McGuireWoods

FUND FLOW

EMERGING MANAGERS PODCAST

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Filling Investor Needs, With Sheryl Mejia of Steward Asset Management

Episode Summary

On this episode of Fund Flow, Sheryl Mejia, Managing Partner at Steward Asset Management, joins host Jon Finger to discuss what spurred the creation of her own firm, how to establish differentiation, and why maintaining empathy for founders is key.

Sheryl built a depth of knowledge working in asset management for large and small private funds before launching Steward Asset Management and fulfilling her desire to create a wider deal pipeline for the industry.

She says Steward chooses to operate so they can win the deals they want. Choosing core pillars of differentiation allows the team to competitively position their relationship with emerging managers based on their unique value add.

Sheryl also shares her advice for emerging managers raising their first fund and GPs who have recently closed their first committed fund. She believes that emerging managers need to understand what need they are filling for the investor — then listen, learn, and iterate the pitch. GPs should use the questions investors ask to refine their pitch and improve.

For those who have recently closed their first fund, the best advice Sheryl can give is to learn to balance leadership time properly. She shares tips on how to avoid underestimating the effort that this balance takes.

Top takeaways from this episode

★ **Build better partnerships with founders.** According to Sheryl, there are three core things that differentiate Steward. The firm provides continuity by allocating to fund one and fund two, declining management fees for the first five years, and providing a dynamic operating partner unit and advisory board.

★ **Ask the hard questions.** Coaching GPs to think through the longer-term impacts of hiring decisions, liquidity events, office locations, and operations are four areas where the team at Steward focuses on adding value.

★ **Find founders with emotional maturity.** Sheryl believes that when bringing a team together to do a deal, it's extremely important to have founders who can work with the team and build a strong culture. She describes emotional maturity in founders as a critical component when evaluating an investment.

Transcript

Voiceover (00:03):

You're listening to Fund Flow, a podcast for emerging managers, offering insights into the journey of new and aspiring fund managers seeking to have access in a crowded market. Tune in as McGuireWoods' partner and host, Jon Finger is joined by guests ranging from first time fund managers to proven emerging managers, experienced LPs poised to back emerging managers, and other key participants in the emerging manager ecosystem. Hear their real world perspectives and gain actionable tips to help inform your strategy and position yourself for a successful fund closing.

Jon Finger (00:39):

Welcome to Fund Flow, a McGuireWoods podcast for emerging managers. I'm Jon Finger, and my guest today is Sheryl Mejia, who is the managing partner at Steward Asset Management. Sheryl leads sourcing, diligence, execution, and monitoring of anchor investments, targeting newly formed private equity and opportunistic strategies. She was also the director of emerging managers at the New York State Common Retirement Fund, giving her an absolutely wonderful perspective on the emerging manager landscape. Welcome, Sheryl. Thank you for joining today.

Sheryl Mejia (01:20):

It's such a pleasure to be with you, Jon. Your work with independent sponsors and funds is so impactful. I'm such a big fan, and thanks for the time today.

Jon Finger (01:30):

Well, thank you. I appreciate those kind words. Let's start, Sheryl, and talk about your history in investing and how it ultimately led you to Steward Asset Management.

Sheryl Mejia (01:43):

Thanks, Jon. Steward is really, as you mentioned at the introduction, is one of a few players in the institutional investing landscape driving first capital to debut private equity funds. And we thrive in that environment of founders and capitalizing new firms and funds. And so, really, I think the background that built up to us being able to engage in that marketplace is multidimensional, and really benefited from being in very large shops but also some small ones. Steward is ultimately a combination of kind of three principles that retrofit very nicely into what I've done. Find areas of the capital markets that there are gaps or capital's not abundant. Work with strategies that don’t require a lot of leverage and in sectors that have strong cash flows. And then, of course, the third, most important part, probably in any new firm and any new initiative is let's bring a team of extremely smart people together, both internally and across the table from you to deploy.

So I left my MBA about 30 years ago, almost 30 years ago... It's amazing... and joined Bankers Trust Company. So, that name may not be known by all, but it was an innovation machine in its time, ultimately bought by Deutsche Bank. And luckily, I met my partners, David and Vera. Today there's actually seven owners of Steward, but they're two of the early ones that I called and reached out to to bring our team together.

