THE REALITIES OF RAISING ASSETS FOR SUB-INSTITUTIONAL HEDGE FUNDS

by
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- **76.4% of hedge funds 'TAP OUT' their network of investors within 1 year.**
- **50% of the hedge funds that have closed had AUM less than $49 million.**
- **89% of all hedge funds FAIL to reach $100 million in AUM, the minimum institutional threshold**
- **Only 1 out of every 275 sub-institutional level funds establishes a "3rd Party Marketing" relationship.**
- **61% of hedge funds with AUM less than $100 million have no marketing at all.**
- **81% of all hedge funds have no marketing plan.**

BUT............

- **66% of all hedge funds believe an effective marketing process is critical for a successful business.**

The days of promoting pedigree and investment performance as the sole or primary tactics to raise assets are gone. The hedge fund investor climate is hyper-competitive, highly-skeptical and highly-selective. Furthermore, all too often start-ups, first-time funds and emerging managers waste valuable time and resources "chasing institutional unicorns" by pursuing the wrong investors given their fund profile. Gaining visibility, increasing awareness and building relationships within the most appropriate, suitable investor segments and channels given the fund profile are the key imperatives marketing and raising assets.

Marketing and raising assets are separate but complementary processes and for a start-up, first-time fund, emerging manager or sub $250 million AUM hedge fund both are completely different than for a larger or more-seasoned fund. The investor opportunity set is different, as such the manager evaluation and allocation process for sub-institutional funds addresses a diverse set of issues and questions resulting in unique assessment and due diligence, which requires an intelligent, specialized and disciplined approach by smaller funds.

While distinct differences exist marketing and raising assets for smaller or larger funds, a fundamental similarity is the basic need for personal engagement and **RELATIONSHIPS** in the pursuit of assets and allocations. Face-to-face meetings with the **RIGHT** investors and intermediaries are when the **RIGHT** relationships actually begin and ultimately where allocations are won or lost. Knowing an investor or intermediary on an in-depth level and enabling them get to know the fund holistically so that mutual trust and confidence are created is crucial to achieve a level of conviction about the allocation decision. This is the foundation and catalyst for organic and acquisitive AUM growth as well as higher conversion and retention rates.

An important aspect in relationship-building and marketing to raise alternative assets is intermediation, the presence of consultants and advisors of varying types. Intermediation is **HIGH** and contributes to increased idiosyncratic behavior in the selection and evaluation of managers as well as protracted due diligence and allocation cycles. Moreover, the degree of experience and knowledge of intermediaries varies greatly, which heightens the need for intelligent, customized engagement. Needless to say, appropriate intermediary engagement is essential to present the fund's ALPHA generation skills in the **RIGHT** format to be readily and easily assessed in order to efficiently and effectively attain a position of 360 degree confidence and conviction among all involved in the allocation process, particularly centers-of-influence (COIs) and primary decision-makers.

However, start-ups, first-time funds, emerging managers and smaller funds have great difficulty efficiently identifying and appropriately engaging the **RIGHT** investors, intermediaries, allocators and distribution channels given the fund profile. This is in large measure a result of the shift by prime broker capital introduction decidedly towards the "institutional sweet spot" of $500 million - $2 billion AUM due to increased appetite of institutional investors' for hedge fund allocations and the need of institutions for structural attributes such size, track record and operational robustness to accommodate fiduciary assets. Also, due to regulatory constraints, cap intro teams are limited in the degree of involvement with both managers and investors: Cap intro teams can't offer advice to managers in terms of whether a fund should or shouldn't market themselves, can't make recommendations to investors and can't make outgoing calls to investors. The fund/manager bears the complete responsibility of all tactical marketing. Honestly, there is a large and constant amount of disappointment with prime brokers' cap intro services. In fact, research reveals 76.9% of new and smaller funds are disappointed by the lack of attention, lack of contacts and lack of results from prime broker cap intro. In addition, many smaller prime brokers have no cap intro function at all. Despite the complaints, the cap intro function at most prime brokers offers solid service to a fund should it "qualify" but the fact is most sub-institutional funds are not of the size and operational rigor or maturity to be eligible for and take full advantage of the services prime broker cap intro teams provide. Subsequently, the possible marketing benefits and results raising assets from cap intro are limited for funds outside of the "institutional sweet spot". It's important that a sub-institutional fund clearly understand that prime broker cap intro should never be viewed as a replacement for the **RIGHT** strong internal marketing.

3rd party marketing (TPM), FINRA-licensed broker-dealer firms and personnel, is an area that brings additional confusion and frustration to start-up, first-time funds and sub-$150 million AUM firms trying to raise assets. TPM/External sales professionals are not realistic options to raise assets for sub-institutional funds until a fund reaches the minimum institutional level of AUM (typically $200 Million) along with solid operational infrastructure. Notably, recent research reveals that only 1 out of every 275 sub $250 million AUM hedge fund obtains a TPM/external sales relationship. In addition, TPMs have also focused their client selection within the "institutional sweet spot". As an aside, there is wide spread misconception among smaller funds that TPM is without financial expense for the fund. While the bulk of the compensation a TPM receives is from incentive-based compensation, the activities of marketing and raising assets on behalf of the fund involve expenses, which are supported by a retainer on a monthly, quarterly or annual basis. "Eat-what-you-kill", commission-only arrangements are not characteristic of reputable or qualified TPMs. Importantly, individuals/firms including fund personnel receiving compensation from transaction activity must be licensed. Failure to comply can lead to substantial penalties for the fund (**See www.johnsn.com for Summer 2013 Alert**). In sum, the realignment of client focus and financial obligations of a TPM have substantially increased the challenges for new, early-stage and smaller funds to build relationships and exacerbated the difficulty attempting to raise assets.

Compounding the difficulty is the self-inflicted wound from the false but pervasive expectation by new and smaller funds that assets will come in automatically as a result of performance or because of pedigree. This perspective leads to lack of a documented and focused marketing plan from inception, which often means lack of the **RIGHT** fund-specific marketing, use of inappropriate, inadequate, ineffective and inconsistent marketing approaches in tandem with poor marketing skills. As such, chronic failure raising assets is the result of inefficient investor identification, ineffective communication and inappropriate engagement with the most suitable, ideal investors, which are mandatory to build **RELATIONSHIPS** and **RAISE ASSETS**.

For sub-institutional funds, raising assets and momentum in growth of AUM are literally life and death matters. Successfully navigating all the challenges, complexities, nuances and regulatory requirements can be overwhelming. Candidly, the fight for every dollar of AUM is tougher than it has ever been. The change of focus by cap intro and TPMs along with the hyper-competitive climate and stringent, highly-idiosyncratic requirements of extremely discriminating investors make structured, focused and disciplined internal marketing a mission critical asset and business necessity for start-ups, first-time funds, emerging managers and smaller funds to raise assets.

Bluntly, any approach to raise assets that does not reflect a structured, disciplined marketing process and primarily promotes or relies heavily on pedigree and/or performance is inappropriate, outdated and ineffective in the post-credit crisis/Madoff era. Investors are now more informed, better educated and access better information. Plainly, investors and allocators have become stronger market participants, so it is impossible for a sub-institutional fund to meet the challenges of raising assets using "old-school" performance/pedigree-centered marketing. Candidly, performance gets attention but rarely brings allocations and while always a key metric, it's just ONE datapoint in the multi-factor assessment that comprises manager evaluation, due diligence and the allocation decision. The clear winners will be those sub-institutional funds that proactively take responsibility and control by making the commitment and investment to **Intelligent Marketing**.

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