Music City Alternative Investment Summit Focuses on Challenges Surrounding Raising Capital

As fund managers already know, capital raising is one the most important and challenging aspects of launching and continuing to run a successful fund. The groups who do it right last, and the ones who don't will usually fail within the first two years. With thousands of funds competing for the same capital, it is crucial to understand what investors and money allocators are looking for when making decisions.

At Richey May & Co., we have served clients in the financial service sector for over 25 years. Not only do we provide top-notch assurance, tax and business advisory services to clients in this industry, but we also support financial professionals with education and networking events focused on significant trends in the marketplace. The Music City Alternative Investment Summit in Nashville, Tennessee brought together leaders from a variety of financial backgrounds to talk about challenges in the Emerging Manager segment of the market. The event consisted of two panel discussions regarding capital raising held from the perspective of investors, fund managers, and service providers. Co-sponsors of the event include Convergex, Hedge Connection, Ikonic Fund Services and Kilpatrick Townsend. For more information on the panel members, please **click here**.

According to Stephen Vlasak, Business Development Partner, Alternative Investments Practice at Richey May & Co., "The reason we wanted to put on an event covering the topic of raising capital is because, whether we are talking with a one million dollar new launch or a fund that has a billion dollars under management, the questions that always come up are, 'How do I raise capital?' 'What does the perfect pitchbook look like?' 'Do I need a track record?' and 'How do I meet with money allocators?' Richey May is a firm that prides ourselves on customer service, so we are always trying to bring value to our clients and friends in the industry. That's why we helped to coordinate and co-sponsored this event."

EMERGING MANAGERS

One issue that has grown in prominence in recent years is the practice of fund managers leaving larger funds where they have built a reputation to start a smaller fund or funds under their own brand. Analysts vary in their opinion of how large a fund can get and still be classified in this emerging manager category; some argue that they pass beyond the "emerging" stage at $500 million in assets under management (AUM), while others suggest the threshold could be as high as $2 billion. These new funds face many challenges in attracting the capital needed to grow and thrive. The Summit's first panel looked at this group and discussed some of the unique challenges they experience and the opportunities they offer to investors.

One of the greatest challenges for emerging managers is knowing how to appeal to potential investors. The panel concluded that emerging managers must be able to distinguish themselves or risk being overlooked in this highly competitive environment. Of all the factors critical to demonstrate to potential investors, the panelists narrowed in on three major characteristics: operational robustness, reporting transparency and quality management of risk, liquidity, and volatility. Investors are interested in knowing the specific plan the fund has for growth and that it has the structure in place for future profitability.

The panelists also discussed how fee transparency can help make them more palatable for investors and their due diligence teams. When institutional investors understand the strategy and the effort that warrants the fee, they tend to be more willing to accept a higher fee for investment. It was also mentioned that operational due diligence teams often have veto rights regarding fund investment, emerging funds without clear fee structures may not get past this stage when courting investors.

The panel went on to emphasize the importance of building relationships with potential investors. Many emerging managers were previously at billion dollar firms, similarly to Jon Michael Morgan, founder of SP Capital LP. Morgan explained that he could not rely on his pedigree for building a new fund, but had to start from the ground floor by developing relationships with investors based on this new endeavor, not on past performance. Investors want to know your story and how they can identify with the manager to get their problems solved – and that means building genuine personal relationships, not using a pitchbook as a crutch. Morgan said, “It is critical that you have [a pitchbook], but try in most meetings to never open it. For me, the pitch book is something that they [investors] can take away, but if they don’t know about me as a person and my story, and how the fund is going to solve their problem, then the pitchbook probably ends up in the trash anyway.” Moderator Lisa Vioni, Founder and CEO of Hedge Connection, pointed out that investors prefer to review a good one page fact sheet first before reviewing a pitchbook. She also mentioned that it is important to make sure you know your strategy and business plan well enough when presenting to an allocator so that you do not need to refer to marketing materials during a meeting.

As an emerging manager with fewer resources than a large firm, the implementation of a marketing strategy was deemed crucial by the panelists. There was debate on whether a designated internal marketing team, or a third party marketer would be more beneficial; regardless, the panel agreed on the importance of investing in a marketing strategy. Will Spencer, Senior Vice President of Convergex, explains, “Performance doesn’t matter if you don’t have any assets” and marketing is critical to attain assets because a “track record can only get you so far, but it’s only one piece of the puzzle.” Vioni told a story that illustrated the concept that raising money is a numbers game. She described a year where she helped bring a fund from $800 million to $2.4 billion after meeting with about 400 investors and receiving allocations from just four. Without money allocated to a full-time marketing approach, emerging managers will fail to raise the capital needs to launch and grow their funds.

Conversation then turned to how to structure deals to best attract investors, and whether acquiring seed capital is advantageous for emerging funds. Panelists agreed that it is important to exhaust all avenues of allocators when launching a fund, so do not be quick to reject seed capital. If you do take seed capital, be sure to have an exit strategy in place from the beginning for this structure. Seed capital, is typically when an investor invests capital in exchange for an equity stake in the management company. This typically takes place at the very early stages, meant to support the business operations until it can generate cash of its own, or until it is ready for further investments. One suggestion was using seed capital to combat the challenge of raising initial funds, however it was noted that once you have built assets, try transitioning to other fund structures for the remaining capital.

