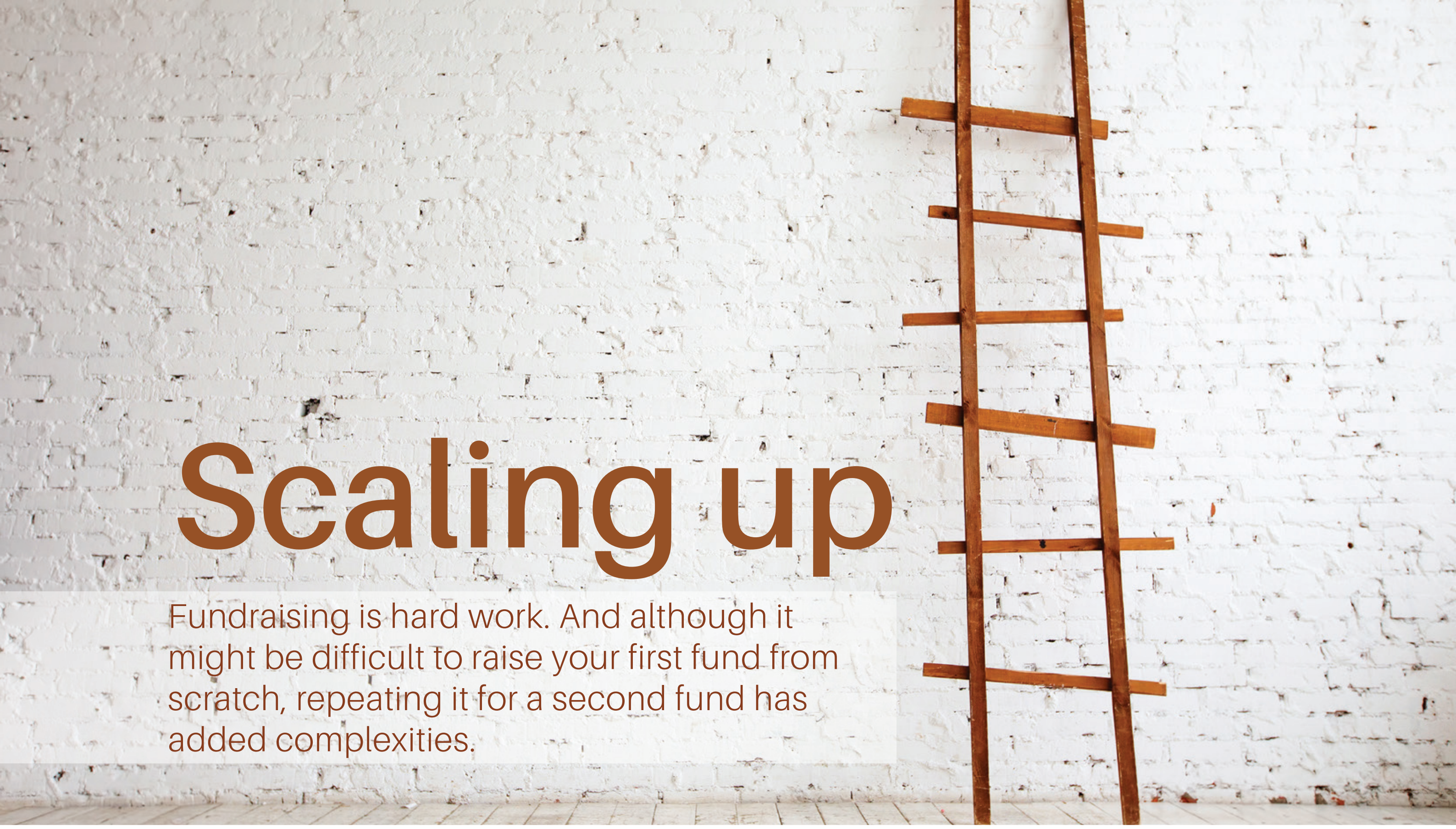


Scaling up

Fundraising is hard work. And although it might be difficult to raise your first fund from scratch, repeating it for a second fund has added complexities.

While institutional investors approached by first-time fund managers for funding are required to place much reliance on the capability of and chemistry amongst the team members at the manager, and on the coherence and viability of its proposed investment mandate, track record becomes ever more important as private equity managers move to subsequent funds.

Richard Flett, managing director and co-founder of Horizon Equity Partners, points to the problem that, because managers have to start raising a second fund three to five years after the launch of their first, there is an inherent problem in that these managers would typically not have a track record of realised investments when fundraising. At best, they would have exited one or two investments from their first fund.

Establishing an exits track record

Hany Assaad, chief portfolio & risk officer and co-founder of Avanz Capital, a manager of private equity fund of funds that specialises in emerging and frontier markets, believes, however, that these restraints due to timing are known, and managers should plan some initial exits right from the start and balance the portfolio construction to include such early exits. From the perspective of being an investor in private equity funds, Assaad says that managers need to complete at least one – but preferably two – exits before commencing the fundraising for the subsequent fund.