But I worked in Global Equities, where, in the mid '90s, that was a really innovative place because covering European and Asian small and mid-cap companies was the big diversifier. And alternative investments was just on the horizon, sun was just starting to rise on, in terms of just even setting the terms that we would use in building a lot of new products. And so at Bankers Trust, I ended up moving out of Global Equities after working for a really dynamic, just global sector knowledge powerhouse in Michael Levy as a portfolio manager. I just learned a lot from him across so many landscapes in the world, and took that skill to spend the last half of my time at Bankers Trust over on the client side. I had been a quant for a lot of my time and wanted to get a view there. So I was able to combine skills there.

Ultimately, after a decade there, I left and worked for a family office. So going from big to small and a family office that was doing interesting private market activity, in terms of funds and direct deals. And we ultimately pulled together and launched a fund of funds product, which continued my product launch experience from Bankers Trust through to the family office. And ultimately, the Schiff family, very smart family that benefited through the '08 and '09 crisis, became the first client of Decagon. So I was happy to continue to work with them in the third iteration, and so we formed a consulting firm called Decagon Advisors, and that was a combination of the family office I'd worked with and some Bankers Trust colleagues. And for a decade, we did investment consulting on small private funds, covering the gamut from private equity to hedge. And also, we built a practice for launch consulting for debut managers. So continued that theme of building frameworks to support founders in their path in especially the early years, where they need a lot of support.

After a decade there, I turned the partnership over to my partners when I was tapped on the shoulder to join New York Common Retirement Fund as the director of emerging managers. So back to a big shop. And it was fantastic. Started there with a portfolio of about 5 billion in assets. It was across all asset classes. And we realized very quickly that the private equity area was one of the most opportune, especially in small buyout, one of the most opportune areas of the portfolio. We wanted to do more there, wanted to do more in opportunistic strategies as well. And so with the leadership and guidance through a strategic planning initiative with Controller DiNapoli and the CIO at the time, Vicki Fuller, we really made plans to build out. The private markets, the private equity components were some of the big part of the strategic plan. We had a lot of success there.

And we really realized that it's very opportune. Small buyout and growth equity strategies have this advantage for small funds, and especially if you're deploying as an emerging manager program, because unlike every other asset class, they invest in a different universe than their bigger peers because they know the middle market and lower-middle market. And so they really are not competing neck-and-neck with deal flow and valuations against their bigger peers. And once you put them in business, once you gave them that capital, they had five to seven years of time to really make that create value. And we found that to be a great formula to get a lot of conviction around that market.

But ultimately, we wanted to go earlier, and we wanted to help create bigger, wider pipeline. And part of the hallmark of that program was diverse teams, which made up about 70% of the managers, of the 120 managers. And we realized there wasn't a consultant or advisor to really help us do that at scale. And so that's the observation that ultimately landed us at Steward. We realized it had to be a sole focused firm, anchoring and providing first capital, because many of the larger emerging manager programs would become conflicted. They couldn't put the structure together of a anchoring where you take LP and GP economics together because they would be conflicted in their Fund 2 and Fund 3 allocations across all their separately managed accounts and fund products. So when we realized there wasn't a provider at New York Common, a light went off. Back to the capital gap. Other people haven't figured it out, and great values and great cash flows in this market. So Steward came to life after that.

Jon Finger (07:53):

Sheryl, that's great. Super helpful to understand how you got from where you were to today. And speaking of today, the name of the game right now for really any GP in this hypercompetitive fundraising environment is differentiation. And flipping the script a little bit, let's maybe talk about how Steward's strategy is differentiated from other LPs as it relates to how they approach relationships with emerging managers and, ultimately, look to invest with emerging managers.

Sheryl Mejia (08:29):

Jon, we've had the benefit, luckily, of looking at and allocating to hundreds of emerging private equity firms and seen that path. And what you are trying to create is the next José Feliciano or Frank Baker, get them on that path. And so really trying to build better partnerships with those emerging founders, understand the market needs of what they need to be successful, and understand what we need to be and how we need to operate to win the deals we want to win. And that does mean really aligning with the talent.

