Emerging Manager Differentiation

The "GP and prospective LP" dynamic is a complex one. The moving pieces are dizzying at best and indecipherable at worst. The asymmetricity at play resembles a game with everchanging rules – an appropriate reaction to this is "nonplussed" – so confusing that parties are unsure how to portray their bewilderment. From an allocator's perspective, I have no rebuttal to this indictment. Analysts try to make the playing field as level as possible by asking GPs unbiased questions (to the best of their ability), requesting information in a standardized manner, and assessing information using internal metrics that aim for broad consistency. However, just like in the real world where very little is standard, cookie-cutters have also proved to be useless tools in the world of private assets investing. Biases creep in, lessons learned from prior scars diffuse the reliability of seemingly bulletproof theses, and idiosyncratic preferences sometimes make final decisions look erratic.

The investment world is filled with haziness, fallacy, and uncertainty – successful navigation through these obstacles is what eventually creates alpha (excess return). The difficulties that exist when GPs attempt to uncover how LPs choose where to invest have led to the formulation of the amorphous term "differentiation". In addition to providing an umbrella definition for truly unique characteristics, this term protects analysts from probing process questions when detours are taken (for the right or wrong reasons) during due diligence. I am just as guilty of frivolously bandying the term as the next analyst, and I am also very aware of how hard it is to convey its meaning succinctly. However, I believe that some guidance would be helpful to emerging managers still wading through the muddy waters of LP jargon. Below, I list a few manager traits that deservedly/universally earn the "differentiated" tag without too much pushback from LP investment committees.

- **Unique perspective within a niche**: Sector-focused managers tend to be viewed as more differentiated than generalist ones. The ability to prove a unique perspective within an already pre-defined niche/sector adds validity to your overall differentiation. For example, if you are a healthcare-focused manager who can prove that your unique expertise lies in regulatory navigation or the bottlenecks that exist within big pharma, you have a better chance of being ordained as differentiated compared to a manager who just highlights investment strength in, say, healthcare services. This is not to say that a generalist manager or a broad-skill manager cannot be viewed as differentiated, they can, but the bar tends to be higher.
- **Thoughtfully assembled team**: An investment and operations team carefully built to form a skeleton key able to unlock value in a targeted market segment can garner "differentiation" appeal. Early in a fund's life, the team is usually made up of people who were there when the fund creation idea was born, and folks who the organization can afford with its limited management fee income. At this stage, roles seem force-fitted to match existing skills. But in rare circumstances, the roles of the founding or assembled team cogently coincide with exact value creation needs – this is a very good thing and can go a long way in earning "differentiation" stripes. And, if this team has been working together for an extended period, bless you, you are differentiated.
- **Networks and deal sourcing**: Some managers have networks that allow them to punch significantly above their weight. Looking at past syndicates the manager has consistently participated in (with relatively smaller check sizes) is a way to verify the potency of their reach. Some managers can demonstrate very low degrees of separation with ease – they can swiftly get to anyone in the world. The high-quality rooms these managers get entry into and the deals that materialize from this high level of access make them differentiated among peers. I am not talking about "proprietary deal flow" which is a

very difficult concept to prove or believe, I am rather talking about a manager's ability to be in the actionable flow of quality transactions with better than average likelihood of success.

- **Just different (x-factor)**: I have come across managers who elude every form of categorization – they are just different in every conceivable way. Their networks are different, their backgrounds are different, their views of the financial industry are different, their views of value creation are different, etc. There is a significant difference between these managers and the norm. Being different in diverse ways does not automatically equate to being "differentiated" – there must be a rational overlay that associates your contrarian nature with the probability of outsized reward – when the association is credibly made, the "different = differentiated" equation becomes true.
- **Same old thing but better execution**: It is sometimes possible to set yourself apart from peers by doing the same general things everyone is already familiar with (and expects) but with better and more disciplined attention to detail/execution. The key here is to underscore how marginal (or more than marginal) improvements increase the potential for successful outcomes. There is some jeopardy in this type of uniqueness because looking too mundane on the surface could limit the number of intro meeting invites - this scenario calls for ingenuity in the presentation of distinctiveness to lure engagement from prospective investors.

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