"Chasing Institutional Unicorns": The Challenge of Marketing and Raising Assets For Small Hedge Funds

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Unicorns are mythical creatures, rarely if ever seen, though some believe that they did once roam the earth. They are often depicted as virtuous and believed to grant wishes. Similar thoughts can be applied to institutional investors and their relationship with small hedge funds.

Despite the ever-increasing body of research that demonstrates smaller hedge funds out-perform larger funds (Analytics firm PerTrac reported that funds with less than $100 million AUM have outperformed larger funds in 13 out of the last 16 years), allocations remain directed to the largest of managers, those with $5 billion AUM and greater. About $0.96 cents of every dollar allocated to hedge funds is directed to the largest funds and it's fierce battle for the remaining $0.04 cents!

Candidly, now more than ever intelligent marketing processes have become as critical as investing expertise and exceptional returns in the ability to raise assets, particularly for smaller funds. However, most small funds lack intelligent marketing, which is perpetuated and exacerbated by discussions that focus allocation discussions regarding small managers on institutions.

Of the 8,000+ hedge funds, 7,000+ have AUM less than $250 million and 75% are under $100 million AUM. In Asia, the majority are sub $25 million AUM. Regardless of geography, discussions about institutional allocations and small funds are largely noise due to structural limitations and operational considerations in the management of fiduciary assets. Institutional investors typically seek to place allocations of $25-$50 million on average. Such larger allocations can only be accommodated by funds with AUM of at least $250 million, which enables large investors to comfortably remain within their concentration limits by not exceeding a certain percentage of a fund's AUM (usually 5%-10%). (**The mean size of an institutional allocated hedge fund is $565 million AUM**.) More importantly, the operational infrastructure and requirements to manage fiduciary assets are considerable. In addition, institutions and consultants seek funds that have a minimum "audited" track record of 2-4 years. These requirements exempt most small funds from institutional marketing and fundraising.

Also, Funds-of-Funds while remaining integral components in the allocation and distribution of hedge funds are becoming less viable as an allocator for small funds given the increasing pressures of scale, fee compression and declining AUM. In addition, seeding and the appetite for incubation has abated. Candidly, the entrepreneurial transition from prop desk employee to business owner can be difficult. In sum, institutional segments are generally NOT appropriate or suitable for the vast majority of small managers. Still, most waste valuable TIME, EFFORT and MONEY "***chasing institutional unicorns***".

The most important and historically critical investor segment for embryonic hedge funds is private wealth: ultra high net-worth individuals and single/multi-family offices. Many of today's best-known hedge fund managers were launched with investments from wealthy individuals and families. However, now significant impediments exist in reaching and receiving allocations from such investors efficiently. The private wealth segment is highly-fragmented, highly-idiosyncratic and highly-intermediated. The depth of knowledge and experience with hedge funds varies widely among such investors as well as those who reference themselves as consultants or advisors to these ultra-affluent individuals and families.

While the challenges for a small hedge fund are admittedly significant, the opportunities are as well. Some believe the removal of advertising and solicitation restrictions on hedge funds via The JOBS Act will be a catalyst for smaller funds to better compete with larger funds, source new investors, get beyond initial launch networks and traditional segments as well as reach investors and intermediaries in more efficient and effective ways. However, it may be an opportunity squandered if small hedge funds continue to fail implementing intelligent marketing processes and the associated infrastructure to promote effective marketing and efficient fundraising. The days of promoting pedigree and returns as the primary marketing tactics to raise assets are gone. Intelligent processes to gain visibility, increase awareness and build relationships within the most appropriate, suitable investor segments and key intermediary channels given the fund profile are vital and at the heart of marketing and raising assets, which by the way are distinctly separate but complementary activities.

The REAL question is not if small funds can deliver exceptional returns but will they "stop chasing unicorns" and become better informed, think more strategically, prepare more astutely and consistently execute marketing at the high-level demanded by a hyper-competitive and stringent fundraising climate.

About Us: Johnson & Company is an Austin,Tx-based hedge fund marketing advisory firm. Our service focus and solutions bring the essential strategic insight and tactical resources to small hedge funds, which provide the basis for economical, expedient, effective and efficient marketing and fundraising execution.

As Founder and Managing Partner, Bryan K. Johnson has 20+ years experience within alternative investments. Previous to launching Johnson & Company, he served as Global Head of Marketing and Business Development for the Alternative Investment Group at Moody's Investors Service (MIS), responsible for the deployment of Operational Quality (OQ) Ratings For Hedge Funds. Prior to his tenure with Moody's, he served as chief expert witness and lead consultant for The Attorney General of Texas and The State of Texas in the evaluation of hedge funds and private equity firms in the acquisition of the assets of Texas Genco in the multi-billion dollar true-up of Centerpoint Energy (CNP:NYSE). He was also Founder, Chairman and Chief Executive Officer of Gotham Bay Partners, a Denver-based Alternative Investment Firm, providing alternative manager selection and analysis as well as asset allocation services to private wealth clients.

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