McGuireWoods

FUND FLOW

EMERGING MANAGERS PODCAST

November 3, 2022

The State of the Emerging Manager Market With McNally Capital's Beth Rahn

Episode Summary

Starting a fund is a challenging task on its own, but the pandemic added another layer of difficulty for emerging managers looking for limited partners. Having lost the ability to network and fundraise in person, many LPs played it safe and stayed with the funds they already had relationships with, leading to an upward trend in "re-ups."

"LPs in 2020 and 2021 — you could kind of hear the anguish in their voice. They wanted so badly to be able to take the time to do diligence and vet and underwrite new managers. But […] there's only so much capital to go around," says Beth Rahn, Principal and Head of Family Capital at McNally Capital.

Thankfully for emerging managers, we're starting to see a reversal of that trend in 2022 as LPs continue to show interest in the growing emerging manager market. The best thing emerging managers can do to seize that opportunity, Beth says, is to take their time building relationships and establishing a reputation.

"It's human nature to want to build a relationship with a manager before making a commitment," says Beth."So take the time to go out, meet investors before you actually need their capital."

Tune in to this episode of Fund Flow as host Jon Finger talks with Beth about the future of the emerging manager market, diversity initiatives within private equity, and where emerging managers should improve.

Top takeaways from this episode

★ **Build better partnerships with founders.** According to Sheryl, there are three core things that differentiate Steward. The A consistent strategy is key. Even after establishing a second fund to adapt to investor needs for committed capital, McNally has achieved growth, success, and high returns by maintaining a consistent and unchanging investment strategy focused on low- to middle-market and family-owned businesses.

★ **Early partnerships are appealing to LPs, even in today's environment.** Building a relationship with a limited partner — especially as an emerging manager — takes time. But the idea of getting into a deal early is appealing to LPs. Despite the impact of the pandemic and the trend toward re-ups, Beth says the demand for the emerging market is continuing to grow.

★ **When it comes to DEI in private equity, there's room for improvement.** Conversations around DEI are gaining momentum, but there is a long road for DEI to become the standard in private equity. Beth says that for conversations to turn into policy, GPs need to keep doing the work and making the commitment to invest behind those efforts and set the hard guidelines for those policies to be followed.

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's 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):

Good afternoon. This is Jon Finger and you are listening to the latest episode of Fund Flow. Today we have Beth Rahn with McNally Capital. Beth is a principal and head of Family Capital at McNally Capital. Beth leads McNally's fundraising and investor relations efforts and she also manages the firm's extensive network. Welcome Beth. Thank you for being on today.

Beth Rahn (01:08):

Thank you, Jon. Thanks for having me. I appreciate it.

Jon Finger (01:11):

Absolutely. I'd like to start off if we can and talk about your investing path and how that led you to McNally Capital, I guess about 10 years ago, right?

Beth Rahn (01:23):

That's exactly right. Yeah. I am just past nine years with McNally Capital. From a past perspective, I started my career in private equity. I, right out of undergrad, joined a private equity firm with a focus on fundraising and investor relations. Quickly, and not surprisingly, as many folks who work in the industry can attest to, I very quickly fell in love with the industry. I'm a very strong believer in the importance of private capital to drive growth. So I quickly drank the Kool-Aid of the importance of private equity, just wanted to continue to build my career in the space.

(02:00):

Ultimately went to get my MBA at Kellogg. When I was at Kellogg, I knew I wanted to continue to build my career in private equity and specifically remain in a fundraising role. I really liked the sales aspect of private equity investing. And so while I was at Kellogg, I came across McNally Capital. I was introduced to the team and the firm 10 years ago and the rest is history. I joined McNally as we were starting to build our private equity track record and it's been a really fun and a really interesting growth story to be a part of.

Jon Finger (02:36):

Yeah, for sure. And I've been on the sidelines, but certainly watching it with great appreciation. I'd love to have you share some of your insights around how McNally has evolved over the years because I know it has just from watching it again on the outside, but maybe talk a little bit about that evolution.

Beth Rahn (02:57):

Yeah, no, well you've been a part of it and you've been a contributor to our evolution, which I appreciate.

Jon Finger (03:02):

Thank you.

