The Worst Time To Conduct Due Diligence

After over two decades of investment manager/sponsor assessments, I have concluded that "the worst time to conduct due diligence on a GP is when that GP is officially fundraising". Although this statement has provocative overtones, embedded are large deposits of truth that I will attempt to excavate and refine convincingly. I respect the established conventions, norms, and mechanics of traditional fundraising, but still can't shake the feeling that there is something inherently unnatural about the ready-set-go fundraising protocol most of us have been subliminally trained to accept and follow. A bursting-at-the-seams DDQ (Due Diligence Questionnaire) accompanied by all manner of market analyses, past quarterly reports, and historical deal memos, within a well-stocked data room, are all conducive to the due diligence process, but the transactional spotlight that suggests "I gave you all that you could need, now give me money" creates an odd decision making atmosphere. So am I trying, in a clandestine manner, to simply reiterate a cliché I have heard from some seasoned investment industry players who suggest that "fundraising is most effective when you are not actually fundraising"? In a nutshell, I agree with this sentiment, but the nuances that led me to my answer beg unpacking, which I attempt to do below.

- **Best behavior syndrome**: Although the current brutal fundraising environment is seeing funds take an average of 18 months (from launch to final close) to gather capital, an average of about nine months has been the historical norm. Taking time to process the ramifications of wedding an entity for 10+ years after nine months of courting, is, as the kids say nowadays, "diabolical". As an analyst builds confidence from years of analyzing funds, he or she rightly starts to question the practicality of the widely accepted timeline/process. The whole thing is akin to the efficiency (or lack thereof) of using a resume, some interviews, and a few reference calls, under a tight deadline, to make a long-term hire for an important role. The consequences of getting it wrong can be irrevocable. For obvious reasons, the manager/sponsor tends to be on their best behavior during official fundraising due diligence. Typically, responses are prompt, conversations are cordial, rebuttals are met with accommodating open-mindedness, requests are pleasantly expedited, and manager availability is prioritized. Is this all real or is this what is expected during fundraising? Which of these amazing attributes will halt or wane once the sub-docs are signed? Although there are ways to truly or artificially gain comfort around these inquisitions, the ticking clock makes all conclusions feel premature.

- **Is more time for due diligence the answer?**: To say more time for due diligence will solve the woes of GP/LP relationship-building is too simplistic - if only our world were that straightforward. Time unarguably does play a role in the construction of comfort, but it is more of an additive factor than the "primary" one. The way time is used is more important than just having more of it. Time allows for a more comprehensive assessment of a GP in its natural habitat. Time inevitably scripts scenarios that provide useful visages for prospective LPs to assess GPs. It is much more valuable to witness a manager's response to a floundering investment in real-time than to read or hear a sanitized narrative after the fact. My general view is that more time for due diligence is not necessarily the answer, but more time for relationship-building is fertile ground for increased investor conviction.

- **The uphill battle faced by Placement Agents and Investor Relations personnel**: I saw this quote the other day that really resonated "Sometimes people don't want to hear the truth because they don't want their illusions destroyed". I believe this is what most placement agents and investor relations folks are facing when they explain the realities of fundraising today to fund managers. The dizzying saturation within the

investment manager space, which has led to ruthless competition for securing LPs, which has further led to a buyers' market, requires new approaches to fundraising. The days of drive-by fundraising have come and gone. Nowadays, tribe-building is the goal. The game is now chess, not checkers. All efforts around attracting prospective investors must be executed with the expectation of results appearing somewhere down the line – this could be one or two fund cycles away. I know this is easier said than done, but regardless of ease, knowing the rules of the current game is a lot better than trying to master the game no longer being played. Fund managers must acknowledge that using valuable time and resources to facilitate long-term brand- and relationship-building is a prudent approach for organizational longevity. This mindset would also allow placement agents and investor relations personnel the ability to forge real connections with prospective LPs rather than wholly relying on nuggets of information inferred from speed-dating-like interactions.

- **That unfinished feeling**: I am quite sure I am not the first, nor will be the last analyst to diligently speed through fund due diligence to meet a GP's mandated timeline, and commit to the manager, only to be left with a nagging sense of insufficient understanding of the manager's idiosyncrasies. The easy counter to this is to only invest in funds where every single one of your hesitations has been appeased. However, in reality, there will be times when a manager has built such a stellar reputation (with tangible evidence) that they can dictate all terms. Prudent investors have to weigh the pros and cons of such situations and sometimes kowtow for the potential outsized betterment/returns of taking that risk. To be quite frank, given the strains and logistical nightmares inherent in fundraising, if I were a GP who could wield the power of dictating terms (particularly around timelines), I would likely also exercise that authority. The bigger point here is that if some work (formal or informal) was done on the manager before official fundraising began, the duress of adhering to a strict fundraising timeline would feel less abrasive.

In my line of thinking, re-upping LPs have a tangible informational advantage, making them a good resource for new LPs assessing a fund. However, for Fund 1s, all prospective LPs are in the same boat. Some enterprising investors have found clever ways to circumvent fundraising time pressures and insulate from recency bias/risk by first learning a manager through a secondary or co-investment. Here, the investors get to, on a firsthand basis, assess a direct deal with a GP or fundless sponsor, or buy into an already invested portfolio at a discount. This provides a front-row view of a manager in action, rather than the safe-for-all-viewers depiction put forward during the official raising of a fund. All investors need to develop forward calendars and start interacting with favored funds before fundraising officially begins. Similarly, GPs should develop target lists of desired LPs and attempt to build rapport and share regulatory-compliant information before their next fund is officially in the market.

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