

## “FAQs for New Fund Managers”

A brief overview of five of the most frequently asked questions (FAQs) from managers planning to raise new private equity and venture capital funds:

### 1. What does a fund need to do to attract institutional investors?

At the very minimum, institutional investors look at 3 criteria when evaluating funds:

- Fund generation – generally should be fund III or beyond, to demonstrate staying power and investor confidence;
- Management team longevity – sometimes hurdles as high as 10 or more years of stable team working relationships are required;
- Size of fund – typically a single institutional investor does not want to constitute more than 5 or 10% of the fund, or invest less than \$10mm, which implies an absolute minimum fund size of \$100-200mm.

In addition to these criteria, of course, like all investors, institutions are interested in a strong, historical investment track record that is projectable to future results.

Exceptions are made in rare instances for outstanding “emerging manager” funds, but the subjective hurdles are high and mostly derivative of the criteria above.

### 2. When do I need to do a PPM?

It's important to have at least four documents – a Powerpoint, the Private Placement Memorandum (PPM), the Limited Partnership Agreement (or LLC Operating Agreement, if using an LLC structure), and the Subscription Agreement – in final form and ready to share with investors from Day 1 of your fund marketing effort.

Until you provide investors with a PPM, you cannot legally ask them to consider the investment; and until you provide them with an LP (or Operating) Agreement and a Subscription Agreement, they cannot give you their formal commitment. Delays in the preparation of these documents necessitate tedious follow-up and can result in tangible lost commitment opportunities. Furthermore, you can't hand an investor these documents the day before you plan to close: you must allow time for them to receive, review, and obtain their own advisors' opinions on them.

### 3. How long will it take to raise money?

Twelve months if all goes well, longer if not. The clock starts ticking when you have your materials together (see item 2. above) and start making actual investor calls; before that, it's all planning and preparation, not fundraising. Think about the target size of your fund, the average anticipated investor commitment, the number of meetings you will need to have per investor (usually at least 3 live interactions), and the inevitable administrative delays in collecting and processing the closing documents, and you will get to a year fairly fast.

This time can be shortened for successive fund generations (II, III, IV, etc.) by (a) re-use of fund documentation and administrative processes, (b) continuous communications with existing investors to reduce the need to “re-sell” the fund, and (c) ongoing cultivation of the potential investor audience to prequalify the likely prospects.

#### 4. Why would I use a placement agent?

It has been reported in the press that 40% of funds use placement agents; the actual percentage is probably much higher. Funds have always used agents for the same reasons that companies use investment bankers to handle their IPOs:

- Preestablished investor network,
- Reduced burden on management, and
- Specific process expertise.

It is a myth that use of a placement agent indicates a lower "quality" fund. If anything, it's indicative of how a fund's partners choose to spend their time – on core investing activities rather than fundraising activities.

#### 5. Who pays for syndication (placement) costs?

There has been a sea-change in the category of who pays the cost of fundraising. Originally the General Partner paid the fundraising expense, so the amount and timing of the cost was limited by the Management Fee the GP was earning. Then the trend shifted to the GP borrowing the fundraising money from the capital calls on the LPs, and paying it back as the management fee was earned. Now at least 50% of the funds in formation charge all or part of the syndication cost to the fund itself, typically with an overall dollar cap. This gives the GP more flexibility in delegating fundraising activities to professionals.

Other FAQs that frequently arise:

- How many managing and/or venture partners are perceived as optimal?
- Are investors expecting "preferred" or hurdle rates of return?
- Should we have a rolling close, multiple closings, or a single closing?
- Should there be rewards/penalties for early/latecoming investor commitments?
- Should we consider an "evergreen fund"?
- How much capital does the General Partner need to contribute?
- Should we accept individual investors, and if so, how many, and on what terms?
- What kind of structure is appropriate for a "side car" fund?
- How flexible should we be in negotiating special terms and side-letters for particular investors?
- Should investors be given coinvestment rights?
- Should we use an exclusive placement agent?
- How should we communicate with investors on an ongoing basis?

These and other pertinent questions will be addressed in future White Papers, and in individual consultation.

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