So there's, I think, three core things we differentiate on. One is, it's very big differentiator, is that we allocate to Fund 1 and

Fund 2. So we put a package together, criteria to unlock three tranches of capital. The last tranche will be in their Fund 2, and their Fund 2 may ultimately be in our second fund. That may be an allocation there. But our knowledge of the process, going from Fund 1 to a Fund 4, that life cycle, and a manager as they build their strategy and build their firm, is that the number one question on LPs' minds are, "Is your Fund 1 investor, is your Fund 2 investor continuing to the next fund?" And so it's very important. We actually save capacity in Fund 3 and 4 for our LP so that they can step in. So that provides even further continuity. But most seed investors forget this and are shortsighted. And so we really think this is probably the most important component of what we're doing.

The second is that... things really helpful to create success... is that we do not take management fees in the first five years. And we actually try not to take them after Year Six, but we will take them in order to offset management fees across the board, ours and theirs, so that we make sure we net our investors out at minimum of the management fees. We typically just try to take carried interest participation and get enough from that to really get in that return profile from 2 to 3X, take a 2 to 3X strategy, make that 3 to 4X through the lifecycle. That said, the reason we do that is not because we're trying to be generous to the manager or give them a kickback after the personal J Curve, getting the firm set up. It's so they can build a firm, so that we're not eating the seed corn.

Private equity is a very attractive form of ownership. It is the highest returning asset class, but it's because it's a very active form of ownership. And so when we think about teams in Fund 1, they have to be on this path of hiring. We actually cap salaries so that those management fees get reinvested in the firm, and it creates a stronger base, and they'll start adding team members. I think of it in terms of going from Fund 1, where there's 10 investments, to Fund 2, where there's maybe 10 to 15 investments, and that's a total, potentially, of 25 companies in this example. If they're going to take two board seats on every company, that's 50 board seats and is how many people you need to fill that roster. And so that active form of ownership that's very successful does require a very hands-on management. And so team members and investment in the firm is absolutely required early on. Otherwise you can unhinge your success.

The last thing I would mention, the third thing, how we differentiate, is our operating partner unit and our advisory board. These are some of the most dynamic people that I've worked with in the industry. And when we brought them together to create Steward and be co-owners of Steward with us, we realized that when we put a manager in the room with this team, they can see the global reach... Most members have 30 years of experience or more... and that they realize the potential of our force behind theirs, especially as they're going to get through those early, difficult years, where they're fundraising, doing first important deals, and just all that support that we can provide. So I would say we're trying to iterate with informed lens to give founders the support and strategy they need to get to a successful Fund 3 and 4.

Jon Finger (12:29):

That's great. I want to talk a little bit more about this active coaching your GPs that you alluded to, whether it's through you and your colleagues, the operating partners. I think that's one of the things that, as an LP with emerging managers, truly is a way for you to make an impact and go beyond just differentiation. Right? I mean, clearly lots of LPs are just checks, and that's important to emerging managers. But maybe talk a little bit about that strategy within your investment activities. Dive into a little bit about some of the things that you bring to the table with GPs, potentially how you vary your coaching with different GPs. Again, I'd love to just learn a little bit more about that because I really do think that's something that is really impressive that you bring to the table with emerging managers.

Sheryl Mejia (13:30):

Thanks. It is about being one of the first LPs that will ask them the hard questions. And I think it starts about three months before they'll get a term sheet from us. And often the three months isn't necessarily our delay. It's really that they're not quite there yet to give us all the information we need. They're just building it up. A lot of our framers can be helpful. I think of it in four key areas where we're very impactful. One is that on the investor front, there's an efficiency in understanding the landscape. There may be 3,000 institutional investors who would love to learn about your strategy, but about 1 to 2% of those are ready to do an early close of Fund 1 or even equipped on a governance standpoint. But they'd like to have you in their sights for when they're ready for you.

And so how to create efficiency in your LP relationship building, not just in terms of following up and engaging and asking the right questions to understand what stage you are with each investor, where they want to really think and position you, and when they can potentially be ready for you. And so I often say, "No is no for now." Typically, if you've got a very compelling strategy, they often definitely want to follow you, but very few will be first. And so trying to figure out who needs the most attention early on is very helpful.

Another area is operations planning for stages of growth, planning for what the minimum standards are for capitalization for operational side and what can be outsourced at this an early stage and what can be brought in-house later. Some of those operational planning points, really quick, we often send a vendor list off to managers just so that they can start getting through those process because hiring vendors can take some time. And working through the contracts there, which I'm sure you've helped with over the years, negotiating those.

