A GP's Family of Funds – Product Proliferation Musings

Product expansion is or will almost certainly be (at some point in the future) a real consideration for every GP who launches a maiden fund. From a business perspective, product proliferation makes a lot of sense. If you possess the people, processes, and data whose combination has been proven to create value, why wouldn't you seek other ways to capitalize on this? All other businesses worldwide look for adjacencies to their leading products and services, so why would investment managers be any different? Actually, in the world of private investing, finding managers who go through their entire existence investing out of only one flagship product is as odd as seeing a real-life unicorn dressed up as a black swan for Festivus. Admittedly, that statement is made in jest and is somewhat extreme, as I have encountered a few such rare managers. However, many of these rarities run flagship vehicles that have ballooned so much that they might as well have created other products, because several smaller/rightsized strategies could have easily fit into the now mind-bogglingly behemoth flagship offering.

On the other hand, the subject of GP product proliferation can be quite polarizing among LPs. I have met some LPs who viscerally despise it, others who believe it is a great way to get more exposure to their favorite GPs, and many like me who take it for what it is and assess its negative and positive attributes on a case-by-case basis. We all know that this phenomenon will not disappear anytime soon. Therefore, the sooner we develop coherent frameworks that help determine a GP's underlying aspirations, the better. Beneath the disdain for, or reluctance to, engage with GPs who oversee multiple products are justifications that carry real weight. GPs who manage multiple products and aspire to do so should have well-thought-out responses and structures to combat LPs' rational fears.

Below are several reasons why LPs tend to avoid or excessively scrutinize managers who demonstrate relatively high product proliferation behavior.

- **The distraction factor**: When GPs launch new products to supplement their flagship offerings, their core competence can become diluted. New strategies usually require distinct approaches, distinct criteria for selectivity, different forms of marketing, different terms, and sometimes even different people. The work involved in proving to LPs the ability to manage a range of strategies can cause GPs to take their eye off the ball that put them on the map. I can attest to the fact that when LPs are confronted with assessing a manager with multiple products, a considerable amount of time is spent trying to figure out what the manager is best at. Very few GPs will admit they are somewhat mediocre in one or more of their product lines, so they discuss all their strategies with equal gusto. Sometimes, when pushing a GP to take a stance on product grades, an LP will receive a line like, "Well, that one is our flagship product and is what put us on the map." Also, flagship strategies either tend to be so oversubscribed and/or have become so large that LPs who want exposure to that manager are forced to take consolation with the sister and brother funds of the flagship. Additionally, managing multiple products can distract managers because pursuing additional fee streams is time-consuming, may reduce accountability (with GP responsibilities spread across multiple products), and can unconsciously result in style drift. Every time an LP feels like a GP's specialization (even for generalist GPs who typically still have favored sectors) is beginning to be compromised, alarm bells go off.

- **The delineation factor**: When a manager has multiple products, delineating strategies is critical. The GP's internal team, as well as current and prospective investors, must clearly understand the investment criteria for each product. This helps with marketing on the GP side and categorization and portfolio construction on the LP side. Asset/investment size, investment stage, security type, geographic location, sector, allocation hierarchy, core/value/growth, etc., are some common delineators used to separate fund strategies from one another. The GP has to monitor the potential for overlap and provide sufficient information for LPs to assess which of the GP's core competencies they believe are advantageously transferable to other areas that the new products will focus on.

- **Asset gathering fear**: I think the term "asset gatherer" is mentioned much too often in the private investing world. This term is one of LPs' most dismissive and subtly manipulative tactics, used to dump a manager or dissuade other investors from considering that manager. It packs a real punch. LPs are very aware of the seductiveness of additional fees (with relatively minor additional effort) to GPs. Although having multiple products does not automatically make a GP an asset gatherer, it quickly flashes a hazard light that most LPs notice and will likely explore through various questions. Rightsized non-flagship funds with clear delineation criteria and logical justifications for their creation can shield GPs from the "asset gatherer" moniker, at least for a period.

- **Culture dilution**: When a GP manages one product and the entire firm is focused on that specific product, it is relatively easier for a culture, mindset, and philosophy to coalesce around that product than to rally the firm's people and infrastructure around multiple products. As new products are added to the lineup, and different people, processes, and data are used to stand up the new products, there is a high potential for culture and goal distortion. Many GPs with multiple products will challenge this premise by stating that all their products germinate from a core thesis, philosophy, and/or skillset, so they believe they can keep culture intact. Additionally, GPs try to cross-incentivize the different product teams to avoid the over-siloing of ideas and ensure broad collaboration. I applaud all these efforts, but from my due diligence experience on managers with multiple products, it is quite easy to quickly find the product teams that exude "favorite child" syndrome and the ones that feel underappreciated. Either way, if not monitored with eagle eyes, culture can take a real hit as the number of products grows.

- **Operational risk with added complexity**: This point is an amalgamation of all the previous points. With multiple products, GPs must consider many things besides investing LP capital. The back office accounting and valuation of various diverse funds, the legal implications of each product, the human resource ramifications of additional personnel working on different projects, the fundraising timelines for the different products, the management of the various LPs with distinct needs based on the funds they are committed to, the compliance hurdles, and the constant need to show alignment while defending against perceived conflicts of interest, are all operational realities that add complexity. Such complexities require time, attention, and resources to ensure a smooth-running ship. Unfortunately, these complexities also lead to a self-fulfilling prophecy of increased product proliferation because they require more capital to overcome effectively, and hence, more fees are needed.

- **Takeout target**: The successful launch of multiple products signals to the world that a GP is skilled at managing a complex organization. It also shows that a GP has been (and will likely continue to be) able to convince LPs to commit capital to products other than its flagship strategy. In today's world, these signals attract a multitude of strategic acquirers seeking a stake in, or full control of, the GP's management company. These acquirers promise the GP relatively instant lump-sum monetization, capital for additional growth (yes, you guessed it, more products), help with GP commitment amounts for each of their vehicles, marketing support, etc. LPs worry about such scenarios because they can adversely affect GP/LP alignment, enhance key person risks, decimate internal culture, warp incentives, and create financial instability (depending on fee-sharing/economic terms).

I must stress that a GP's management of multiple products should not automatically be considered negative. Many GPs with multiple products have stood the test of time and thrived as independent (or even partly owned by outsiders) value-creation conduits for their LPs. Yes, some steer investors to take a piece of all their products, if they want access to the most cherished one, and yes, some fail miserably at ginning up interest for non-flagship products. However, as the saying goes, "water will always find its level, " LPs will almost always know how and where they want their exposure to a manager to reside. If there is proof and thoughtful justification that a product can create value, LPs will show up, whether it is a standalone product or part of a larger family.

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