The Personality of Investors and Their Commitments

On the surface, the common maxim “capital is capital” might seem to predominantly drive GP decisions when raising capital. However, seasoned fund managers will be the first to tell you that there are strings attached to where their raised capital originates. Obviously, the fund and its strategy are the unifying factors for all who seek an allocation, but the needs and expectations of different groups of investors can vary (sometimes acutely). The benefits of having a diverse investor base are well-known to GPs. Likewise, LPs are keenly aware of the implications or signals (founded or not) of GPs having large clusters of past investors falling into particular categories. For me, the differences in what the various investor categories scrutinize always came to vivid life during LP reference calls. Here, it is important to reemphasize that regardless of preference idiosyncrasies, we still arrived at the same destination despite varying routes. So what do different investor groups seek, and how can each group add to a manager’s organizational maturity/progression? Although each and every investor, regardless of grouping, will exhibit unique traits, generalizations based on major commonalities can be used as a guide to help answer the put-forth questions.

- **Institutional Reinforcement**: As funds graduate from an initial investor base heavily comprised of friends, family, high-net-worth individuals, and family offices, to a cohort of endowments, foundations, sovereign wealth funds, and pensions, their institutional demeanor changes (or must change). Increased institutionality typically manifests with higher caliber service providers (auditors, legal counsel, data repositories, etc.), augmented consistency/clarity of periodic reports and client communications, enhanced coherence of messaging and narratives, and general adherence to professional behavior. In a way, institutional clients use their highly sought-after dollars to subtly nudge or firmly urge non-institutional GPs to up their overall game.

- **Risk Tolerance and Creativity**: It is widely believed that high-net-worth individuals and family offices have a higher tolerance for risk-taking. Funds with an investor base primarily made up of risk-tolerant investors are usually implicitly or explicitly granted more leeway to be avant-garde with investment targets and structures. Funds with unconventional strategies and/or ultra-innovative structures will (or should) focus on raising capital from investor groups who have historically demonstrated an appetite for investment approaches that strive to be contrary to the norm.

- **Downside Protection and Cash Flow**: Liability matching, long-term structural characteristics, and the sheer amount of capital that must be put to work, can drive the desirability of certain funds to certain investors. Some long-tailed funds or investment strategies underpinned by assets that will generate long-term cash flow will be appealing to investors like pensions and sovereign wealth funds who try to match future liabilities with the cadence of illiquid investments. Some pensions are willing to accept an overall lower return in exchange for some semblance of long-term stability. For fund managers who consider their relatively lower target returns compared to peers, to be a fair exchange for the peace of mind gained from higher predictability, it is logical to target prospective LPs whose goals include exposure to these characteristics.

- **Exclusivity and Some Degree of Snobbery**: In addition to outsized return potential, some investors are drawn to the elitist cachet, vanity, and recognition (within their own strange circles) that comes with participating in a particular manager or sector. The more “not too many people know about this fundraise” and off-the-radar the manager is, the better. As someone who has represented endowments and foundations for the lion's share of my career, I can wholeheartedly relate to this. There is some intellectual superiority that emanates from seeing, backing, and/or evangelizing a manager first. It is hard to explain. The problem with this is that the investment starts as a hidden secret (among the most well-networked) and then quickly turns into an open one with a long line of folks pleading to participate. Through this all, a monster has been created – this is how you birth managers that provide limited due diligence time with senior personnel and will cut back your allocation with any whiff of actual or perceived disrespect.

- **Honorable mentions**: I would hate to leave out consulting firms and funds-of-funds from this discussion. Consulting firms and funds-of-funds can take on any of the above personas depending on their mandate and/or end client. However, these organizations have the unique ability to bolster the ripple effect of narrative transmission, as well as act as a one-stop shop to bring in a good amount of capital and investor diversity. Many investors use a GP's receipt of capital from a consulting firm or fund-of-fund as a decent litmus test for investment viability and institutionality.

Aspiring fund managers should take note that their source of capital reveals a lot about their investment strategy. Diversification of investors is not only a prudent insurance policy for future fundraising, but it also ensures that you are not unfairly branded into certain (risk, return, sophistication level, institutional level, …..) buckets.

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November 24th, 2024