Another area, a third area we think about, which is different than operations, which is the sort of overarching foundational decisions you make about your business. Who's on the bus, who's getting carry, what the ownership structure looks like. Really being thoughtful about the LLC agreement and the management company between founders. If someone leaves, how do they leave positively, in a positive leave or a negative leave, whatever way they're going to leave. And long-term budgeting for how capital's going to be added to the business. It's much more stable when there's a group providing capital to the business. And the one thing I'm seeing a lot right now in the foundational decisions is headquarters and geographic locations of teams. And it's very unnerving for LPs to see teams that have not worked together before being in different offices. That is something you can't always get your head around. Keeping in mind alignment and what institutional standards. Filling out even for your own benefit ILPAs DDQ, just to know what the questions you should be asking yourself, is also very helpful.

The last thing I would mention is that one of the most impactful areas is the pacing of investments. Often dealmakers think on the deal level, but they're not always ready or prepared in planning out the next five to 10 years of what the fund-level decisions will be, in terms of the first deals and how many realizations you need to have before Fund 2 starts and whether there'll be a gap where you'll be out of the market, and maybe you need to do a single fund or a single-deal fund between Fund 1 and Fund 2 to meet that gap if you don't have realizations in Fund 1. Prefer not to do that. And so knowing how to think about the portfolio in terms of liquidity, time for the value-add to really materialize, and what the strategic trajectory is in your subsector of your industry. Decisions like that, I think we can be very, very helpful in thinking through what Year Eight looks like in Year One and what decisions are impactful that you need to make now, what the impact is longer term.

Jon Finger (17:37):

Interesting. So I guess one area you touched on, what guidance are you and your colleagues giving GPs as it relates to their overall fundraising strategy in today's re-up environment, where it is so difficult, I think, to get those meetings, to get those new funds closed? What's been some of your overall guidance to emerging managers?

Sheryl Mejia (18:08):

In some circles, the re-up problem, it still exists, for sure, in some competitive sets. But it's also been augmented with the denominator effect, where everyone's overweight their... Not everyone, but a good portion, many LPs are overweight their private equity, so it's even harder to get that coveted parking spot with a premium LP, where they can only have 40 to 50 GP relationships, and how to think about that. I think of it in two ways. One, in terms of guidance we give, want to make sure they have empathy for the LPs' decision-making process. And when the LP's community is having problems that maybe you need just step back for a month or two. And this happens quite often, where there's some shock in the market, and you just need to be a source of information, not fundraising. And so empathetic to the LP.

So if you were a large institutional LP and generally fully invested, you were closing the books in the first quarter on 2021, a fabulous year. Everything worked. Your asset allocation is pretty much on target because you can move your equity book around and equities have rallied, adjust things as you need. Just as you were closing the accounting on 2021, this perfect year, 2022 was upending all good plans. And we've seen this movie a couple times in the last couple years. And at the same time, the IPO window was narrowing. So PE wasn't distributing as fast, and public equities are declining, and most institutional LPs resulted in an overweight in private equity and a slowing down of their well-thought-out pacing program. But there were a few that were underweight private equity, and they've had this incredible opportunity to now get in at even better values.

The other dimension of that is that certain private equity portfolios are heavier in VC, and there's been some IPO declines, and VC tends to have a higher loss ratio in 2022. Looks like it'll be a little bit more challenging for that. It might play out to that higher loss ratio for venture portfolios that hasn't been seen in a number of years. And so some of those dynamics are coming to play. And so people have to rethink. LPs have to stop and reassess that the environment. And that's where the GPs get a chance to be informative, provide visibility, but not necessarily to say, "We'd like to close next month or three months now. When do you have a window to be in our... Would it be a first quarter of 2023? Would it be the fourth quarter of 2022? When is your reasonable window that you get to work on this?"

I'm going to talk my book a little bit because I think small buyout is in this beautiful spot of lower loss ratio, higher cash flows, and less leverage, in this environment of rising rates, where it's sort of tucked between VC and large buyout. Benefited from lower rates for quite a long time. That's changing. And it's an interesting sweet spot that I think there's been a lot of dedicated institutional investors that stayed in the middle market, love to get that exposure, but it's not the majority. The majority are underweight the middle market. And I think it's really a good time to be prepared to get to market and talk to investors, because of the problems that are occurring in other parts of their private equity portfolio. And there'll be, I think, a greater focus on the middle market, lower middle market, because of the more reliable cash flows and lower loss ratios.

