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AUM Doesn't Grow on Trees

Organisation and Best Practices of the Marketing / IR Function at HFs

September 2019

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I. Study overview

When we last examined the Hedge Fund Marketing / Investor Relations (IR) function in 2012, it was a very different time for the Hedge Fund industry. With the memories of the Global Financial Crisis (GFC) still recent but firmly behind them, Hedge Funds were beginning to settle into a new post-GFC normal; while the total industry inflows were not as eye-popping as the double digits that the industry saw pre-crisis, the industry still saw inflows in the low-single digits and the overall industry grew YoY. Against this backdrop, the 2012 piece focused on helping managers understand the value of the Marketing / IR function and to optimise it in order to participate in the growth the overall industry was experiencing – the title, 'Ready, Set, Grow!', encapsulates the general optimism of the industry back then.

Fast forward to present day, the environment is starkly different. Flows on average have been negative in the last three years, and 2018 was the first year since the Global Financial Crisis that the industry saw a decline in overall industry AUM, through a combination of both negative flows and performance. In light of these challenging times, we believe this study is also aptly named, since just like money, "AUM Doesn't Grow on Trees". Our re-examination of the Marketing / IR function is intended to help managers better navigate the current challenges, as they seek to reshape their Marketing efforts to fit this new environment.

Methodology:

The team primarily used three different sources to ensure depth and breadth of data for our analyses:

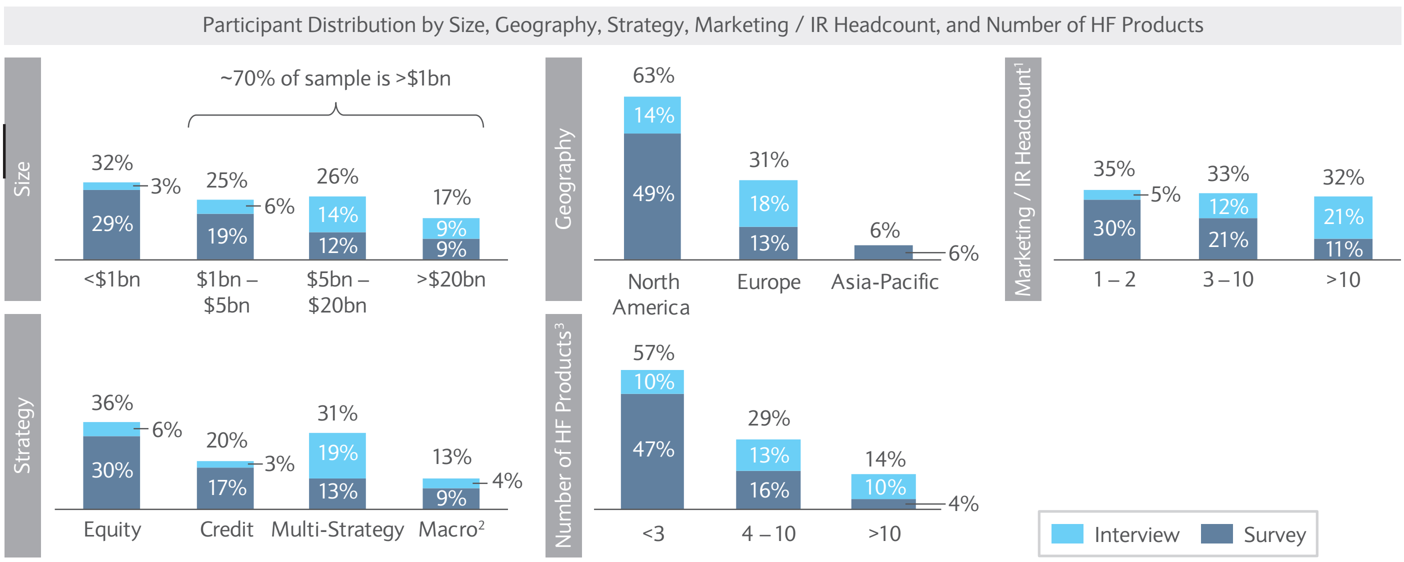
- Conducted surveys and interviews with 71 HFs, with ~$770 billion in AUM
- Survey of >175 investors during 2nd quarter of 2019
- One-on-one discussions with select investors

This report is largely based on the input we received from 71 HFs. The distribution of the participants can be seen in Figure 1 along five dimensions – size measured by Assets Under Management (AUM), geography, Marketing / IR headcount (HC), strategy, and number of HF Products. Select highlights:

The HF managers we spoke with represent roughly $770 billion in total AUM, or almost 25% of the HF industry. The managers were fairly well distributed across the AUM size categories, which should help illustrate the differences between the various approaches larger and smaller HFs take towards their Marketing / IR functions. ~70% of the sample had over $1bn of AUM – 25% had $1bn – $5bn, 26% had $5bn – $20bn, and 17% had >$20bn. ~30% of the sample had less than $1bn in AUM. We strove to have more direct conversations (i.e., interview rather than a survey) with the larger managers to understand the nuances and contexts around the organisation and strategy of their Marketing / IR function.

- ~60% of respondents were from North America, followed by ~30% from Europe, and the balance from Asia
- The breakdown by Marketing / IR HC shows a pretty even split by team size, with 35% of respondents having 1 – 2, 33% of respondents having 3 – 10, and 32% of respondents having over 10 team members
- By strategy, there was a skew towards Equity and Multi-Strategy, at 36% and 31%, respectively.

FIGURE 1: Study Participant Profile



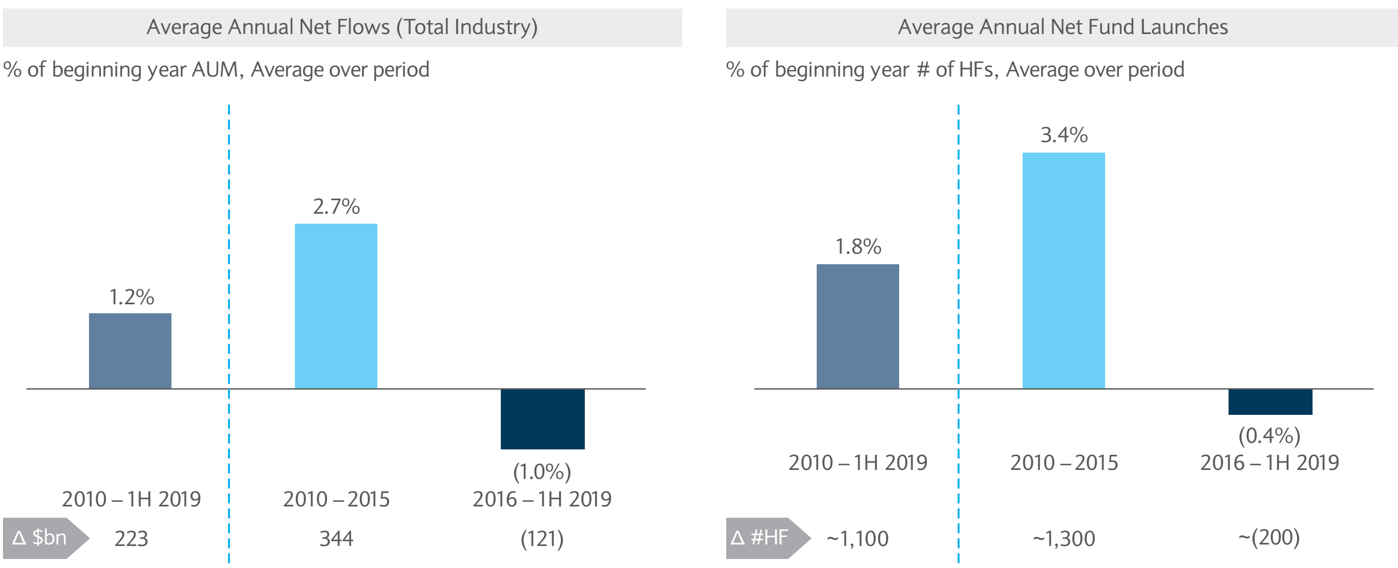
Source: All figures refer to Strategic Consulting survey and interview results only. The results presented are derived directly from a relatively small number of respondents and therefore are indicative only and not meant to reflect conclusive industry trends; 1. The marketing function not only includes marketing, but also investor relations and back office team members (e.g., reporting, documentation, etc.); 2. Includes FIRV and CTA Managed Futures; 3. Pari passu managed accounts are not considered incremental products.

II. Executive summary

The following are high-level observations on the topics addressed in the study:

1. Asset Raising landscape
   a. The past three-and-a-half years have been very difficult for asset raising, the industry experienced ~$120bn of outflows (4.2% of AUM) and ~200 more fund closures than launches (2.5% of funds) from 2016 to 1H 2019
   b. This recent period has been one of the most challenging historically, rivaling or even exceeding the Global Financial Crisis for certain strategies, such as Equity L / S, Disc. Macro, and Special Sits / Activist
   c. However, some strategies fared much better on a relative basis – Systematic Macro / CTA, FIRV, and Equity Market Neutral / Quant generally had the opposite fortunes and saw inflows and net fund launches
   d. While HFs with better performance generally saw better inflows, performance doesn't seem to be the sole determinant of flows, suggesting the need for a strong Marketing / IR function
2. Team Size and Structure
   a. The Marketing / IR function has five core responsibilities: Asset Raising, Asset Retention, Communication, Relationship Management, and Branding – with the focus shifting based on various factors such as performance, firm maturity, etc.
   b. On average, the Marketing / IR team is 7% of total HC, though this ratio depends on the business model the manager chooses – we identified three high level types: Client Focused model, Balanced model, and Investment Focused Model
   c. As AUM grows, the Marketing / IR HC grows as well, though not quite at the same pace, which is driven by economies of scale chiefly achieved by increasing the average ticket size
   d. Compared to 2012, managers have increased their average ticket size, but decreased the number of investors per Marketing / IR HC to try to increase the service levels offered to their larger clients
3. Sales Process
   a. Managers convert ~5% of their prospects into new clients – conversely, investors allocate to ~3% of new HFs they meet
   b. Marketers generally spend half of their time on prospects / new investors but, compared to 2012, they have been much more successful raising capital from existing clients (e.g., the proportion of capital raised by $5bn+ HFs from existing investors went from 50% to 65%)
   c. The difficulty in raising assets from new clients is also reflected in the costs – it now costs ~3.5x more to raise assets from new investors than from existing ones
   d. HFs use various KPIs to evaluate the performance of their Marketing / IR team – the three most prevalent KPIs are Assets Raised, Assets Retained, and Strengthening of Relationships, which align with the core tasks of the Marketing / IR function
   e. ~75% of managers spend between 5 and 20 bps on Marketing / IR costs.

FIGURE 2: **Asset Raising Environment**



Source: HFR, Barclays Strategic Consulting Analysis.

4. Current Priorities
    a. A key long-term objective across HFs is to build a stable capital base that endures across all market and performance environments – to achieve this goal, they seek to diversify their investor base, build partnerships with investors, and expand their product offerings
    b. The Marketing / IR role is critical to building and strengthening Partnerships, depending on manager capacity and investor engagement, which it accomplishes by being communicative, sharing knowledge, and becoming a solution provider
    c. Investors appear keen on allocating to multiple products from the same HF manager – ~55% of investors make multiple allocations to the same manager
    d. While launching new products was not necessary to grow, HFs in our sample that launched new products grew more often and by greater magnitudes than those that did not, and managers with multiple products generally had a stable, growing asset base

III. Asset raising environment

Net HF flows and launches

We begin our study by looking at the current asset raising environment for the overall HF industry to understand the headwinds faced by the Marketing / IR team. As seen in Figure 2, from 2010 – 2015, the HF industry saw steady growth, with both net inflows and net fund launches at ~3% per year, translating to $344bn in inflows and ~1,300 net fund launches over the period. However, more recently, the HF industry has been going through a difficult time. Growth has stalled since 2016, as net flows and net fund launches have turned negative. From 2016 – 1H 2019, the industry saw cumulative outflows of about $120bn, and ~200 net fund closures.