Beth Rahn (03:03):

So we started making acquisitions initially on a deal by deal basis. So, the first eight acquisitions that we completed as a firm weren't done out of a fund, were done as basically a family backed independent sponsor model. And between 2014 and 2019, we completed those first eight acquisitions. I was raising capital for each individual acquisition. So I kind of tried independent sponsor model, the GP, and we are backed by and founded by the McInally family, but the GP of McNally Capital and the McNally family invested in each acquisition.

(03:42):

And then, I was going out and rounding out the remainder of the equity stack that was required for a given acquisition from other outside LPs. That was a nice model for us. It worked quite well for those first state acquisitions. But as we've all seen, and Jon, you've certainly seen this in your role in the market, it's just become an incredibly and increasingly competitive deal atmosphere out there. And so, a lot of our differentiation, and we can get into a broader conversation around this throughout the course of this conversation.

(04:16):

A lot of our differentiation really centers around the fact that we represent family capital that we are backed by family offices. We were started by a family office. We now have a very differentiated and diversified investor base that includes institutional investors. But we have this very unique family capital backing and family capital angle. And that was a huge part of our story and the way that we built partnerships with founders and family owners of businesses that we were working with. And we are typically the first outside capital that's coming into a private business.

(04:55):

So, we're not typically acquiring companies from private equity sponsors necessarily. We are pretty focused on acquiring companies from a founder, from a family who's looking to bring in an outside equity sponsor. And so, because we come from this very unique background and very unique perspective of being started by a family office with a history of running the McNally family's own family business and ultimately going through that exit process, because many of our family office LPs have a very similar storyline, there's this very acute relatability that family and founder owners have to McNally capital that we can basically sit across the table from a founder or a family owner of a business and say, we've walked in your shoes. We've been there. We understand what it is to grow your own business and now go through this transaction and bring in an outside partner.

(05:48):

That storyline worked really well for us and still does work really well for us. It's just a very acute part of what defines our investment strategy, what defines our differentiation and our ability to build good partnerships with business owners. What was missing from our partnership model for the period of time that we were acquiring companies as an independent sponsor was our ability to say to a seller of a company that we had committed capital. That's hard for a seller of a company who's in the process of going through this transaction with their business that they've been building for a decade or two decades or sometimes longer than that.

(06:27):

I mean this company is their proverbial baby, if you will, and they want to ensure that as they're going through this transaction, everyone's going to show up with as much degree of certainty as possible. Everyone's going to show up to the closing table on closing day, ready to go. And what we started hearing from sellers of companies was, you don't have committed capital McNally capital. And so, as a result of that, you present a risk around certainty to close. We had these great conversations. Sellers of businesses really liked our unique angle, they liked our partnership, but we didn't check that last box necessarily having that committed capital up front because we were raising capital on a deal-by-deal basis.

(07:10):

That wasn't always an issue. But I think as this seller environment has become more sophisticated and more educated and as the advisor market has continued to expand, it just became more and more of a talking point. And so, we internally just looked around the table and said, we're starting to lose out on deals because we don't have committed capital. And we don't necessarily really want to change anything about our investment strategy. We want to continue to do exactly what we've been doing because that's served us really well.

(07:42):

Our strategy of acquiring founder and family owned businesses in the lower mid-market has had been successful. So we didn't want to change that, but we realized we needed to solve this issue around committed capital. And so, we decided that it was ultimately time for us to pivot to a committed fund structure. And so, we launched McNally Capital Fund two, called it Fund Two because we had made eight deal by deal acquisitions, which looked a lot like a full portfolio or a full fund portfolio or a full fund track record. So, we now lovingly refer to our pre-fund portfolio as our "fund one portfolio." but launched McNally Capital Fund.

(08:21):

It resonates and it made a difference we felt like in our evolution overall. The launch of McNally Capital Fund Two is our first committed fund model, which we've recently held a final close on. We've now acquired two businesses out of that fund and we're off to the races now. So it's been an interesting evolution. We're very proud of the track record we've delivered. We're very proud of the partnerships that we've developed with sellers of businesses and founders of businesses. And now, we believe we have even more momentum in the marketplace because we've pivoted from a deal by deal model to a committed fund model.

