environment is evident, and GPs are aware they need every advantage to woo an LP to write an actual check. And emerging managers, as always, know they have an even narrower margin for error.

But given the forbidding market, emerging managers are looking to maximize those few LPs that they have won over, and co-investment opportunities can do that. Add to the fact that a lot of emerging managers are investing before their first close, the additional capital can allow them to get building the track record that will woo the rest of the capital they need.

And investors seem keen on the tactic. According to *Buyouts Emerging Manager Survey*, conducted in partnership with Gen II Fund Services LLC, 68 percent of LPs surveyed are making co-investments with their emerging managers, up from 55 percent last year. And 48 percent of LPs surveyed expect to make three to five co-investments in the coming year, when last year, 46 percent of LPs expected to make one to two. But that's not to say co-investments hold universal appeal.

*"The chance to enjoy no fee, no carry returns through co-investment is attractive, and can build a special relationship with some of the anchor investors"*

**SARAH SANDSTROM**
**Campbell Lutyens**

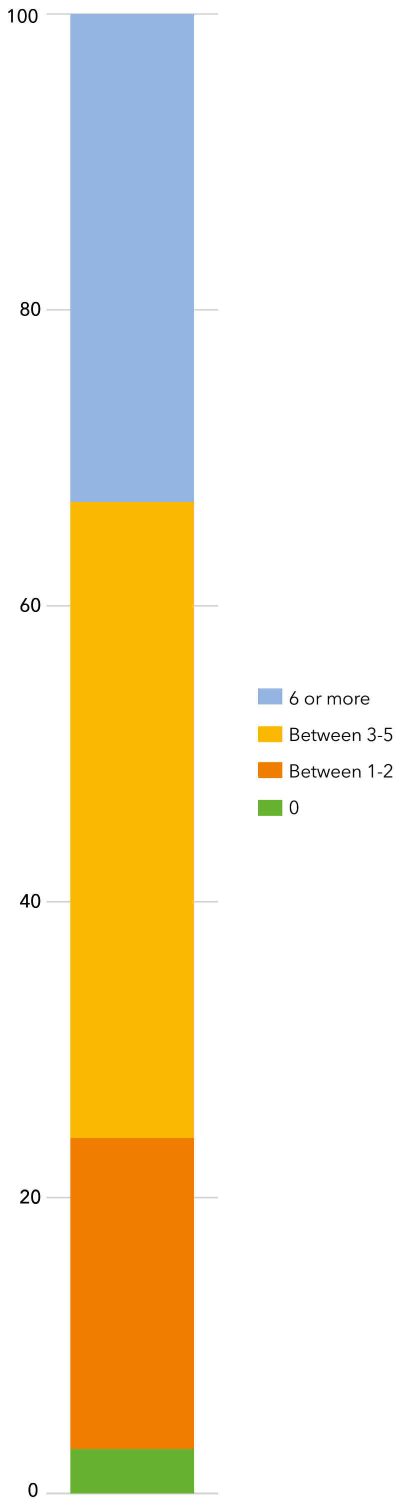
"They matter more to emerging managers, who, by their very nature, are undercapitalized," says Joncarlo Mark, the former chairman of ILPA and CalPERS' senior portfolio manager in private equity, now the founding partner at the LP advisory firm, Upwelling Capital. But Mark makes it clear that plenty of endowments and foundations that back emerging managers don't co-invest.

"They tend to pick the best managers and get good economics from their funds early on," Mark says. "For this reason, the E&F crowd doesn't need to court additional exposure through co-investments."

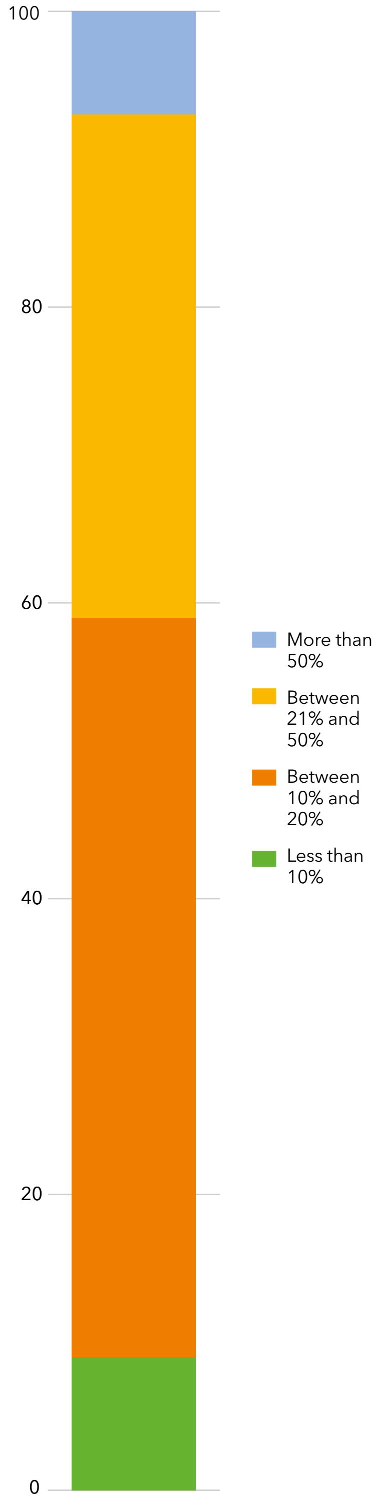
### Exploring co-investments

Yet, some LPs are exploring co-investments even before committing to the fund. "The underlying premise here is that if the LP commits to the co-invest, then the LP would be interested in backing the fund," says John McCormick, a partner with the Monument Group. "And with the growing number of fund-less sponsors building a track