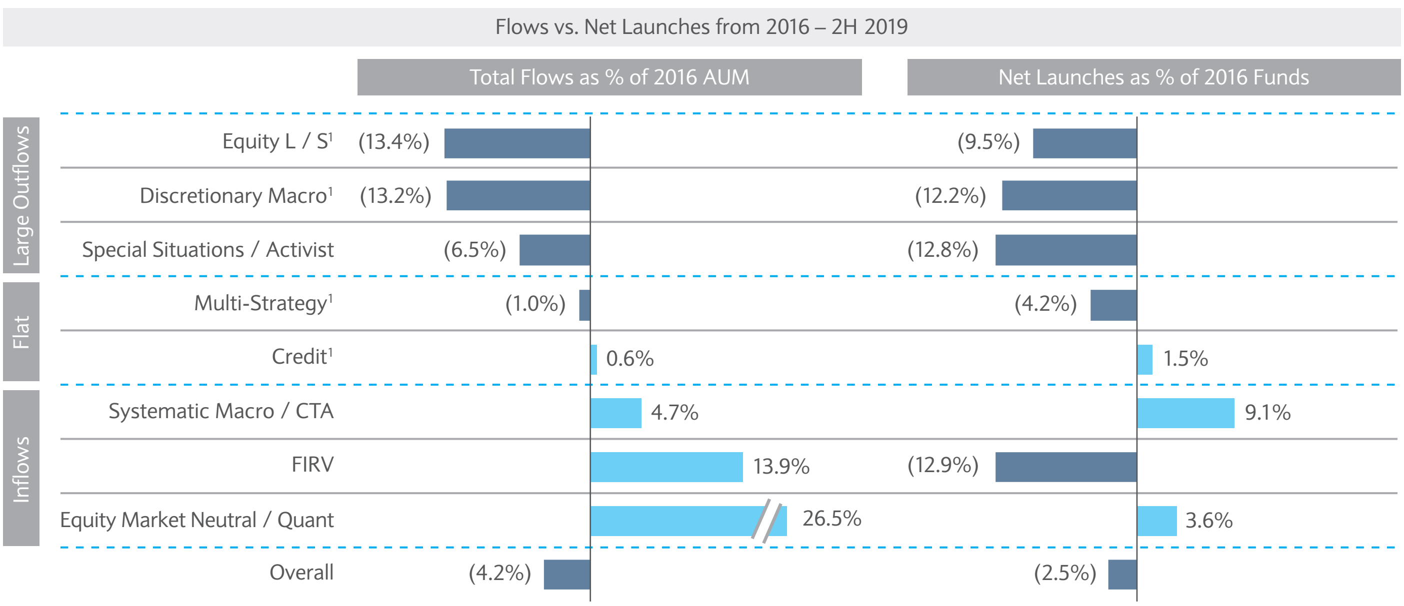
Environment by strategy

The challenges faced by the overall industry do not apply to the individual strategies equally. Breaking down the situation by strategy, a clear diversity of fortunes is apparent. Figure 3 shows the cumulative flows and net launches since 2016 by strategy. Equity L / S, Disc. Macro, and Special Sits / Activist saw both negative flows and net fund closures; Disc. Macro, in particular, was hit hard on both sides, with outflows totaling 13.2% and net fund closures totaling 12.2% compared to 2016. Multi-Strategy and Credit experienced practically flat flows and were either flat or had net fund launches that were slightly negative. The more systematic strategies, Equity Market Neutral / Quant, FIRV, and Systematic Macro / CTAs, garnered strong inflows, and with the exception of FIRV, saw net fund launches as well. FIRV seems to have suffered from net fund closures due to weaker performing funds closing and the difficulty of launching new funds in this strategy. Systematic Macro / CTAs had outsized net launches compared to their net inflows, which may have been due to a new breed of cheaper products having had relatively strong performance in this space.

Recent environment on an historical context

To understand the landscape better, it is important to take a step back and analyse the recent period from an historical perspective. Figure 4 shows 3-year rolling flows in billions of dollars from 1993 to 1H 2019. The left hand side captures the overall industry – there have only been two instances since 1993 when the 3-year rolling flows had a sustained downward trend and dipped into negative territory. The first, unsurprisingly, was during the GFC, and the second is the current period since 2016. While the GFC had steeper outflows, it was over a shorter time period and saw a quicker 'recovery.' Meanwhile, the current period hasn't had as severe a fall (and seems to have flattened in Q2 of 2019), but has continued over a longer period. If we change the lens and look at the results from a strategy perspective, the outflows have been driven by Equity L / S, Disc.

FIGURE 3: Environment by Strategy



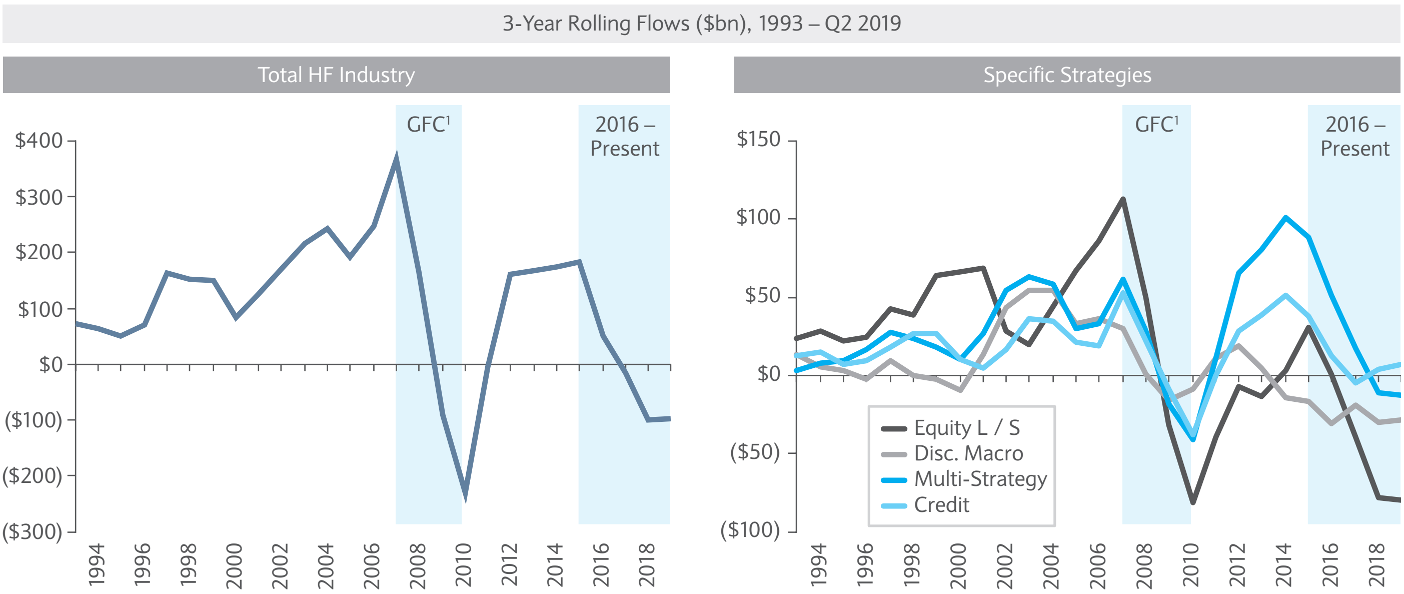
Source: HFR, Barclays Strategic Consulting Analysis; 1. Four largest strategies (combined represent >75% of HF AUM).

Macro, and Special Sits / Activist (not shown). Equity L / S and Disc. Macro are particularly notable – as seen on the right hand side of Figure 4, the current period has had the highest level of outflows (Disc. Macro) since or rivals (Equity L / S) those of the GFC period. Credit and Multi-Strategy have suffered less during the recent time frame compared to the GFC period, while FIRV, Syst. Macro / CTA, and Equity MN / Quant have all experienced positive flows (not shown).

Flows vs. performance by strategy

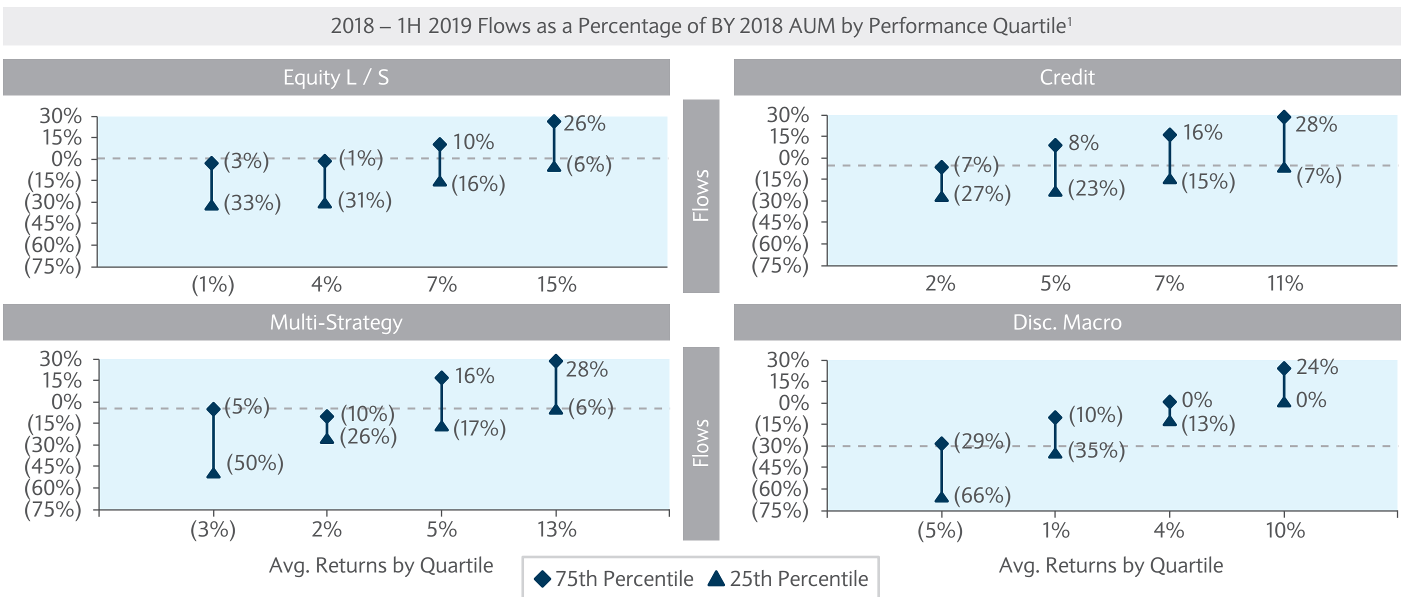
As illustrated by the flows, the current period has been particularly challenging for asset-raising overall. The next question we address is how big of a role performance plays from a bottoms-up perspective in determining the direction of flows. To test this, we divide hedge funds from each strategy into quartiles based on performance, then look at the percentage of inflows within each quartile. Figure 5 shows that while there is certainly a general trend of stronger performers seeing better flows across most strategies, there were funds that performed in the top quartile that had a lower percentage of inflows than some funds that performed in the bottom quartile. This suggests that even though performance is definitely a factor in determining flows, it isn't the only

FIGURE 4: Recent Environment in an Historical Context



Source: HFR, Barclays Strategic Consulting Analysis; 1. Global Financial Crisis.