Jon Finger (08:56):

That's great. I love the story and of course love to hear about those transitions. As you think about that transition and the fund one if you will, what did McNally Capital consider and prioritize in developing your investment strategy that ultimately you are marketing to your LP relationships?

Beth Rahn (09:23):

Yeah, that's a great question. So, we are big believers in consistency and knowing what you do well and continuing to improve upon that, but continuing to do what you do well and what you know. And so, as we deployed the prefund, as we built the pre fund portfolio as we started moving towards the launch and then ultimately the deployment of Fund Two, we really wanted to keep a very consistent investment strategy. And our investment strategy is very much dictated by the history of our partners and where our partners have historically focused and of course the importance of the fact that we ourselves were started and are backed by a family office and family offices.

(10:07):

And so, our strategy has always been focused on acquiring lower mid market businesses. For us, that means businesses with 5 to $30 million in EBITDA in three primary industries, primarily aerospace and defense, where we have a very acute focus on national security and intelligence. That's probably about 50 or 60% of where we deploy capital. And then also focused on investments in the industrials and business services sectors. And I would say most importantly, and I touched on this earlier, the most important element of our investment strategy is that we really are continuing to focus on acquiring founder and family owned businesses.

(10:46):

For all of the reasons that I mentioned earlier, it resonates with our team. We like being the first institutional capital coming in the door to a founder of a business. We find that we are really energized and we have a lot of opportunity to work with the founder that's kind of hitting that point in their growth trajectory where they like the incremental support, they like the incremental strategic expertise and they want a partner who can really help them take their business from where it is through that next phase of their growth trajectory.

(11:15):

So that's been really pivotal to the success of our investment strategy to date. And that was consistent across our first eight deal by deal acquisitions in the Fund One portfolio. So when we launched Fund Two we said, well we don't want to change any of that. I mean this has served us well. We have a great track record. We're building great partnerships with business owners. So we made it very, very clear to all of our investors, whether they were already investors with us or whether they were new investors, who were looking to deploy capital with McNally Capital for the first time.

(11:46):

But we made it abundantly clear that our investment strategy wasn't changing. We were going to continue to do what we've historically done well. We're just now going to do it through the wrapper of a committed fund. So really nothing about our investment strategy has changed through the launch of the fund, which has served us really nicely. It's been good for the market overall because we're the same group we've always been. I think it's just given us more momentum because we're the same group we've always been with the same very differentiated investment strategy now with the benefit of committed capital behind us.

Jon Finger (12:20):

That's very helpful. I want to shift a little bit, Beth, and talk about that fundraise and some of the important components of that. Thinking about selecting the LPs that you ultimately wanted in your fund, what were some of the most important considerations that you guys and gals whiteboarded before you started the fundraise?

Beth Rahn (12:45):

It's a great question and I think having alignment ... Well, I'll take a step back. We are really big believers in alignment and that means alignment between our firm and the founders that we're investing in. We're looking for heavy rollover when we make acquisitions. That means alignment between us and our investors. We want our investors to know that we have skin in the game and we're heavily aligned. And it goes the opposite way. We want our investors to be aligned with our strategy and we want the groups that are providing capital behind our strategy and are the people that are really continuing to advise us as we continue to make acquisitions. We want them to have an appreciation and alignment with our continued success.

(13:23):

So it's an important question to ask around really what do you want your LP makeup to look like when you get to the final close of a given fund? And we of course have those conversations. I do think from an overall investor mix, I mean as I mentioned earlier, we've historically had a very strong family office centric LP base, which has resonated with our history given that, again, we were started by a family office with a family business background. And we really wanted to continue to build upon those family office relationship and really bring in family capital and private capital that had an appreciation for an understanding of our differentiation and our value creation strategy, which I think because of our background really resonates with family office investors.

(14:09):

But we also wanted to diversify into building out a very meaningful institutional investor base as well. And we are big believers and I'm a big believer that having a diversified mix of limited partners really behooves a GP over the long term. And that's the case with any business model and a private equity fund is certainly no different. So as we were kind of thinking about groups that we wanted to bring in the door, we really started to reach out to family offices of course, but also institutional limited partners, who grasped and appreciated our differentiation in the market.