Jon Finger (21:47):

That's great. Very insightful there. Maybe, talking a little bit about your pipeline and really your process, I know you look at over 200 GPs a year. You funnel a portion, say 50 of those, really into the pipeline and then start assessing fit and, truly, your conviction. What are some of the most critical things you look for in the general partner and the team as well, frankly, when considering an investment?

Sheryl Mejia (22:24):

Jon, I'm sure you see this all the time, that when you're bringing teams together to do a deal, the top of the list is this emotional maturity to buy a founder-owned business. That's a requirement of sourcing and vetting managers in the middle market. They're often buying founder-owned businesses or business that have been owned by a small group for a very long period of time before they take their first institutional capital. And I find there's the different personality type to boots-on-the-ground industrial founders, or health care business founders, whatever sector you like, with M&A bankers. It can be a gap there in their ability to talk to each other and be a good mix. And so we find the most successful teams have that emotional maturity to really not walk in and say, "This is what we're going to do," but walk in and have a conversation with the founders and really get an understanding of the business but also build empathy and a working relationship.

Second thing I'd mention is really look for a company, for teams that have this expertise that really allows them... I'll borrow from Tilly Franklin at Cambridge. She talks about bending the arc of companies. I just always love when she talks about that. It's really that ability to create multiples of value because you bringing more than capital. We see that right now. Give you a couple of examples in the chemical company expertise right now. And raw materials is such a premium, with the rotating inputs to electric vehicles, and the recycling and circular economy around that. Food ingredients and supply chains. There's very small number of experts that can not only fix the supply chains but also are knowledgeable about the changing consumer taste. I call it the "Coke to kombucha" transition we're going through in food.

Or health care. The subsector expertise you need in health care is very different than a decade ago, when it was more roll-ups. And so the precision medicine and enhanced discovery and the technology that's being infused in the health care processes for just even delivery of the service, really it's driving wonderful outcomes for society and the inclusiveness, but it's really a different set of expertise than you required a decade ago. So those are some of the things that we think about. And maybe I'll add just a couple more that really are top-of-mind for us. Finding a team that's got a number of decades of experience, that really have worked on a bad situation. I always love to hear about the deal that didn't work, or when you were a young analyst that you were thrown the deal that was already marked down to .8, and you took it back up to 1.5. That's a skill set. That's a resilience you love to see.

And the last thing I mention on this, just things we look for in GPs that may not be obvious or a top of list of traditional due diligence is that when you're a new manager, you've got to build all these relationships and that building the loyalty is something we can think of lot. Can you bring a team together that really has trust and resilience and will want to get through the next 10 years together, plus, 10 years plus, and getting onto 20, the people who want to work together as partners, GLP partners, and also internally? So that's a lot about resilience, and goal setting, and setting expectations correctly so that everyone knows where you're headed.

Jon Finger (26:04):

On that point specifically, how do you think about, assess, and, frankly, weigh the importance of scalability of a strategy? It feels like we continue to see that march from 200 to 450 to 750 to a billion with a lot of groups. How do you think about that question when assessing emerging managers?

Sheryl Mejia (26:38):

It's interesting, Jon. Those are definitely the headline numbers. You see these big, big funds coming out as funds teams march forward. We're often talking to teams that are thinking about a 150, 250, $500 million first fundraise. And we're actually testing their desire for scalability because that's how we invest, and we need to create capacity for our institutional limited partners. And I think the top of that list is, do they have the desire to build a big firm? Because there are some lifestyle changes that will happen in the process of being a founder and building a large firm. There are many small funds that can... very profitable, and great return profile, and stay under 250 million. And so we definitely, through our terms, actually, in our anchor agreement, we improve their economics as they scale because that's what we work out, our economic terms and how we try and build the next institutional fund. Could be a very nice lifestyle to stay under 250 million and just do deals and have mostly family office investor. That can be important.

But to your question of how do you sort of measure that future scalability, of course, the market depth of strategy and experience of the team across various sizes is important, too, as a backdrop. If they definitely are in the path to scalability, then we need to test out, do they have the capacity in their machine, the repeatable process? Is there a market depth for it? And is the deal size, flexibility already proven out on the team? That's what we're ultimately looking for, but it starts with, really, their desire to put in the elbow grease to get it done.

Jon Finger (28:20):

What changes have you seen in the GP stake segment of investing with emerging managers over the years?