FIGURE 5: Flows vs. Performance by Strategy



Source: HFR, Barclays Strategic Consulting Analysis; 1. Quartile based on 2016 – 1H 2019 performance of HFs with >$100mn AUM at BY 2018.

factor, which hints at the importance of having an effective Marketing / IR function.

IV. Team size and structure

Marketing / IR team key responsibilities

Before diving into the team size and structure, we want to discuss the five key responsibilities that we identified as falling under the purview of the Marketing / IR function (Figure 6). At a high level, the Marketing / IR team is responsible for asset raising, asset retention, communication, relationship management, and branding. Asset raising and retention have always been key focuses for Marketing / IR teams, but the degree of focus on each depends on myriad factors (e.g., recent performance, maturity of the firm, capacity for additional assets, etc.). Communication and relationship management are notable as they are not only helpful in the first two elements, but also help keep the manager relevant and the investor informed. One of the most important factors investors mentioned in developing deep relationships with managers was around proactivity in their communication. The investors never want to be the last to know news about performance (especially to the downside) or other firm business (e.g., key stakeholder leaving the firm). One of the areas managers' views differed the most was around branding. For instance, only ~15% of managers in our sample are trying to develop a broad brand that is recognisable even to the lay person, approximately 60% have an objective to build a brand targeted to a specific audience (e.g., pension allocators in the US), while the balance (25%) prefer their firm to stay clear of the headlines, essentially aiming to stay completely 'under the radar.'

Marketing / IR team size

Despite the different responsibilities the Marketing / IR team focuses on, it appears that team size is largely a function of AUM. Figure 7 shows two findings from our study: first, the total firm HC grows at a slightly declining rate relative to AUM due to economies of scale and, second, the Marketing / IR team benefits from similar economies of scale as total firm HC, meaning the Marketing / IR HC stays at a generally constant ~7% of total HC. As a consequence of the economies of scale, 'AUM per Marketing HC' grows steadily as AUM grows – it is ~$800mn for $5bn managers, and goes up to $1bn for $10bn managers and $1.3bn for $30bn managers. We found that the economies of scale aren't coming from marketers covering more clients as the firm grows – on the contrary, the number of investors per Marketing HC slightly decreases, from 23 investors per HC at <$5bn to 20 investors per HC at >$5bn. The key driver for the economies of scale is instead coming from an increase in ticket sizes (AUM per investor) as AUM grows – <$5bn managers on average saw ticket sizes of ~$40mn, while >$5bn managers saw ticket sizes of ~$60mn. In essence, larger managers have been focusing on larger clients and providing better services to them. Similarly, when we look at this across time (compared to our 2012 study), the number of investors per Marketing / IR HC has decreased while ticket size has increased, suggesting the overall industry has been focusing on fewer investors that have the ability to write larger tickets.

Team size as a function of business model

While the size of the Marketing / IR team is largely a function of AUM, there is an additional nuance, dependent on the choice of business strategy the manager chooses. Based on our sample, we defined three business models for HF managers: client-focused, balanced, and investment-focused (Figure 8). The client-focused model has a higher Marketing / IR HC to focus on client servicing and build out client relationships. It's similar to how long-only managers approach their Marketing / IR team, with local presence across investor hubs. The client-focused model not only has a higher average Marketing /IR HC (13% of the overall firm HC) but the percentage of Marketing / IR HC typically grows relative to overall HC as AUM increases. This is because the client-focused managers are able to scale the investment function better than the Marketing function (for example, with the growth of long-only products). The balanced

FIGURE 6: **Marketing / IR Team: Key Responsibilities**

Key Responsibilities across the Marketing / IR Team	
Responsibility	**Description**
Asset Raising	• Provide capacity to both existing clients and new investors • Leverage a 'warm' pipeline for when performance is strong, new products are available, fit with investors portfolios make sense, the forward looking opportunity set is bright, etc.
Asset Retention	• Stem redemptions – leverage relationships, communication • Present different products to exiting investors as an alternative – some managers have a broad portfolio, which they leverage to prevent capital from the leaving the firm
Communication	• Provide regular and proactive updates, including performance (e.g., explanation of good/bad performance) • Share other relevant news (investors don't want to be the last to know): changes to firm, new products, negative headlines, etc.
Relationship Management	• Deepen relationships with key decision makers, create additional touch-points between manager and investor • Identify investors' needs and find solutions, both within the HF and outside of product set
Branding	• Develop a brand strategy that aligns with the objectives of the firm (from 'off the radar' to 'universal') that is sustainable over time – Limited – Actively avoid all press (both positive and negative) and 'stay under the radar' – Targeted – Focus on developing brand amongst specific investor channels or regions (e.g., Japanese Pensions) – Broad – Brand building across all investor channels, including retail investors

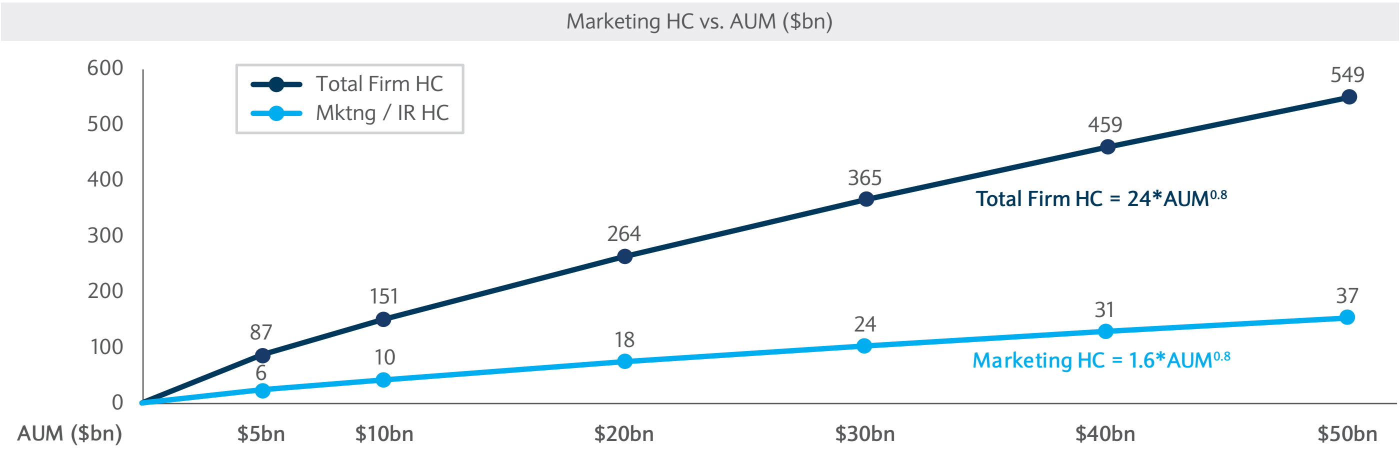
Source: All figures refer to Barclays Strategic Consulting survey and interview results only.

model is, essentially, the 'average' we represent in Figure 7. Finally, investment-focused managers focus more on building out their investment HC compared to their Marketing / IR HC (which, on average, represents only 3% of total HC). Due to this, Marketing / IR presence is concentrated to a few key metropolitan areas (e.g., NY, London, Hong Kong, etc.). Investment-focused managers also have fewer products (3.3 products vs. 5.2 for client focused on average) and are skewed toward less scalable ones. Contrary to what happens to client-focused managers, the percentage of Marketing / IR HC decreases as AUM grows.

Marketing / IR team by level of seniority

After analysing the size of the Marketing / IR teams, we turn our attention to the composition of these teams based on the seniority of the team members as the team size grows. Figure 9 illustrates how the share of mid-level / junior staff increases with AUM. The growth in percentage of junior / admin staff as the AUM grows makes sense since larger firms deal with bigger existing client bases and junior team members tend to focus more on IR than marketing. The percentage of senior partner level HC steadily decreases as the teams grow in size, since the senior members tend to have more leverage from the more junior staff. Eventually, senior Marketing / IR hiring tends to focus on filling out specific coverage needs (e.g., heading up Consultant relations).

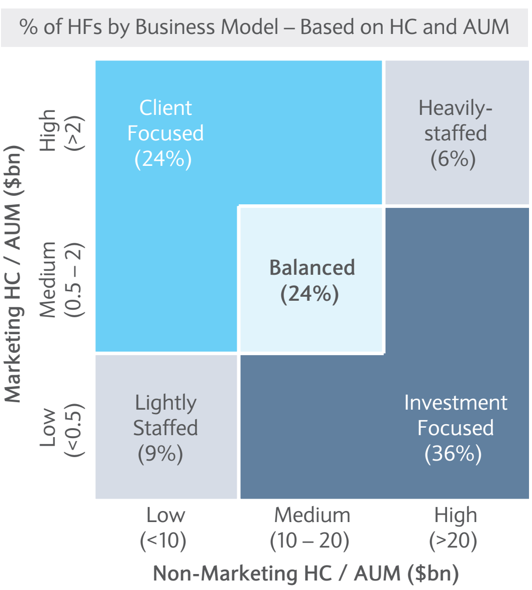
FIGURE 7: Marketing / IR Team Size as a Function of AUM



AUM ($bn)	$5bn	$10bn	$20bn	$30bn	$40bn	$50bn
AUM ($bn) / Mktng. HC	$0.8	$1.0	$1.1	$1.2	$1.3	$1.4
Mktng. HC / Total HC	7%	7%	7%	7%	7%	7%

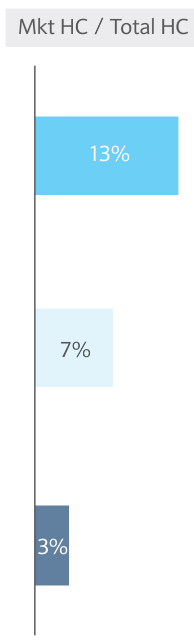
Source: All figures refer to Barclays Strategic Consulting survey and interview results only; Note: Regression computed for all firms with a total Headcount of at least 25 people.

FIGURE 8: Team Size as a Function of Business Model



Source: All figures refer to Barclays Strategic Consulting survey and interview results only.