(14:46):

And I think that that led to a lot of interesting conversations. McNally Capital is very unique because of our background and is very unique because of our family business background and that serves us well. What I think has been really interesting in the market is that there are more and more groups like us that are coming to market and bringing in outside institutional capital. More groups that are backed by a family that have a family business background and that's where the original source of capital comes from, but have gone out to bring in other outside capital partners as well.

(15:18):

And I think the more of us that have been out in the market raising capital and having more of a market presence, that's kind of served all of us really well. So, Pritzker Private Capital has done this, they've launched some funds and they've brought in outside capital declaration partners as an example. There are many other groups like McNally Capital out there that have kind of followed a similar trajectory. And so, that's been really interesting to have that conversation with the investor community and to really work with investors who have an appreciation for an understanding of really how differentiated this kind of group like McNelly Capital is in the GP environment.

(15:56):

And so, our goal was to find groups that really had an appreciation understanding of that investment strategy of the value that a family background and family capital strategy can bring to the market and how incrementally strategic that is in building partnerships and building relationships with private business owners and ultimately utilizing that partnership to yield outsized returns for your underlying investors. So I think really that alignment, that support of our end mission, that support for our investment strategy was incredibly acute.

(16:33):

I think that the rest of what we were focused on is frankly whatever GP wants to be focused on, right? It's finding LPs who want to invest with you today but want to invest with you over the long term who aren't thinking, hey, what's my strategy in 2022? But who are saying, hey, we want to invest with you today McNally capital, but we also want to invest with you over your next 10 funds. We're going to do the diligence and the hard work upfront today. Not that they're going to stop doing the diligence and the hard work in future funds, but they're really going to invest a lot of time to get to know us upfront with the anticipation that they will be long-term partners of ours.

(17:11):

And we want that. I mean we want that consistency in capital. We're big believers in long term relationship development.

LP relationships do take a long time to cultivate and nurture. And so, we want that to go both ways. We know that we have to invest a lot and a lot of time into building LP relationships, but we want those limited partners to feel the exact same about us as well that they want to be partners with us today and throughout the futures. I think those are really the primary criteria that we took into account as we were thinking about who the right limited partners would be.

(17:47):

And I'm happy to say we have an incredible roster of investors that have come into McNally Capital Fund Two. We have an incredible roster of investors that supported us through Fund One and we have a lot of consistency in that investor base. We're big believers in bringing the right partners into the table. I will tell you, we talk a lot at McNally Capital about the no jerk rule. Some people have another way to phrase what I just said, but I'll refer to it for the purposes of this podcast as the no jerk rule.

Jon Finger (18:18):

Appreciate that.

Beth Rahn (18:19):

Yeah, I'll save you from some editing. But that is important to us. That matters to us and to our team. That matters to me in particular because I'm the primary person that's interfacing with our investors. But that goes a lot to the values and the culture of our organization. And it matters to our investors. I mean, our investors want to come to our annual meeting and come to our event over the course of a given year and really enjoy the people that they're spending a day or two days or a dinner or whatever it might be with.

(18:47):

So that's acute. That's kind of the soft unwritten criteria that we have that has also really resonated with us. And again, it's just a really thoughtful group of investors that were grateful to have brought together and fun too.

Jon Finger (19:02):

Great insights and testament to the success that you all had during that process At the same time, what were some of the most common reasons that you saw some LPs hesitant to invest in a true first time committed fund vehicle not withstanding the robust independent sponsored family investing experience you guys had over the years?

Beth Rahn (19:27):

It's a great question. And it's an interesting market because there's so much demand from the limited partner community to invest in emerging managers. But there's also a lot of hesitancy to invest in an emerging manager and a lot of incremental diligence that limited partners want to do for an emerging manager. So, there's definitely a need to kind of marry up those two perspectives. I think what I've seen is that limited partners, while they're eager to have the opportunity to invest in a first time fund, want to ensure that they can see a full cradle to grave track record from a given manager.