Emerging Manager Panel – Key Take-a-Ways:

This panel was concluded with final tips from both Morgan and Spencer:

- Distinguish yourself; don’t underestimate the strength of your personal story, whether you have a track record or not;
- Display operational robustness and communicate that effectively to potential investors;
- Find investors who will stay committed for the long-haul

DEVELOPING RELATIONSHIPS WITH ALLOCATORS

The discussion for the second panel shifted to how fund managers can find and develop key relationships with allocators to attract interest and support their fund’s growth. The panelists framed their conversation by focusing on three major questions:

1. How do you find and connect with allocators?
2. How can you differentiate your fund through your communications to establish genuine – and ultimately fruitful – relationships with allocators?
3. How important is a long track record, and what if I don’t have one?

Finding Allocators

When marketing your fund to allocators, the panelists reasserted that it’s a numbers game; you have to put yourself out there consistently and often by attending conferences and making calls to make the math work. Remember, emerging managers face fierce competition for the attention of allocators; it is crucial to set goals

and develop a realistic budget that allows you to invest the significant time it will take to make key connections in the industry.

It was also noted that while conferences are key venues to make contact with many allocators at once, Vlasak jumped in with the reminder that “you also have to pick up the phone!” Some of the key tips for connecting with allocators via phone calls included:

- Be quick and to the point in your call or message
- Be patient and respectful; give allocators a few days to respond before calling again
- Be positive in tone
- Follow up your call with a thoughtful email

Establishing Trust through Communication Content

Once you’ve established a plan and goals for reaching out to allocators, the panelists turned their attention to the content of your communications. It’s not nearly enough, they stressed, to send an email; in fact, simply communicating with the intention of selling is a clear way of closing the door on a potential relationship. Instead, consider your communication as an opportunity to educate and provide value-add information to allocators. Meaningful information, such as news, articles and whitepapers, will not only establish credibility with allocators, but will also help them look good to their clients.

Additional advice for communicating with allocators included:

- Be concise, keeping written communications to no more than 1,000 words.
- Utilize graphics for visual interest and clear communication.
- Include your contact information. A simple piece of advice, but the panelists noted how often they receive email communications with no phone number or information about the fund.
- Use an email blast platform to measure engagement. These systems provide analytics on how many and which recipients opened the email, what links they clicked on, etc. This data will help you refine your future communications to make sure they are relevant and appealing.
- Become a thought leader in the public domain. A strong, knowledge-based blog can provide clear insight for allocators into your credentials to successfully manage a fund.
- Be consistent. Be true to yourself and the identity of your fund, and don’t keep changing your approach to please everyone.

Meredith Jones, Founder of MJ Alternative Investment Research, summed up the need for value-added communications by saying, “I don’t like being sold to. I want to make my own conclusions and decisions. I want to trust you and like you. Ultimately, people are going to give you money because they trust you and believe you are going to provide value to them and/or their end investors.”

The Importance (or Not) of a Long Track Record

Moderator Vioni next asked the panelists to reveal how important track record is when evaluating a fund, and further, what type of track record carries the most weight. Starting with the most persuasive, the panelists listed the following ranking of track records:

1. **Real-time.** Obviously, if your fund is more established and can point to strong returns for investors, this is the most compelling evidence for allocators to invest.
2. **Predecessor.** If you’ve managed a successful fund in the past, this may suggest similar results for your emerging fund. But keep in mind that if your new fund is being managed differently than historic funds, allocators will not see this as an apples-to-apples comparison.
3. **Paper.** The panelists named this a very distant third place, and cautioned managers that they should not expect allocations based on a paper track record alone.

So what if you cannot point to a long track record, or if you’re relying on a paper track record to position your fund to allocators? Create a model portfolio, recommended Jeffrey Spotts, CEO at Prophecy Fund, that shows positions and allocation sizes. This will make the allocator feel more comfortable with your approach, rather than simply looking at one line of performance.

About Richey May & Co., LLP

Richey May & Co. hosts forums such as this one throughout the year in order to support the financial services sector in our community. We bring together panels to provide fund managers with an opportunity to learn more about best practices that can help them succeed and to network with many of the investors and asset managers that are critical to their growth.

As a public accounting firm with hundreds of Alternative Investment clients in over 36 states, and relationships with many of the top service providers and specialists in the country, Richey May is dedicated to providing expert audit and tax services to the industry. Our team combines the dedicated expertise found in a national accounting firm with the hands-on approach to client service you'd expect from a boutique provider – a unique model that allows us to bring expert solutions and strategies to your specific business needs.

Richey May is dedicated to sharing best practices and trends in the industry - both from our advisors and from colleages in the industry - to help you stay competitive in the local and national marketplace. For more information on our firm and the services we provide, please contact **Stephen Vlasak** at **svlasak@richeymay.com**. You may also visit our website at **www.richeymay.com**.