Business Models and Implications on Marketing / IR Team Size	
Client Focused	• Higher Marketing / IR headcount to focus on client servicing and building client relationships • Similar to L / O model, with local Marketing / IR presence across investor hubs • As AUM grows, the % of Marketing / IR HC over total firm HC increases
Balanced	• Average Marketing / IR headcount to sufficiently service clients • Marketing / IR presence concentrated to key regions, with additional satellite presence • As AUM grows, the % of Marketing / IR HC over total firm HC is constant
Investment Focused	• Lower Marketing / IR headcount, more focus on building out investment headcount • Marketing / IR presence is concentrated to a few key regions (e.g., NY, London, etc.) • As AUM grows, the % of Marketing / IR HC over total firm HC decreases



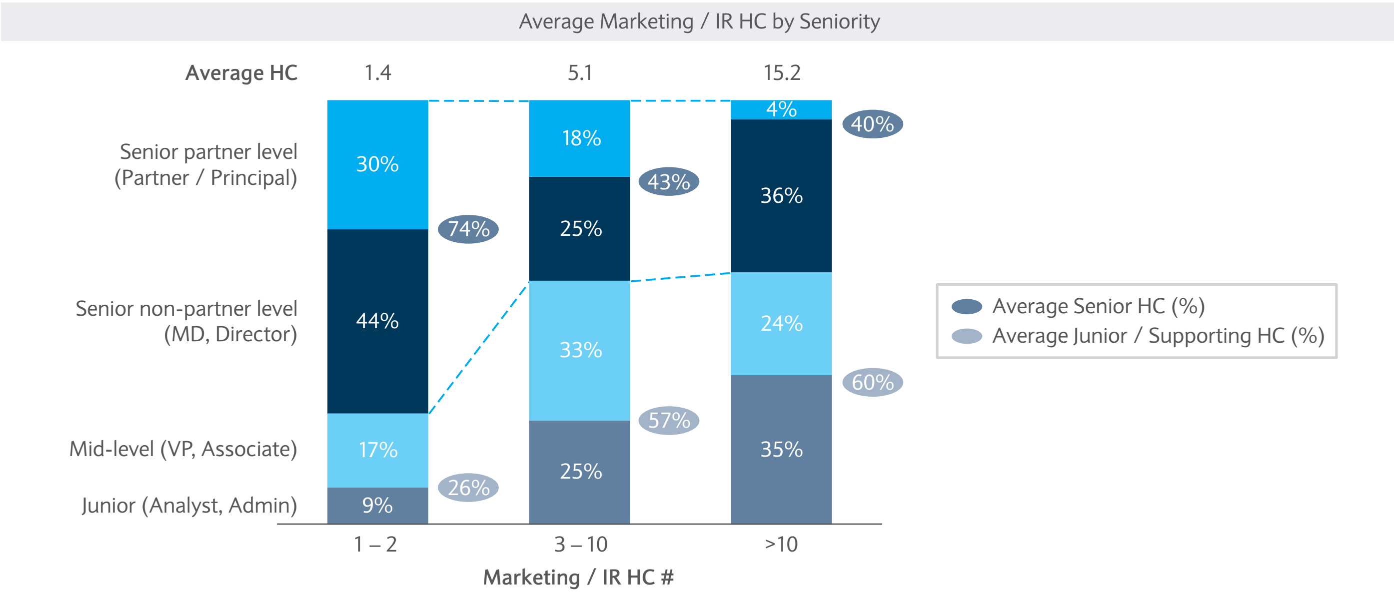
Hiring background

In order to understand how team size increases, we next look into the backgrounds of new hires. Figure 10 illustrates that approximately 70% of the new hires across different seniority levels come from the buy-side (mostly HFs as well as Private Equity and Asset Management firms) followed by 20% from the sell-side (Capital Introductions and other roles, generally across sales and trading), with the remaining coming from a mixture of graduate programs, internal hires, and allocators. Furthermore, when we asked managers what they were looking for when making hiring decisions, it turned out that technical capability (product knowledge) was the most essential characteristic for a new hire – we had the same result after our 2012 study, but it was to a lesser extent (70% of the managers looked for this back then). The need for product knowledge suggests that HFs are looking to reduce the time burden of PMs / Investment Professionals, and looking for someone who can convey credibility and thought leadership when speaking with the investors. Lastly, the two other characteristics to mention when looking for candidates were sales experience (proven sales track record) and expansive relationships (rolodex).

Reporting structure

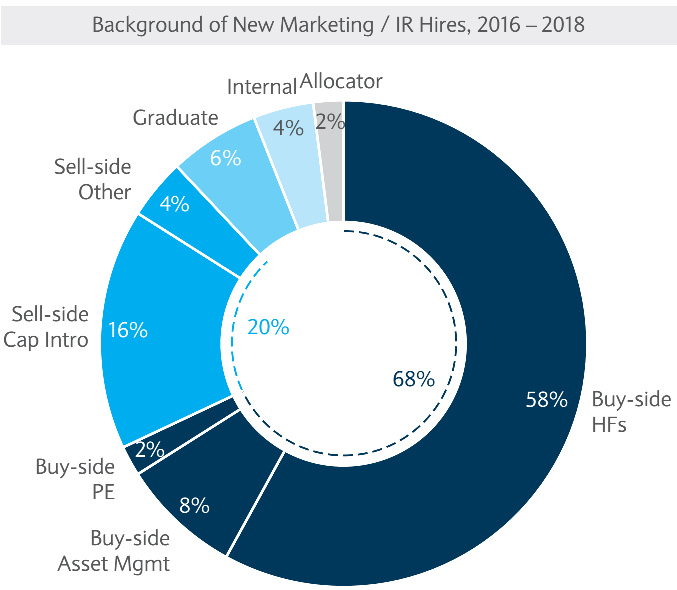
Overall, the Marketing / IR function most often reports to the non-investment side of the business: 60% of our respondents report to the COO or CEO / President – the remaining 40%

FIGURE 9: Marketing / IR Team by Level of Seniority



Source: All figures refer to Barclays Strategic Consulting survey and interview results only.

FIGURE 10: Marketing / IR Hiring Background



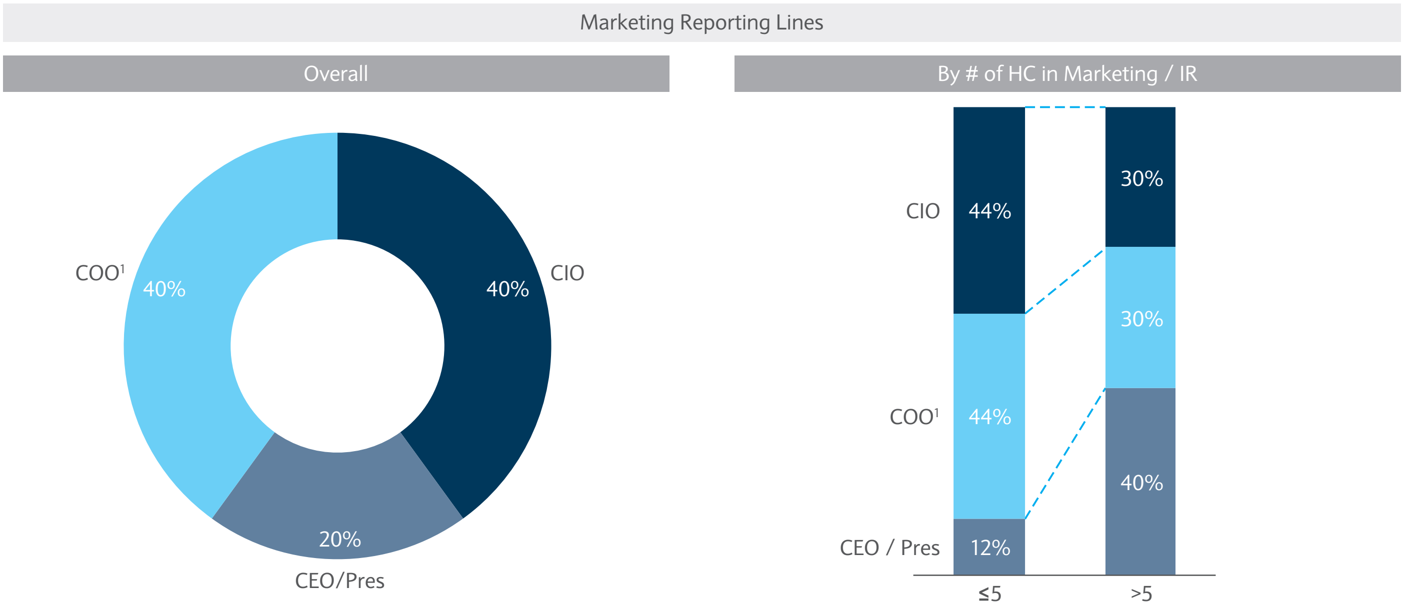
Source: All figures refer to Barclays Strategic Consulting survey and interview results only.

reports to the CIO (Figure 11). However, there appears to be a transition away from both the CIO and COO as firms increase in HC. Essentially, as the Marketing / IR HC exceeds 5, the team is more likely to report to the CEO / President, who is generally in charge of the front office, client-facing roles. This transition allows the CIO to focus on the portfolio and the COO to focus on operations.

Team organisation

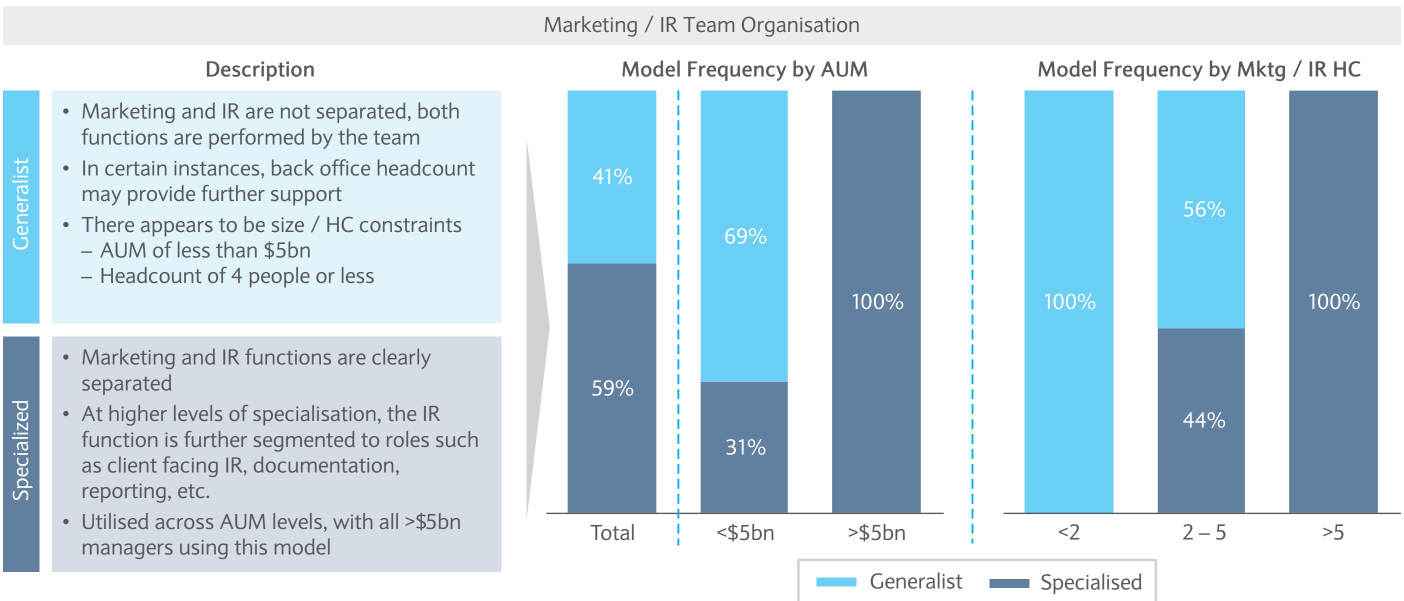
As we delved into the Marketing / IR function, we identified two main organisation models across the teams (Figure 12): Generalist and Specialised. Generalist teams do not separate the Marketing and IR functions and have people that perform both functions. The Generalist structure seems to be constrained to HFs that have less than 4 Marketing / IR HC and AUM of less than $5bn. As we mentioned earlier, the growth in HC brings the need for specialisation across the firm. As such, firms that have more than 5 people in their Marketing / IR team exclusively utilise a Specialised model. At the very least, these teams clearly separate the Marketing and IR functions. Some of these managers take specialisation a step further and segment the roles into client facing IR, documentation, reporting, etc. Managers with a Specialised model generally have a 1:1 ratio between Marketing and IR staff, regardless of AUM, strategy, and team size. It is important to note that both models may have additional support from back office or administration HC.

FIGURE 11: Reporting Structure



Source: All figures refer to Barclays Strategic Consulting survey and interview results only; 1. Includes one CFO.

FIGURE 12: Marketing / IR Team Organisation



Source: All figures refer to Barclays Strategic Consulting survey and interview results only.