(20:12):

They want to see consistency in capital deployed. They obviously want to see very strong returns generated and they want to see exits completed and not just one exit but a track record of exits. So I refer to this as I always talk about how limited partners want to kind of watch the movie or see how the movie plays out. They want to watch the track record evolve. They want to see the evolution of capital deployed. They want to see the evolution of exits realized. I find that limited partners really like the opportunity to see and vet maybe two or three co-investment opportunities before making a commitment to the fund because that really helps them learn about the investment team, learn about how you are vetting the market, why are you making an investment? What are you worried about in this investment? What are the risks? How are you mitigating those risks?

(21:03):

Even if they don't come into giving co-investment opportunity, it gives a limited partner the opportunity to really get to know a manager. And even LPs that don't do co-investments, they still kind of want to go through the case study of why did you do this deal? Why are you doing this deal? Tell me about this exit you just completed. Bring me full speed through the last five years of value creation that led to this exit. So again, that's kind of what I refer to as limited partners really like to have the opportunity to watch that movie play out and really get to know a track record and ultimately see that full cradle to grave life cycle.

(21:40):

And it's thoughtful because in aggregate, I think those LPs would just want to build a very thoughtful established relationship. And that can't happen overnight. They need to over time understand the method to the madness of certain managers and really what the true and core differentiation and investment strategy is about a given investment manager. So, I encourage managers to take that to heart. We knew when we launched our first time fund that we needed to have a good track record. We needed to be able to show attribution from our existing team to that track record.

(22:12):

And there's a lot of ways to get around that, right? A lot of independent sponsors have done five deals or eight deals and have exited some of them and have a full track record before they launch their fund. There are other managers that are spinning out of another fund and can show attribution to the track record that they have. But I do think being able to show an LP that you have that full cradle to grave life cycle and track record that you can point to just gives them a lot of comfort in knowing that there is a greater consistency in how a given manager then can deploy capital on a go forward basis.

Jon Finger (22:47):

So I want to talk a little bit around the merging managers. You touched on it, that's what this podcast is all about. With emerging manager programs on the rise at whether it's family offices, pensions, wherever, what do you foresee for the future of the landscape of LP's willingness and desire to invest with emerging managers?

Beth Rahn (23:14):

I have been really impressed and intrigued by how much demand there's been from the LP community to invest in emerging managers. And I think LPs see the benefit of investing in emerging managers. You make a commitment to the first committed fund, you're on the ground floor. You've started that relationship building with the GP early on. And so in the ideal world when the GP is consistently delivering top defile returns and is going back to market with the next fund and are completely oversubscribed and are kind of hand selecting who they're going to bring in and who they're not going to bring in, the people that were there from the beginning are going to get prioritized.

(23:57):

So I think limited partners have an appreciation for the benefits that coming in early and building that partnership with the GP early can do. So, my read on the market is that that's just going to continue with time. There's been strong demand. I think there will continue to be strong demand in the emerging manager marketplace. I definitely wouldn't encourage a manager necessarily to take that appetite from LPs at face value. I mean, as discussed, it still takes a lot of time. And I think that a given GP needs to invest that time and attention into building LP relationships and finding the right LPs who will be the right partners. Not just today, not just in this fund but for the next fund and the fund after that and the fund after that.

(24:43):

But I do think that that demand and that appetite from LP for the emerging manager marketplace is really only just going to continue to grow.

Jon Finger (24:52):

I think recognizing when you are in market versus not certainly while we've observed that strong desire to really partner with and back emerging managers, I do think that the past 12 months, give or take, where it does feel like there's been a disruption within the normal life cycle, if you will, or cycle or fundraising where you have this heavy re-up sooner than people thought. And it's happening consistently and with a lot of different managers. I do feel like that has upset the apple cart a little bit with a lot of institutional investors. And to a degree it has just by definition I think impacted some of what emerging managers have faced the past 12 months in the sense that it was a wonderful environment for emerging managers.

(25:53):

And I think it still is. It does feel as though some of those bumps, if you will, or unforeseen events have caused a little bit of a challenge within the emerging manager system, if you will. But any thoughts on what you've heard from your colleagues recently about what the re-ups have done to just kind of the ability of new managers to frankly just get air time?