Sheryl Mejia (28:29):

Yeah, there's been a lot of growth, especially in the last decade. I mean, Dyal led the headlines, and I think it was recently purchased by Blue Owl from Neuberger. I think of the GP stakes business in two ways. One, the first, the big one's that now, I believe there's 50 billion in the marketplace between Dyal, Petershill, Capital Constellation, and others that will buy a stake in an already existing fund that may be on Fund 3, 4, or 5. And they'll take a piece of the management company, most typically, but it could take different pieces of economics, and they will own that in either perpetuity or self-liquidating status. They typically won't invest in a strategy.

Our end, to contrast that, the GP stakes for debut funds, which is where we compete with four pretty consistent competitors. And I think there's a couple of crossovers. So maybe make it seven in total who are pretty much in market. We're still under about 5 billion in the marketplace today. It's not enough for what needs to happen. And that's capital to go into the fund. Through interest in the fund, it actually creates the initial management fees and stabilizes the firm. And for that initial fund investment, you receive a GP stake in interest. I think just one or two of our competitors will take a ownership in the management company. Most of us don't. It's not as desirable on the smaller side. It's better to have the contractual rights without the liabilities.

This is a marketplace that's still very nascent. Family offices used to be a big competitor, but they began doing more direct deals. So there's really less capital here. This is why we created that because we want to create that bridge for teams to spin out or go from independent sponsor to a captive fund vehicle and allow them that bridge to create the next Robert Smiths or Henry Kravis. We want to be backing those teams that really have that desire to be their own founders and create their own destiny. And we're trying to counterbalance the megafund trends in private equity that I believe are, not eroding returns, I would say, but capping the returns. There's been many studies that show that if you're under a billion in a fund size, the upside dispersion could be quite high. So the selection is more rewarded on the... There's more alpha on the upside.

Jon Finger (31:04):

Maybe take a bit of a more macro view here. What is your outlook for fundraising for the rest of 2022? Certainly here, many groups talk about they're already tapped out for 2022 and anything would have to be '23. But what is your broader outlook for the rest of the year and then, also importantly, '23?

Sheryl Mejia (31:33):

I'm pretty positive. I don't think there's as much capital in the third quarter of 2022 to close as there will be in late 2022 and early 2023, where I think the investment committees of some of the largest and midsize endowments and pension allocators is that they're struggling of how they're going to invest now, given inflation. And there is no doubt that equities that don't have a lot of leverage... Back to speaking my book again, Jon, so call me out here. But the inflation with growth story, if you have growth in the economy and there's inflation, the best place to be, the best asset class to have, is an equity exposure. And if you have inflation without growth, then it's much trickier sledding, and you have to be in arbitrage-type of strategies and alternative strategies, and you want to be in special situations and more opportunistic things. And those are much harder to select and build relationships in that opportunistic time when you need them.

That is the top level big investment committees are thinking. I think there's a couple of very large players that have been underweight private equity, and the biggest being CalPERs. And they just announced a strategic allocation to increase their private equity book. That could have an outsized influence on the capital flowing as they put that money to work. So the interesting thing is, in thinking of different types of investors geographically, I tend to think that right now, institutional investors are more positive on the US than a US investor is. And the reason may be a simple viewpoint, vantage point, where the dollar has risen. At the same time, we may be down 20% in our equity. But the dollar going up has mitigated some of that. So we don't look, to a foreign investor looking in, as we look to ourself, feel ourselves.

And I think emerging managers should start fundraising internationally a little bit earlier than they might have the inclination to do with oil prices going up and the strong US dollar, the reinvestment of capital by foreign institutions. They're making great relationships. And the Middle East, in particular, has been extremely active and a very influential player in the US private markets. And you're seeing them not just invest in the large players anymore. They're diversifying around. All this said, Fund 1's have had an enormously hard time. You couldn't meet. You couldn't create relationships. And then the re-up environment was accelerated. Many managers, many institutional allocators, are not taking meetings. But now there are fewer Fund 1's in the market, and we really believe that if you've had the tenacity to stick it out, early 2023 is a great time to actually put a little flag in the ground. Now, starting the summer with investors saying, "Listen, we'd like to get to your 2023 allocations."