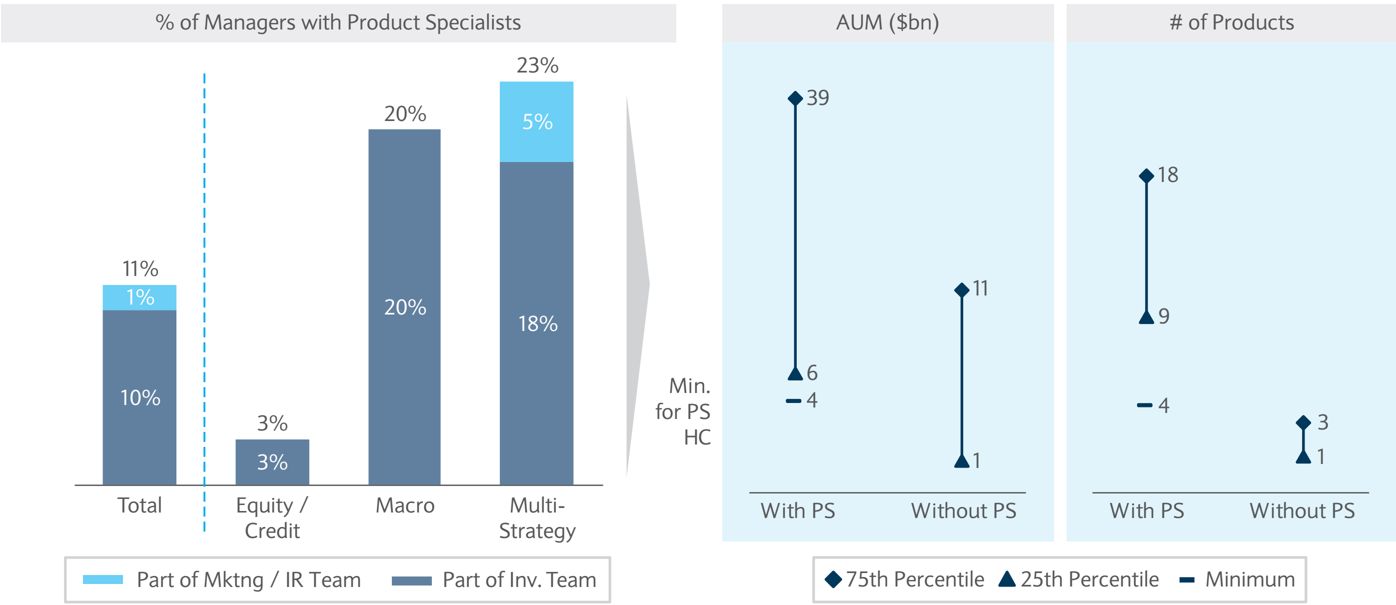
Product specialists

In addition to the HC that sits within the Marketing / IR function, we looked into the role of Product Specialists, who generally support the Marketing / IR function via technical expertise. We found that only 10% of the HFs in our sample have Product Specialists and that overwhelmingly they sit within the investment team (Figure 13). These HFs appear to have come to the conclusion that their Marketing / IR team should be able to "talk the book" at a high level, but that when conversations with investors turn very technical, it is important to have someone that can come in and provide further insight. However, what the HFs are looking to avoid is having another salesperson in the room. Thus, the Product Specialist is a member of the investment team and may be the bridge to PMs who are less available for client meetings. Product Specialists are most prevalent at Macro and Multi-Strategy managers (~20%), which are generally more technical than their Equity / Credit counterparts. As you might expect, more complex managers, based on higher levels of AUM and a greater number of products, are much more likely to have Product Specialists. From our sample, the minimum level of AUM to have a Product Specialist is $4bn and the minimum number of products is also 4, coincidentally.

Coverage model

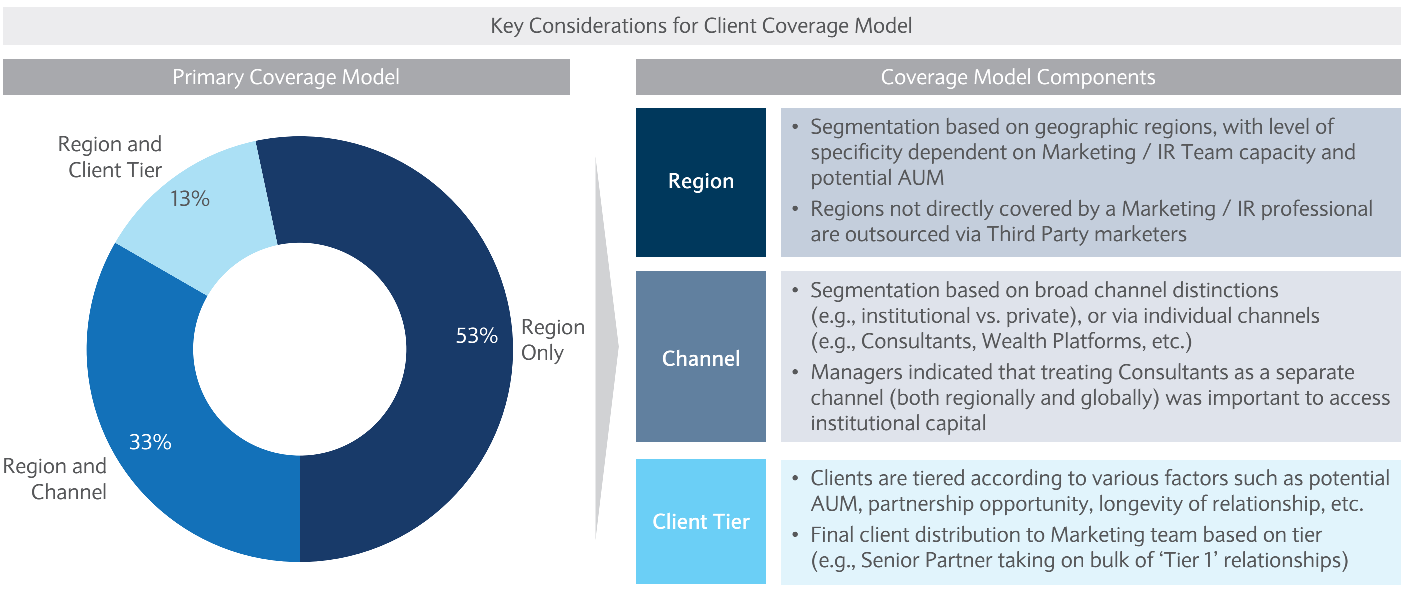
The last question we address related to the organisation of Marketing / IR teams focuses on how managers arrange their sales coverage. Across our respondents, we identified

FIGURE 13: Product Specialists



Source: All figures refer to Barclays Strategic Consulting survey and interview results only.

FIGURE 14: Coverage Model



Source: All figures refer to Barclays Strategic Consulting survey and interview results only.

three coverage criteria that are not mutually exclusive: region, channel, and client tier (Figure 14). All of the respondents indicated they use region as the first factor when establishing coverage. This means that they segment clients based on geographic regions which, depending on HC, could be pretty broad. In some cases where the Marketing / IR team does not have the capacity or reach to cover a specific region, managers may outsource to a third party marketer. The next layer managers add to their coverage criteria is channel. In this case, managers may segment clients on broad channel distinctions such as institutional versus private / intermediaries / wholesale or if the team size warrants, they will go more granular and allocate clients by individual channels (e.g., Pensions, Endowments, Foundations, Consultants, Wealth Platforms, etc.). It is worth pointing out that Consultants are generally covered differently, since they are often not the end allocator (though this is increasing), but a gateway to institutional money. The third mechanism for dividing clients is 'Tiering,' where clients are divided based on the opportunity they represent – which may be based on AUM, potential partnership opportunity, longevity of relationship, etc. When tiering is part of the coverage model, the senior members of the team tend to take a big chunk of the Tier 1 client base, while more junior members take lower tiers.

V. Sales process

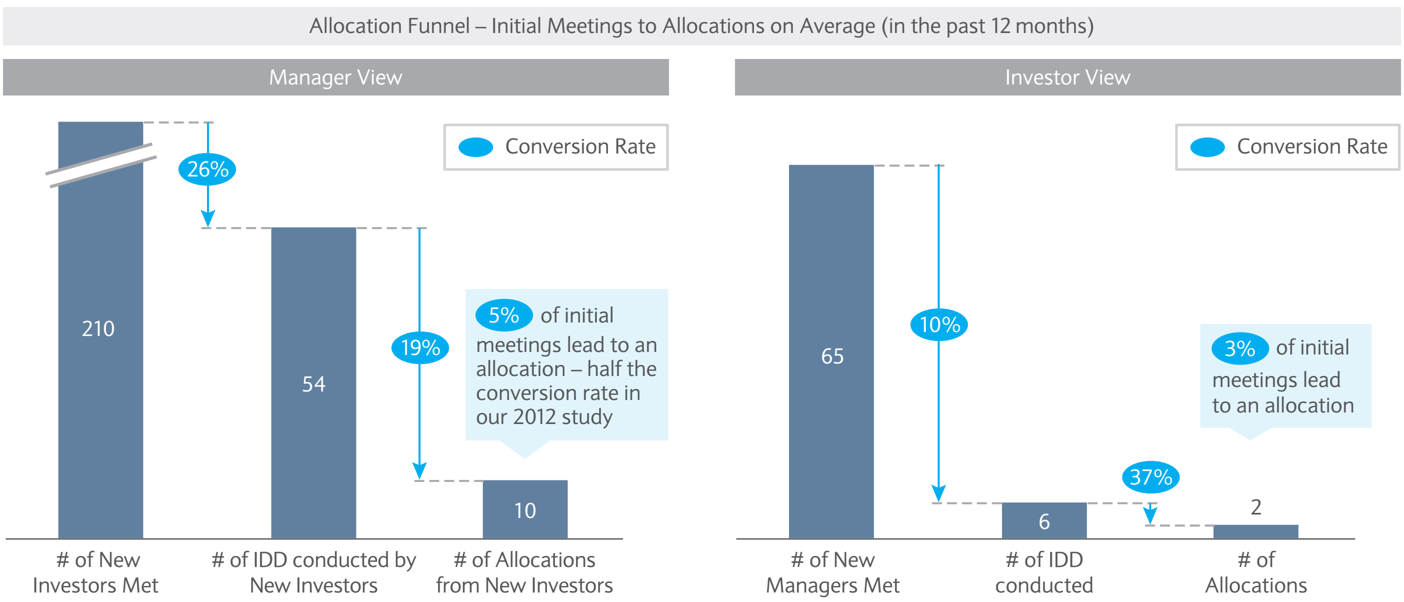
Conversion rates – Manager and investor view

We now shift gears and look at the sales process for the Marketing / IR teams. We start by evaluating the likelihood of converting a non-allocated investor into a client. In the past 12 months, managers indicated on average that they were able to convert only 5% of the new investors they met, which is half of the conversion rate we found in our 2012 study (Figure 15). The picture is not so different from the investor view: on average only 3% of their meetings with new managers translated into allocations. The number of meetings and conversion rates vary based on the manager size and the investor channel. For instance, managers that have more than $5bn in AUM met around 400 prospects in the past year, while this number was only around 100 for managers that have less than $1bn in AUM – this is partly a function of the number of marketers: on average, each sales person met with ~100 prospects and converted 5 of those into new clients. In terms of investors, institutional investors met, on average, fewer managers (~50 versus ~75 for the rest of the sample) and had a lower allocation rate (2% versus 4% for the rest of the sample). The low conversion rates further illustrate the difficulty of asset-raising in the current environment.