Beth Rahn (26:21):

I completely agree with everything that you just said. I mean you faced an environment in 2020 where the world went quiet. And all of a sudden road shows, people every week being on the road, getting in front of LPs, raising capital, pivoted overnight to the only way you're going to have a diligence conversation between a GP and an LP is via video conference. And that was the case. It was state by state of course, but that was the case for I mean, what, a year or 18 months or however long it was.

(26:55):

And even then once things started to open up, it started to open up very slowly. And so, the 2020 dynamic was really interesting of course because LPs who had this appetite for investing in emerging managers couldn't get to know a first time manager. So, unless that LP had five meetings and had already done the onsite diligence with that manager, it was going to be harder for them to get investment committee to make a commitment to that manager because they just didn't have that in person face to face interaction to build the relationship.

(27:31):

And so, what we saw in 2020 was this flight to existing relationships and flight to existing managers that really kind of supported the re-up dynamic that you were just describing. And then in 2021, every manager and their brother and sister came back to market with a fund launch that might have been put on hold in 2020. So now, you're facing a new set of challenges in 2021, where you just have this absolute explosion of funds that are in the market with limited LP dollars to go around. On top of that, you're still facing these exact same in person or rather lack of in person meeting dynamics, lack of an ability to really necessarily get to know a GP by doing onsite diligence.

(28:21):

And so, again, you have all of these funds coming back to market. So this huge re-up environment and on top of that, this continued appetite by LPs that still really like their ... And believe in their emerging manager strategy, they just can't necessarily get to know first time funds that they've never vetted before, that they've never made a funds commitment to before. And so, it was a very challenging fundraising environment for first time managers. You're kind of hit by a double whammy.

(28:49):

I mean, I spoke to a lot of LPs over the course of 2021 who weren't even saying no to new managers. They were saying no to half of their existing managers because that's how aggressive the fundraising environment was. And I mean, you only have so much LPs thoughtfully who are thinking about vintage year diversification and so they only have so much capital they want to invest over the course of a given year. And when you've got 20 of your managers coming back to market but you only have 10 slots, then you don't really have any room necessarily for new groups to come in.

(29:27):

Now, I have been hearing interestingly, a lot of that re-up demand still trickled over into early 2022. And even in Q1, I was still hearing from people that they still had a backlog of re-up from 2021. Now, what I'm finally for the first time in maybe 18 months, what I'm starting to hear from LPs, and this has really just been something that I at least have been hearing for maybe the last quarter and a half I'll say, is not that things are getting quiet, but co-investment opportunities have gone down a little bit.

(30:04):

We've all kind of been seeing the deal environment evolving or changing with the broader market in the last couple of quarters. And the re-up market has gone down a little bit such that LPs are kind of for the first time in 18 months saying, I have time to take a conversation with a manager that I've never talked to before, which is what they want to do. I think these LPs in 2020 and 2021, you could kind of hear the anguish in their voice that they wanted so badly to be able to take the time to diligence and vet and underwrite new managers.

(30:37):

But there's only so many hours in the day and there's only so many members of a team and there's only so much capital to go around and so you had to prioritize accordingly. I'm now hearing from LPs that they're kind of finally getting that opportunity in this market once things seem to quiet down a little bit here in midyear 2022 that they can start doing that.

Jon Finger (30:57):

That's super helpful both for the emerging managers and then also just great insights for the community and I appreciate that. And I have seen and heard similar. At the same time you mentioned the word diversity and then, so I want to spend some time there. I've been incredibly impressed with your ascent and your trajectory within this ecosystem. We all see these continued reports about how funds led by diverse, whether women are otherwise, diverse GPS are systematically being underallocated by institutional investors.

(31:36):

And I think clearly the environment over the past 18 months hasn't helped that. At the same time, I think it's something that is ever present. I'd love to hear you talk about the challenges that you face in your career being a woman in this field. And what are some of the things that were helpful for you in overcoming those challenges.

Beth Rahn (32:01):

It's such an important topic. First of all, thank you for your incredibly kind words that's very thoughtful of you to say.

Jon Finger (32:06):

Of course.