"It is not just the exits that count but how well the fund manager plans and executes exits, taking into account portfolio construction and timing of the next fund raise."

While any exit is useful for putting the proverbial 'runs on the board', Garth Willis, Director at Capitalworks, says "once you have talked the talk, an investor will want evidence that you have walked the walk before they are prepared to commit capital to a fund". They want to be able to "interrogate the real-life examples of a team's actual investments in order to assess both the feasibility of the investment strategy as well as the team's ability to execute that strategy on a repeatable basis".

Garth Willis

Daniel Hatfield

It's this repeatability that is key, especially when raising money in second and third funds – a point reiterated by Edge Growth managing director Daniel Hatfield. "Particularly when the mandate of your second fund differs from your first, the onus is on you to prove that your track record is still relevant and that the competence and experience of the team aligns to the scope of the new fund."

Starting out and establishing a track record is tough. "The chicken and egg game that you have to play during the establishment phase is painful but necessary," says Samantha Pokroy, CEO and founder of Sanari Capital.

"Investors would like to see deal flow and pipeline before committing capital to your fund. They want a look and feel of the investments you are going to make. They want to know that you can bring in the deals. So you start sourcing and progressing discussions with owners, management, and sellers. But then you get to a point where you need to move to a more serious intent and, without the committed capital, it is hard to do that!"

Team talent

Pokroy maintains that "team construction is critical, particularly when you are a small start-up team and heavily reliant on each other. Long-standing relationships and open communication are key."

Indeed, team composition and team dynamics are fundamental. Assaad says he would look for diverse teams with different expertise profiles and backgrounds. He insists that gender diversity is also critical.

Because Capitalworks is itself a business that is owner-managed, says Willis, it has a very strong cultural fit with many of the management teams that it looks to back. "Our investment philosophy is one of adding value to our portfolio companies beyond the capital invested and it is therefore important, in order for us to deliver on our vision for capital growth, to ensure that we attract talent that has a passion for commerce rather than solely being passive asset managers."

Luc Albinski, managing partner at Vantage Mezzanine, says "experienced limited partners have told us that the primary reason for poor or very poor fund performance is a team melt-down often linked to the departure of key individuals. For many of the more seasoned LPs, a critical evaluation of the team dynamics constitutes a large part of the due diligence they perform on a fund manager."

Nevertheless, fund raising remains "extremely disruptive' according to Flett. "Your best and most critical talent have to take time out from managing the portfolio and, generally speaking, the length of time it takes to raise funds has definitely been increasing over the past 15 years."

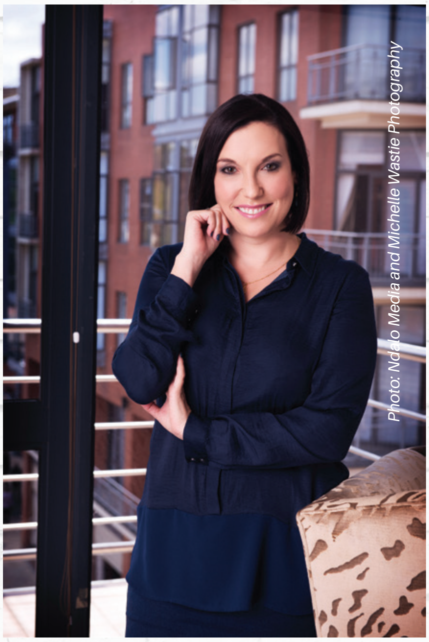
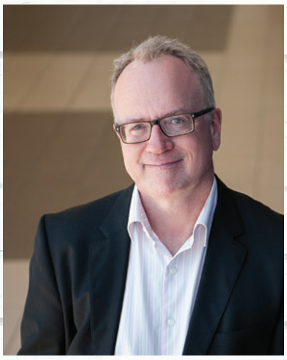


Photo: Ndalo Media and Michelle Wastie Photography

Samantha Pokroy

"Team construction is critical, particularly when you are a small start-up team and heavily reliant on each other."



Richard Flett

Luc Albinski

Strong conviction needed

Pokroy, who is busy raising Sanari's first fund, says she's "experienced first-hand the demands of always being in sales mode. This is by definition exhausting and the only thing that sees you through the potentially hundreds of investor meetings or engagements is a deep passion and conviction about what it is you are selling."

Horizon Equity's Flett says some fund managers have been looking at alternative ways of raising money. "The most prominent example in the South African context was Brait's decision not to raise another fund, but rather to raise capital through their listed management vehicle in 2011 as it transitioned to an investment holding company.

"More recently," says Flett, "we've seen some managers starting out again turning to listed vehicles. The JSE in 2013 allowed the use of special purpose acquisition companies (SPACs) and this has gained some traction."

"While fund managers in some cases are starting to look for alternative vehicles, that doesn't mean that the traditional private equity partnership structure is going to die anytime soon." Flett says. "It has so much acceptance, especially by international investors, that it still has a long life ahead of it."