Time spent and assets raised by investor type

We now look into how marketers spend their time and what the eventual payoff is (Figure 16). Not surprisingly, it appears that smaller managers (sub $5bn) spend more of their time with and receive a greater proportion of their new capital from prospects than existing clients, which makes sense considering they are often looking to build out their investor base. Meanwhile, larger managers, appear to split their marketing time relatively evenly between prospects (new investors) and existing clients, even though significantly more of their new capital comes from existing clients. Across the board, the managers we spoke with indicated they over allocate time to new investors (prospects) since it is important to keep a "warm bench," even if they were closed or had recent weak performance. Managers have found that even during periods of net redemption or when they are fighting to retain assets, they need to maintain a strong prospect pipeline. This is because it is extremely difficult to rebuild the pipeline once it is turned off, and those investors may eventually replace outflows or fill newfound capacity. Nonetheless, it is worth noting that the payoff from raising capital from existing clients has increased significantly since 2012 among HFs with more than $5bn in AUM (i.e., new capital from existing clients went from 50% to 65% since 2012). This outcome aligns with the findings of our 2019 Outlook study (Crossing Currents), where

FIGURE 15: Conversion Rates – Manager and Investor View



Source: All figures refer to Barclays Strategic Consulting survey and interview results only.

investors indicated they are increasingly consolidating their HF assets in fewer names and further explains why the biggest HFs are only getting bigger.

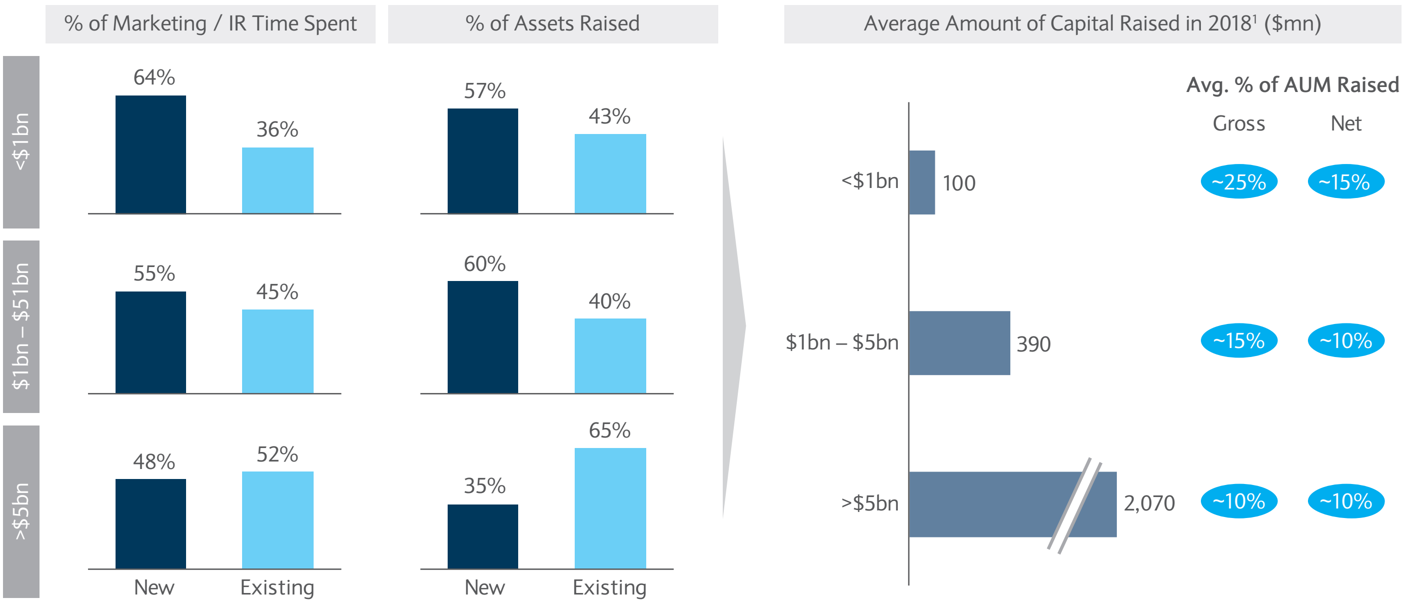
Cost of raising capital – 2012 versus 2018

Next we look at the cost of raising capital from both new and existing clients (Figure 17). We calculate this by factoring in the time spent by the Marketing / IR team on both new and existing clients and the inflows that came from these investor groups, relative to the costs associated with the team split by the time spent on each investor type. The cost of raising capital from new investors is significantly higher (2x – 3x) than from existing investors. Furthermore, compared to 2012, the cost of raising capital from new investors rose, while it remained relatively flat or even slightly declined for existing investors. The cost associated with raising capital from new investors has become much more expensive over the last 6 years due in large part to the aforementioned low conversion rates and prolonged conversion process even when successful.

Marketing / IR KPIs

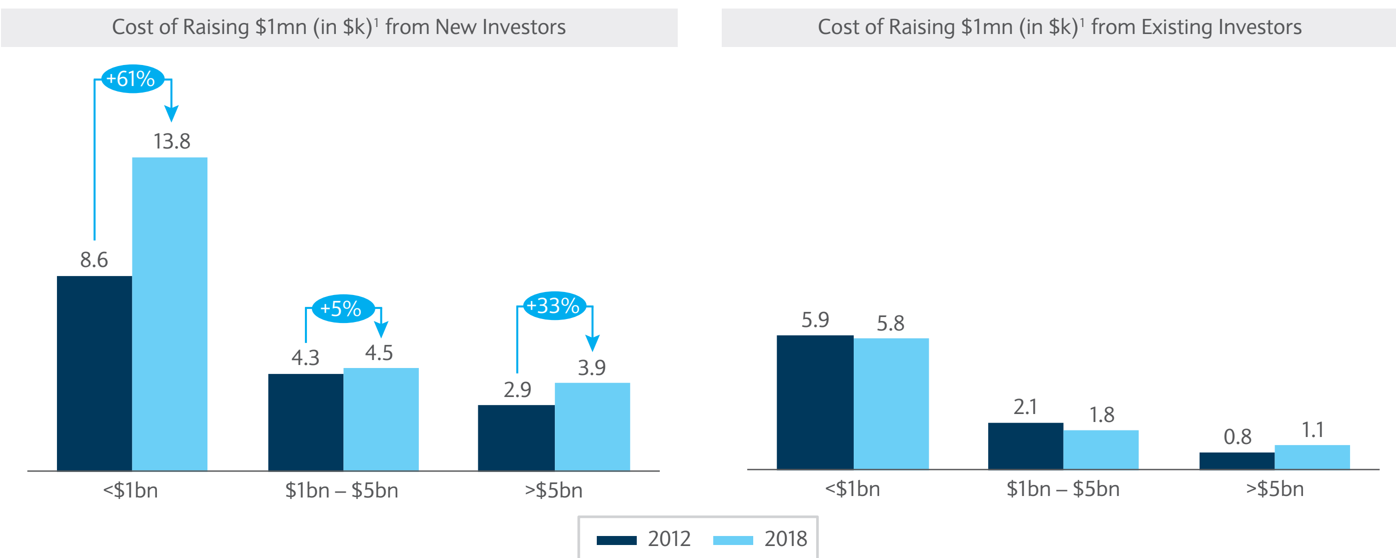
Given the ever changing asset raising environment, managers evaluate the performance of their Marketing / IR teams based on various qualitative and quantitative factors when

FIGURE 16: Time Spent and Assets Raised by Investor Type



Source: All figures refer to Barclays Strategic Consulting survey and interview results only; 1. Our sample is skewed by HFs that received inflows, compared to the industry that had outflows.

FIGURE 17: Cost of Raising Capital – 2012 vs. 2018

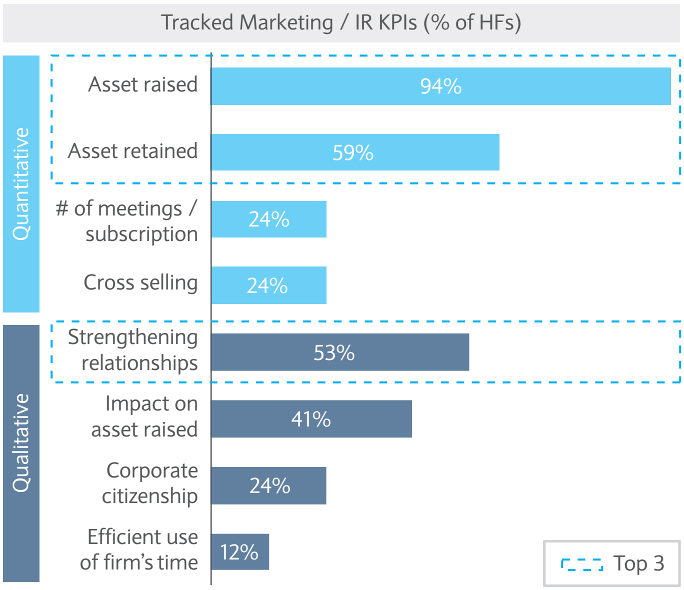


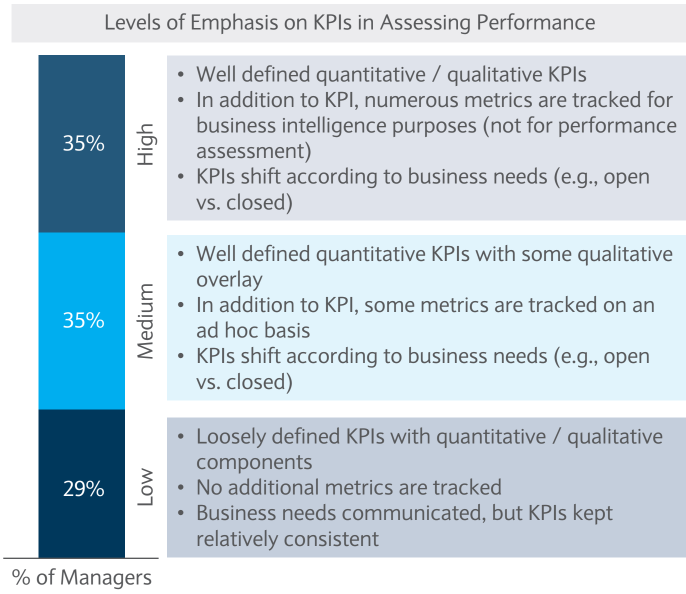
Source: All figures refer to Barclays Strategic Consulting survey and interview results only; 1. Cost of raising $1mn from new investors is estimated by (Total Marketing & IR Cost * % of Time Spent on New Investors) / (Total $ Inflows * % of Inflows from New Investors); 2. Cost of raising $1mn from existing investors is estimated with the following methodology: (Total Marketing / IR Cost * % Time Spent on Existing Investors) / (Total Inflows * % Inflows from Existing Investors * % Time spent by IR on raising assets from existing investors) assessing how to compensate their employees fairly. The three most popular KPIs (key performance indicators) across our sample were: (1) assets raised; (2) assets retained; and (3) strengthening relationships. Additionally, managers track KPIs including number of meetings / subscriptions, cross selling, impact on asset raised, corporate citizenship, and efficient use of the firm's time (LHS Figure 18). However, not all managers put the same level of emphasis on KPIs when assessing performance. Managers were pretty evenly split to Low, Medium, and High levels of rigor regarding their approach to metrics. Finally, while managers clearly took various approaches to KPIs, they did consistently avoid: (1) tying certain metrics directly to compensation; and (2) putting in place metrics that enable 'gaming' of the system.