Beth Rahn (32:07):

And second of all, thank you for asking such an important question. I mean this is a huge topic. This is a topic that I am personally invested in. This is a topic that I'm professionally invested in. I'm just a huge believer of the importance of diversity in private equity. And there is a huge under allocation in diverse funds. We've made a lot of progress, which is great and we have a lot of work yet to do and continuing to build a more diverse industry in the private equity space.

(32:40):

And I talked about this in fact, Jon, when I was profiled in McGuireWoods Women to know. And so, I am actually going to pull from ... I went back to that because as you sent me this question to think about, I was thinking, I've talked to McGuireWoods about this before. This is an important topic.

Jon Finger (33:02):

To get you a greater platform here.

Beth Rahn (33:04):

Well, this is an important topic to me, but the fact that I've now been asked this question twice by McGuireWoods in two very different occasions and venues means that it's a very important topic to McGuireWoods, which I appreciate. So please keep asking those questions because if we don't talk about it then the problem won't get solved. I mean, from a gender standpoint in particular, there are so many studies that have shown this correlation between hiring more women in the executive suite and generating increased profitability, which is huge and obviously increased profitability is great for the company as a whole. It's great for all of the investors. It means more promotions. It means more rewards for the whole team. That means you're able to recruit better team members and more team members and bring the right talent on board, which yields even better results and better profitability.

(33:51):

So, this is very much a dynamic that is to everyone's benefit for men, for women, for GPs, for LPs to invest in greater diversity from both a gender and a race, you name it, to support greater diversity in leadership in private equity. And there is, as you noted, there's a huge underrepresentation right now in private equity. And that's a detriment to the bottom line. And so this is rightfully a topic that is, the good news is this is now a topic that's getting a lot of GP and LP attention.

(34:24):

And that trend line of how much attention and time and effort and study and commitment that is going into this topic is really only going in one direction, which is just fantastic. I will say, over the course of my career, I have really benefited by getting involved in some just excellent organizations that support gender diversity and private equity.

(34:51):

PEWIN is a great example. Wave is a great example. And I've found that the community of women in these organizations have just been incredibly supportive to me, incredibly supportive to the field in general. So I'm a big believer in tapping into your resources of networking, of using your relationships to support, find support for yourself, find ways to pay it back and in the karmic world, pay it forward. So I've found a lot of benefit by working with those different organizations.

(35:23):

And I think we all know this can't just be a woman's issue. This is a people issue. So I found a lot of support in these women's organizations, but this needs to continue to be an active dialogue across the board. LPs need to keep asking the hard questions around diversity. McGuireWoods is doing a great job of continuing to ask the hard questions around diversity, but we have to keep talking about ESG policies.

(35:50):

We have to keep talking about DEI policies. GPs need to keep doing the work and making the commitment to invest behind those efforts to make commitments to really kind of put the hard guidelines in around those efforts. So I think the momentum on this topic has been great that will continue. Again, it is continuing, which is great, but we've got a lot of work to do. I personally am very grateful for and very proud of the diverse team that we've built at McNally Capital.

(36:17):

I mean, all you have to do is take one quick look at our website in our team page to see how diverse we are. And particularly in the context of a typical private equity firm and I think as we continue to grow as a team, we have to keep that lens in mind. So that's been a very impactful element for me personally. I have benefited and I appreciate being part of a more diverse team, but there's always room for improvement at our firm and in the industry more broadly. So, we've got to keep having these conversations.

(36:48):

And I have appreciated the extent to which LPs will say, you got to do X, Y, and Z if you want a commitment for me. And I think that's a good direction for the industry to be moving in.

Jon Finger (36:59):

Yeah, I wholeheartedly agree with that. A selfish plug at our independent sponsor conference here in a couple months, one of our true flagship panels is going to be on diversity and really having a thoughtful conversation around that. And to your point about truly taking action and how that manifests itself and what everyone can be doing. So I appreciate your commentary there. I think ...

Beth Rahn (37:25):

No, likewise. I appreciate all the work you guys are doing for this.

Jon Finger (37:28):

You bet. You bet. So maybe broadening out a little bit from diversity, what changes do you hope to see within the ecosystem of emerging managers in the coming years?