Jon Finger (34:30):

That's great insight, Sheryl. Thank you so much. I want to shift, finally, to two related questions, based on your expertise and what you have seen over the years. I'd love to hear your advice to an emerging manager who wants to, or is about to, begin fundraising for truly their first committed fund, and then maybe also your advice for a GP who recently closed their first committed fund. And what sort of things would you stress as they build their portfolio and their future?

Sheryl Mejia (35:14):

Thanks, Jon. Lots to mention there, but I'll just pick a couple of top ones.

That's a year in a nutshell. I think with the manager that's just getting out to market or just finishing their first iteration of their book, which you'll look back, typically, and be horrified by, later years, because you have to learn from the marketplace. You can't necessarily get the visibility. And we help with this quite a bit, but there still is who you're going to be partners with, in terms of these are going to be really long-term partnerships. If you're getting a Fund 1 investor who wants to be with you, likely you have a mission or benefit to them that you may not even know about. And I often like to say... People always say, "Are you a mission-first organization? You do a lower middle market. You're about economic growth. You've got tons of ESG deals. You've got diversity teams." "We don't identify as mission. We don't identify as mission and mission investor, but there may be some mission we're accomplishing for you. You'll help us discover this." And that's often a really good place to start. Not that that's not for everyone, but that's how we handle it.

I think calling yourself a mission or ESG fund is a very difficult hurdle, which can get you in some extra tension in certain investor groups. Can work very, very well, but really, on a different level away from even the mission things, understand what need you are filling on a risk level, on a sector level, on a complimentary learning level, for investors. And you sort of iterate, and you find that out, and then you end up swapping up your deck and describing your strategy different ways, and you keep learning. We designate someone at every meeting to document the questions investors ask of us, because that is how you learn you. Every investor tells you why they either are moving forward or not moving forward through a meeting by the questions they ask. That's what we found.

For a team that's recently launched and maybe past their final close of Fund 1, I think the biggest challenge is how to balance their leadership time properly and making sure they have systems to spend a time in each important bucket of their firm. We all like to do what we like to do in the morning. I tend to get the things I don't like to do out of the way by 10:30, try to at least. But everyone's got their method, and you have to spend a certain amount of time in accounting and tax, certain amount of time with your service providers, even if you're not the COO. And then human resource development cannot be underemphasized. Our assets are intangible and mostly team-based. So I think that balancing off the operational responsibilities across the team so there are redundancies, very important. So that's an existing team that's getting through that, deploying their first capital.

But ultimately, on both cases, whether you're new to the market or you've just closed your first fund, anytime you underestimate what it takes, you actually end up looking not very smart. Ultimately, people will invest with a manager because they are the best decision makers, great judgment. And so showing you're smart enough to really anticipate. Luck is preparation meets opportunity. So that preparation, anticipating what needs to get done ahead of it being urgent, in that "urgent and important" box.

I think the other, the final piece of it I would probably add to that, Jon, and I'm sure you can double up on this, and you have even more stories than I do, is that when I hear someone... They said, "Oh, yeah, we closed that in six months," I laugh. I said, "Was that from the first subscription document you get to the last, or what was that?" And typically, that means that, "Three years ago, I started talking, putting the bug in the ear of a potential partner, who then invested, two or three years later. Then that process took six months." So I will say, budget for a long fundraise and be happily surprised. But Jon, I'd love to hear your thoughts. I'm sure you're called on for advice all the time.

Jon Finger (39:25):

Yeah. No. I mean, that's great perspective, and I certainly agree with you. I think some of those unicorn situations I've certainly seen, but to the point, they tend to be pretty unicorn. And as you alluded to, it is all about that relationship between the GP and the LP. And think one of the things that we always talk with our emerging managers around is as you think about those deals you're doing pre-fund, on an independent sponsor basis, always be forward-looking and really think about crafting your investor network, where, ultimately, you want to get the deal done but, importantly, how it sets you up for success as a committed fund manager. And making sure that you're structuring your investor base that way, and your relationships with that in mind, I think, is super helpful. And to your point, it is all about a years-upon-years long process that a lot of emerging managers go through with their potential LP base to, ultimately, LP base. So absolutely agree with you there.

Well, thank you, Sheryl, so much for coming on the podcast today, sharing just wonderful perspectives from the LP side. Someone who's been in and around the emerging manager landscape for years, and really insightful commentary here. And thank you to our listeners for tuning in to this episode of Fund Flow. And we hope you join us next time.

Voiceover (40:54):

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