Compensation model

Following the look into the performance assessment of the Marketing / IR team, we now delve into the outcome – compensation. HFs determine compensation via two models: purely discretionary and discretionary with a formulaic component. The former model applies more to mid / junior level staff, while the latter is more prevalent at Senior (Partner / MD) levels (LHS Figure 19). When we look at how this translates into 'real' numbers, we see that the most senior members at HFs with

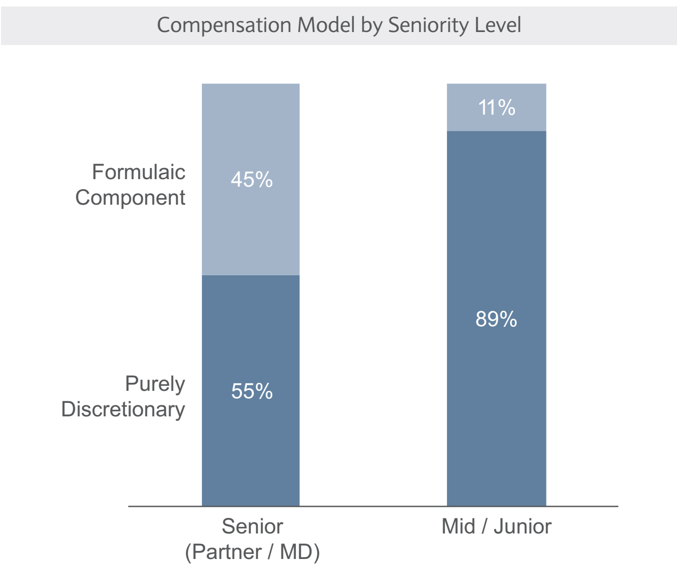
FIGURE 18: Marketing / IR KPIs

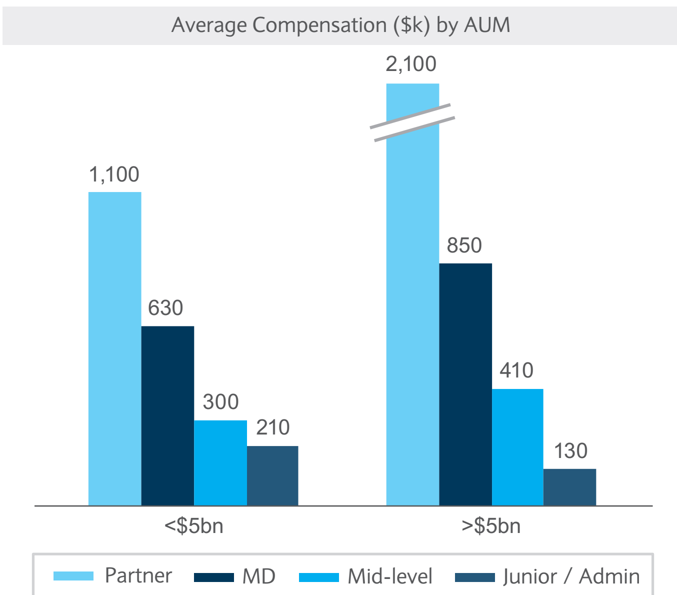




Source: All figures refer to Barclays Strategic Consulting survey and interview results only.

FIGURE 19: Compensation Model





Source: All figures refer to Barclays Strategic Consulting survey and interview results only.

$5bn+ in AUM make almost twice as much as their counterparts at sub $5bn HFs. For the balance of senior and mid-level staff, the $5bn+ HFs still pay more, but the ratio goes down from ~2:1 to ~1.3:1 (RHS Figure 19). At the most junior levels, the smaller firms (<$5bn AUM) earn significantly more than those at larger firms earn – suggesting that junior staff at smaller HFs have more responsibility than those at larger HFs.

Total marketing / IR cost as a function of AUM

Finally, we calculate the overall costs of the Marketing / IR function, taking into account both compensation and non-compensation costs. We found that generally the relationship between compensation and non-compensation costs (e.g., events, conferences, travel, collateral, etc.) was about 70% and 30% respectively on average. The combined costs of the Marketing / IR function as a portion of AUM were rather diverse across managers: ~20% spend less than 5bps of AUM, ~50% spend 5 – 10 bps, ~25% spend 10 – 20 bps, and only ~5% of managers spend more than 20 bps (Figure 20). On average, there seems to be economies of scale for the Marketing / IR costs relative to AUM. For instance, we found that a sharp decline occurs in total Marketing / IR costs in bps of AUM as the AUM reaches ~$12bn, after this point the overall cost flattens at around 5 bps (Figure 20 RHS).

At a more granular level, the Total Marketing / IR costs are also dependent on the choice of business model we described earlier. For instance, as we expected, client-focused managers tend to spend more on Marketing / IR, both in terms of compensation and non-compensation costs (~12bps). On the other hand, investment-focused managers spend significantly lower amounts on Marketing / IR (just under 8 bps).

VI. Current priorities

Upcoming plans

At the beginning of this study we described the difficulty HFs overall have been experiencing in their efforts to raise capital. Given that backdrop, the managers we spoke with had three clear near-term goals: diversifying their investor base, building partnerships, and expanding product offering (Figure 21). Each of these goals serve the long-term objective of building a stable capital base that can support the business in all market and performance environments. Managers are planning to diversify the investor base by assessing potential concentration risk (e.g., impact of regulation on certain channels), identifying relatively overweight or underweight investor segments, and establishing appropriate plans by investor channels, geography, and investor size.

Partnership defined

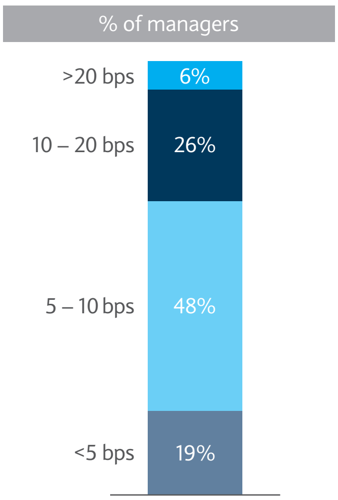
Building partnerships is a more nuanced goal in the sense that partnership is a spectrum rather than a single objective. Both managers and investors indicated that they are selective when it comes to choosing where on the spectrum of partnership they stand – they take into consideration multiple factors such as alignment of interests, resource constraints, etc. Through our conversations with investor and managers, we identified three levels of partnerships, with each building on the previous level: Economic, Knowledge Sharing, and Strategic (Figure 22).

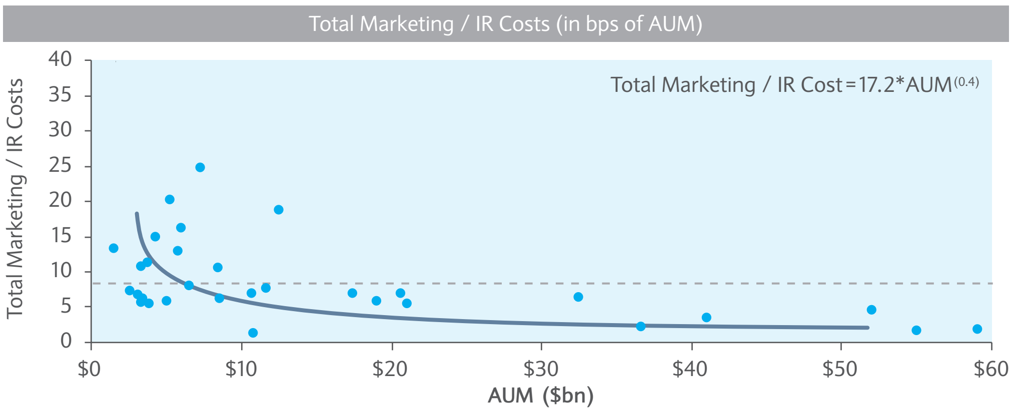
The Economic level is the basic form of partnership where the manager and the investor basically establish an economic arrangement based on a trade-off between fees and / or capacity in exchange for ticket size, longer lock-ups, and / or certain terms. The second level, Knowledge Sharing, brings an often two-way exchange between investors and managers, where views on the market, competitive intelligence, further insight into an allocation as well as non-HF portfolio analysis are shared. The final level, Strategic, involves managers providing customised product offerings and solutions with input and seeding from investors, as well as integration across multiple aspects of the business (e.g., sharing best practices between ops / infrastructure, alignment of priorities).

This final level requires a significant amount of resources from both sides, thus, only happens between large complex managers and large institutional investors. As a function of this, managers that offer multiple products are more likely

FIGURE 20: Total Marketing / IR Cost as a Function of AUM

Total Marketing / IR Costs (bps of AUM)[1]





Avg. Costs (bps of AUM)	Client Focused	Balanced	Investment Focused
Non-Comp (~30%)	3.7	2.4	2.3
Comp (~70%)	8.5	5.7	5.4
Total	12.2	8.1	7.7

Source: All figures refer to Barclays Strategic Consulting survey and interview results only; 1. Total Marketing / IR Cost is split as 70% Comp. Cost and 30% Non-Comp. Cost on average.

to develop Strategic Partnerships – overall ~40% of our respondents have developed Strategic Partnerships.

Partnership's gives and takes

Since partnership is meant to be a two-way street, there is an expectation for both managers and investors to contribute some level of resources at every level. Naturally, as the depth of partnership progresses, both sides keep putting more on the table, while strengthening the previous levels even further (e.g., 'Strategic' partners receive even more robust Knowledge-Sharing). Figure 23 illustrates the progression of resources as the partnership deepens. For example, at the Economic level, managers provide fee reduction for larger tickets and / or longer locks, customised 'super-feeder' structure for large allocations, and terms that align incentives (e.g., hurdles, adjusted crystallisation schedule, etc.). When managers and investors reach the Knowledge-Sharing level, HFs add access to PMs / CIO to discuss trends and outlook on various asset classes, access to various internal teams (e.g., operations, treasury, etc.) to share best practices, customised risk reports, and help with a holistic portfolio analysis (including non-HF portion of the portfolio). Once the partnership evolves into the Strategic Level, managers offer items, such as structured employee exchange programs to develop and share best

FIGURE 21: Upcoming plans

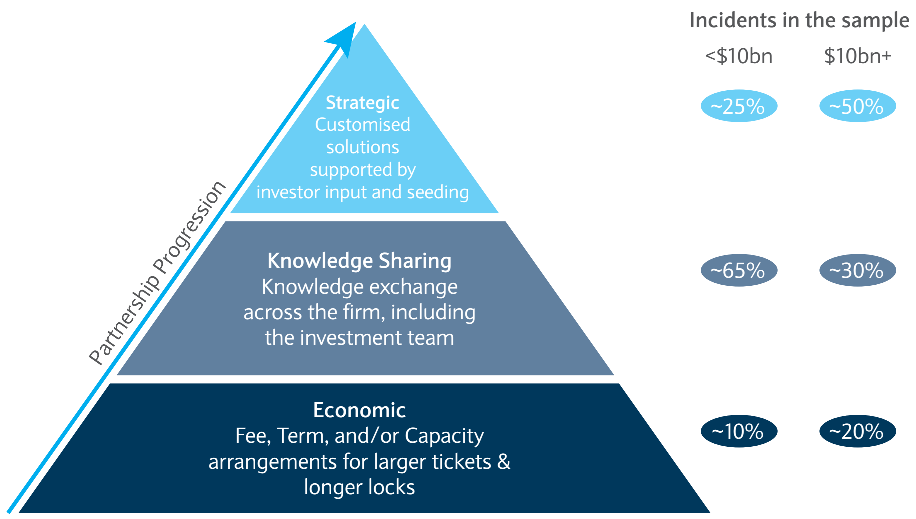
	Near-term Focus	Long-term Objective
1 Diversify Investor Base	• Evaluate current investor base and assess potential concentration risk, (e.g., impact of regulation on certain channels) • Identify investor segments, which may be relatively overweight / underweight • Diversify investor base across various above criteria and establish appropriate plans by investor channel, geography, investor size, etc.	Build a stable capital base that supports the business in all market and performance environments
2 Build Partnerships	• Identify investors to partner with or to strengthen relationships with: – Partnership is a mutual selection process between managers and investors – Relationships with investors need to evolve beyond being a 'returns vendor' • Some examples include increasing access to various individuals across the firm, provide bespoke analyses and reporting, etc.	
3 Expand Product Offering	• Become a solutions provider for current investors and key prospects by expanding the product suite • Identify products not strictly related to the flagship with a particularly strong opportunity set to market broadly	

Discussed further on upcoming pages

Source: All figures refer to Barclays Strategic Consulting survey and interview results only.