Beth Rahn (37:44):

Well, this is a little bit of a layup of an answer, but I certainly hope that emerging managers continue to focus more on diversity and everything that goes behind it. And, again, that is a very multifaceted answer. Diversity in DEI is one element of a broader approach to ESG. So, I'm heavily invested in supporting diversity at McNally Capital and in the private equity industry. You have to take that more broadly to universal focus around ESG though, which is ... I mean, it is environmental, it's social, it's govern, it embodies diversity, but it embodies so much more than that.

(38:26):

I said at the beginning of this conversation, the reason why I continue to work in the private equity industry, the reason why from the day I was 22 was excited to continue working in this industry is because I firmly believe in the value of private capital. I think it is so impactful from an economic growth perspective, from a standard of living perspective, from an ability to drive impact in our world, in our communities. And with that comes a lot of responsibility. And I think there is a huge opportunity in private capital to really focus on driving profitability and that matters.

(39:03):

I am a capitalist through and through, but doing it in a responsible manner that takes that ESG lens into mind. And I think you have to live your values through your investments as well. I don't think it's an either or. So in the emerging manager marketplace, it can be a little bit harder to apply ESG because it's not easy. I mean, you can kind of say as you can be a $10 billion fund or a hundred million dollar fund and have the same desire to apply an ESG policy or a diversity policy.

(39:39):

But it's a lot harder to do when you have less resources which is typically the case with emerging managers and with smaller funds who just have smaller teams and less resources necessarily at their advantage. So, to really apply a true ESG policy, to really apply diversity, you have to have the arms and the legs to track how your portfolio companies are monitoring, report on that to your underlying LP base. Continuously reassess revet and improve your ESG policy as the market evolves, as your portfolio evolves.

(40:14):

Conduct on an annual basis or a quarterly basis, whatever it is, this ongoing policy within your portfolio companies. These are all very doable things, but they take a lot of time and a lot of money. So, we've all seen how well the upper mid market and the largest managers in the private equity space have done and how many strides they've taken in putting ESG policies to work. It's definitely occurring in the lower mid-market, but it's harder because it takes a lot of resources to apply that.

(40:48):

McNally Capital wrote our ESG policy. We have it in place and we apply it and we stand behind it. But I want to continue to see emerging managers making that focus. I think it started at the top of the market and it's now kind of trickling down where every manager is expected to have a focus and bend on that. But I would like to see greater attention paid to that in the emerging manager marketplace.

Jon Finger (41:13):

Thank you. That's great. I'd like to finish with one last question, Beth, and I think you probably know what it is, but what advice would you give to someone who wants to raise their first committed fund with the benefit of hindsight? You've been through it. You've lived through it. I know you've learned a lot from it. What are some nuggets you would provide to people out there?

Beth Rahn (41:39):

I think anyone who wants to start their own fund, start early, invest time in building your track record as an independent sponsor if needed before you launch the fund. Or just ensure that you have that very direct attribution to a track record. If you're spinning out of an existing manager, I would say heed the advice of your limited partner community, listen to the questions that limited partners are asking. Have an open mindset that offers room for improvement.

(42:09):

When we first launched our fund, we had a lot of really good questions from LPs in the initial days of fundraising that frankly and admittedly I think made us and continued to make us better investors because we were pushed by our LPs to get tighter in certain areas to drill down in certain areas. And so, I think, you have to kind of check your pride at the door and listen to your investors and just be open to those questions, be open to opportunities for improvement.

(42:37):

I would definitely just encourage this massive investment in LP relationship development. I mean, Rome wasn't built in the day. I think it's human nature to want to build a relationship with a manager before making a commitment. So, take the time to go out, meet investors before you actually need their capital. Let them kind of see your strategy and learn your strategy in real time. And this is the old adage that everyone knows, the best time to fundraise is when you're not fundraising. So start early and I think listen to the questions and the feedback from your LPs.

Jon Finger (43:08):

That's great. That's super helpful. Well, thank you, Beth, so much for coming on the podcast today and sharing some wonderful firsthand perspectives on what it means to be an emerging manager and some of the other great topics from today. And thank you to our listeners for tuning into this episode of Fun Flow and we hope you join us next time.

Voiceover (43:32):

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