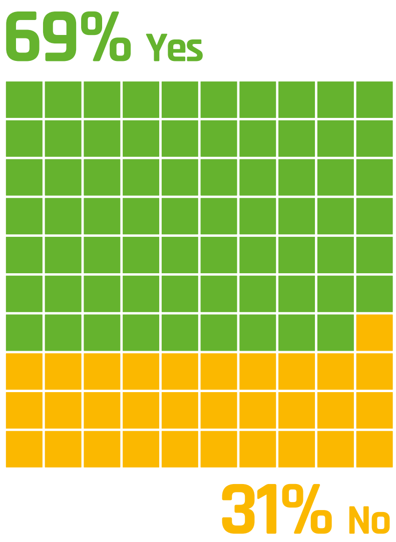
**If you make co-investments with emerging managers, how many do you anticipate making over the next year? (%)**




**What is your target allocation as a percentage of your total PE/VC portfolio regarding co-investment opportunities? (%)**




**Do you make co-investments with emerging managers?**




Source: Buyouts Emerging Manager Survey 2023

record of deals before fundraising, this will likely continue to be more prevalent."

"Co-investing can be an essential ingredient," adds Sarah Sandstrom, a partner with the placement agent Campbell Lutyens.

"The chance to enjoy no fee, no carry returns through co-investment is attractive, and can build a special relationship with some of the anchor investors." In essence, the act of co-investment arrangements can bring GP and LP closer together.

"Co-investments are especially important for us with regards to emerging managers because it's often the way that we can actually get to know a manager even better," says Patricia Zollar, managing director of Neuberger Berman, who leads the firm's emerging manager private investment practice.

"It answers so many questions about their network, sourcing style, negotiating tactics, how they actually execute their investment thesis, that can be hard to do with a brand-new manager."

That sounds ideal, provided that emerging manager still looks great in a close-up.

# Company Overview

Gen II Fund Services, LLC is the largest independent, U.S. based, private equity fund administrator, administering over $1T+ of private capital. The Gen II team is the longest-tenured, most experienced team in the fund administration industry. Our senior management team has more than 25 years of experience and are recognized as leaders in private equity fund administration. Our dedicated client service teams, led by a Principal with an average of 15 years of fund administration experience, provide our clients with world class service and expert guidance.

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Chief Executive Officer

**Norman Leben**
Co-founder

**Steven Alecia**
President

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# Q&A

*The Bansk Group raised $800m for its debut with a strategy fit for all market environments and a string of deals that proved their case before the close, says senior partner and CIO Brian O'Connor*

**Q What was the elevator pitch for Bansk's inaugural fundraising effort?**

A Bansk invests in distinctive consumer brands in four categories of consumer staples: food and beverage, household products, beauty and personal care, and consumer health.

One of the things that resonated with LPs is that we're a combination of investors and operators with deep experience and expertise in these categories. And so with that comes a lot of knowledge, resources and relationships that allows us to have a competitive advantage in sourcing and then creating value post-transaction. We invest in profitable and growing business with positive tailwinds. We're looking to invest anywhere from $100 to $400 million of equity in each deal.

**Q What were the challenges in reaching your target?**

A Without a doubt, the biggest challenge was the market itself. Shortly after we launched the effort, the market turned pretty dramatically, which tightened the fundraising environment, especially for first time funds, so we're certainly pleased with where we ended up. Even if the whole process took us 18 months to complete.

**Q Was the partners' track record key to beating the odds?**

A Absolutely. Our collective team has had a very strong track record in our prior lives and together at Bansk. This is because we made some early investments while we were fundraising, and when those companies performed well out of the gates, that only bolstered our case that we could deliver on our strategy. But there's no question our track record was seen as a significant factor for LPs.

**Q During the fundraise, what were some recurring themes in the conversations with potential LPs?**

A I'd say that we spent a lot of time explaining to investors our focus and strategy. Because when people think about the consumer sector, they are thinking about a much broader landscape, one that includes consumer and retail, which can be everything from fashion, to restaurants, to durables. And that's not the area of our focus, precisely because they can be more volatile. Instead, we focus exclusively on consumer staples, and that means identifying distinctive, growing brands in those four categories of food and beverage, household products, beauty and personal care, and consumer health.

**Q Given the tenure and track record of the core team in this space, were you able to raise money from LPs who had backed your funds before? What role did existing relationships play?**

A There were some investors that had invested with myself and my partners in the past. That definitely helped build momentum in what was an incredibly challenging market.

So I think that was certainly something that helped us out.

However, I think it was the combination of all our attributes that allowed us to thrive despite the broader climate. It was our experience, track record, our combination of operating and investing skills, our ability to execute attractive transactions already and a focus on the most recession-resistant corners of the consumer sector. Given the market at the moment, it's important to be crystal clear on your strategy and how it differentiates. ■


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