FIGURE 22: Partnership Defined

Partnership Models – Manager Distribution (%)



Source: All figures refer to Barclays Strategic Consulting survey and interview results only. *Generally, the communication occurs via the Marketing / IR team, though it may be via direct access to investment professionals.

practices across the firm, joint DD on certain investments, close collaboration across multiple teams, co-investment opportunities, customised products with investor specific mandates, etc.

In addition to these general trends, we observed that most managers are happy to share their insights broadly with their partners, but they are more restrained in offering access to internal human capital. This seems reasonable considering the intellectual capital they create may have scale, whereas investment professionals' time is scarce and does not have scale. Another important observation is that knowledge-sharing seems to have transitioned from exclusively manager to investor to much more of a two-way street.

Marketing / IR role in strengthening partnerships

Taking a step back we want to point out how partnerships develop. It really starts with the investor and their capacity to engage / interest in engaging at a meaningful level with the HFs they are allocated to. There is a significant portion of investors that make an allocation and only want to receive updates on a regular basis and hear from the HF when there is something meaningful to discuss. Then there are investors that see their HF allocations as access to specific capability / insights as well as those that believe the relationship with a manager is far reaching beyond the allocation. Investors who fall into the second and third camps are most likely to engage in developing partnerships with managers. Similarly, there are

FIGURE 23: Partnership's Gives and Takes

Partnership Progression

	'Gives and Takes'	Managers	Investors	Manager Examples
Strategic	• Additional Investment Opportunities	✓		• Structured employee exchange programs to develop and share best practices across the firm
	• Exchange Programs	✓	✓	• Conducting joint DD on certain investments (e.g., co-investments)
	• Integrated Teams	✓	✓	• Multiple teams (e.g., operations, treasury, etc.) working in close collaboration
	• Product Ideas	✓	✓	• Providing co-investment opportunities
	• Seeding New Products		✓	• Creating customised products with investor specific mandates (e.g., higher concentration, ESG filter, etc.)
	• Allocations to Multiple Products		✓	
Knowledge Sharing	• Transparency (e.g., customised reports)	✓		• Providing access to PMs / CIO to discuss trends and outlook on various asset classes
	• Broad access the firm	✓	✓	• Providing access to various internal teams (e.g., operations, treasury, etc.) to share best practices
	• Competitive intelligence		✓	• Creating customised risk reports
	• Visibility into internal priorities (current focus)	✓	✓	• Helping investors perform a holistic portfolio analysis (including non-HF portion of portfolio)
Economic	• Fee Concessions	✓		• Fee reduction for larger tickets and/or longer locks
	• Longer locks	✓	✓	• Customised 'super feeder' structure for large allocations
	• Larger Tickets		✓	• Offering terms that align incentives in (e.g., hurdles, adjusted crystallisation schedules, etc.)
	• Creative Terms	✓	✓	
	• Capacity	✓		

Source: All figures refer to Barclays Strategic Consulting survey and interview results only.

FIGURE 24: Marketing/IR Role in Strengthening Partnerships

Level of Client Engagement

Low → High

Communication	Knowledge Sharing	Solution Provider
• Monthly / quarterly reports covering performance risk, exposure, attribution, etc. • Data accessibility via online portals or data repositories • Proactive and transparent communication of material events – both positive and negative news or events that are related to the performance of the fund or the fund in general	• Conducting bespoke analyses • Providing whitepapers and research reports • Sharing internal resources to help investors (e.g., assisting with non-HF portfolio analysis, sharing best practices on operations and infrastructure, etc.) • Creating additional touch points between the investor and the firm (e.g., senior management, CIO, etc.)	• Showing flexibility and willingness to discuss investor needs – oftentimes, beyond the scope of the product that is currently or potentially allocated to • Acting as a solution provider as opposed to a product pusher • Developing products that support specific investor objectives
Timely and transparent communication fosters investor trust	Intellectual value add beyond just being a 'performance provider'	Investor stickiness via allocations to multiple 'off-the-shelf' as well as bespoke products

Partnership Development

Source: All figures refer to Barclays Strategic Consulting survey and interview results only.

HFs that do not have the bandwidth or economic flexibility to entertain partnerships, even at the most basic levels. With that said, for investors and managers that have a willingness / interest in establishing partnership level relationships, we found that the Marketing / IR function plays a crucial role in the process. The Marketing / IR team is responsible for fostering communication between the manager and the investor, sustaining the knowledge-sharing path, and providing solutions as appropriate during the process of constructing partnerships. Figure 24 illustrates what the Marketing / IR team offers at each of these stages.

Investor interest in multiple funds from the same HF

As mentioned above, one way for investors to partner with managers is to make multiple allocations to the same manager. We found that more than half of investors (55%) in our sample make multiple allocations to the same manager and 70% of these investors have at least 2 of these types of relationships in their HF portfolio (Figure 25). The main reason behind the decision to make multiple allocations to a single manager was 'trust' (~60%): it becomes easier to underwrite a HF where there is a long trusted relationship.

Expand product offering

Considering the relatively widespread acceptance by investors for managers to offer additional products, it seems to be good business for HFs to expand their product offering. Doing so diversifies their portfolio and opens the door for growth. Figure 26 shows that the median number of products for managers that saw their AUM decline was only 1, while those with more diversified portfolios were at least flat, but more often had varying levels of growth. Essentially, what we found was that limited diversification seems to have a barbell effect on growth as some of the managers with limited diversification were relatively flat, while the balance experienced significant growth. Meanwhile, the managers that were well diversified were the most likely to have moderate growth – it seems that they diversified away some of the upside and some of the downside. Another indication of the benefits of adding products can be seen by the comparison of growth between managers that offered new products vs. those that did not. Managers that launched a new product were more likely to experience growth (~90% vs. ~70%) and were likely to achieve a higher level of growth (~70% to ~40%) compared to managers that did not expand their offering. It is important to note HFs that launched new products focused their expansion where they had expertise (e.g., the new product was an adjacent strategy or was a long only (LO) adaptation). Most of the new products were HF related across all AUM levels, while larger managers (>$5bn) were more likely to create a LO product than their smaller competitors.

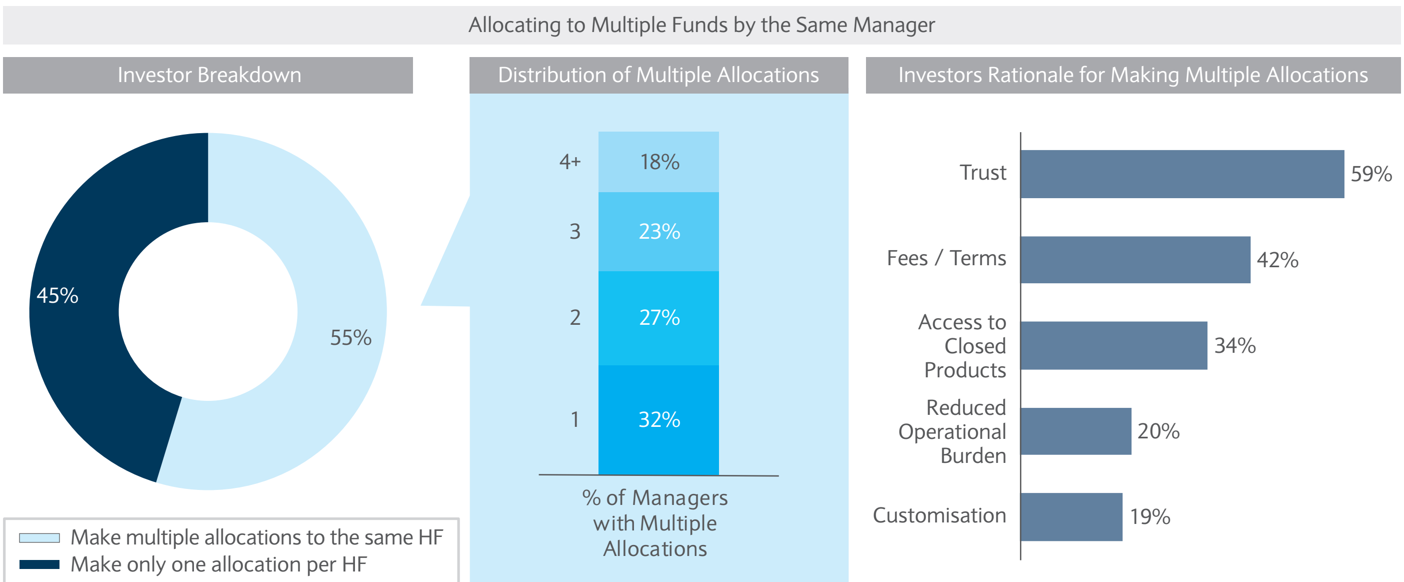
Final considerations

In conclusion, it is important to point out a few items to keep in mind while thinking about the Marketing / IR function and asset raising over the near term.

The efficacy of the Marketing / IR team is critical for a HF to grow and thrive, especially under the current market conditions. The current environment is arguably as challenging as any – it even rivals the Global Financial Crisis conditions for raising capital in some strategies. Not only have there been outflows, even investors looking to make allocations have taken considerably longer to do so (e.g., the rate of converting prospects into investors has come down considerably from what we found in our 2012 study). A key mitigating factor is that existing clients have become a greater source of new capital, especially for $5bn+ managers, and they are much less expensive to raise money from. Furthermore, managers have coped with the new environment by targeting larger allocators and investing in Marketing / IR functions to provide better service, develop stronger relationships, and to continue cultivating prospects. The result has been the desired effect, as the average ticket size has increased over the last 6 years.

When looking at how Marketing / IR teams allocate their time, we need to take into consideration the size and organisation of the team, which depend on the business strategy each manager chooses. Overall, we found that HFs typically have 5 – 10% of their total HC dedicated to Marketing / IR, although the range hides two different business models: the 'client focused' and 'investment focused' models. The client focused model typically

FIGURE 25: Investor Interest in Multiple Funds from the Same HF



Source: All figures refer to Barclays Strategic Consulting survey and interview results only.

has a wide array of products (including a number of scalable ones) and offer a high level of product customisation, which requires a relatively large Marketing / IR team (typically >10% of total HC) to 'push' the different products and work with clients on appropriate 'solutions.' Conversely, the investment focused model has a limited array of products (only one, in some cases) that are typically capacity constrained, which leads to leaner Marketing / IR teams (typically kept to less than 5% of total HC) that lean on a 'pull' marketing strategy, where investors seek out the HF to a greater extent.

Finally, from an asset raising perspective, HFs are trying to build a diverse, stable investor base that understands their business and sticks with them through different market environments and various performance results. Thus, they are looking to develop strong partnerships with key investors. Although there are varying levels of partnership, the ultimate goal, when possible, is to develop the most advanced form of partnership (Strategic), where investors support managers via seeding and allocation to multiple products. It appears that investors are keen to participate in these types of relationships as more than half have allocations to multiple products from a single manager, driven in large part by their 'trust' in their managers. All of this can be seen by the fact that from 2016 – 2018 HFs that launched new products grew significantly more often and by a greater magnitude than HFs that did not expand their product portfolio, and managers with multiple products generally had a stable, growing asset base.

VIII. Capital Solutions

The Capital Solutions team within Prime Services offers a unique blend of industry insights and tailored client solutions for a broad range of issues.

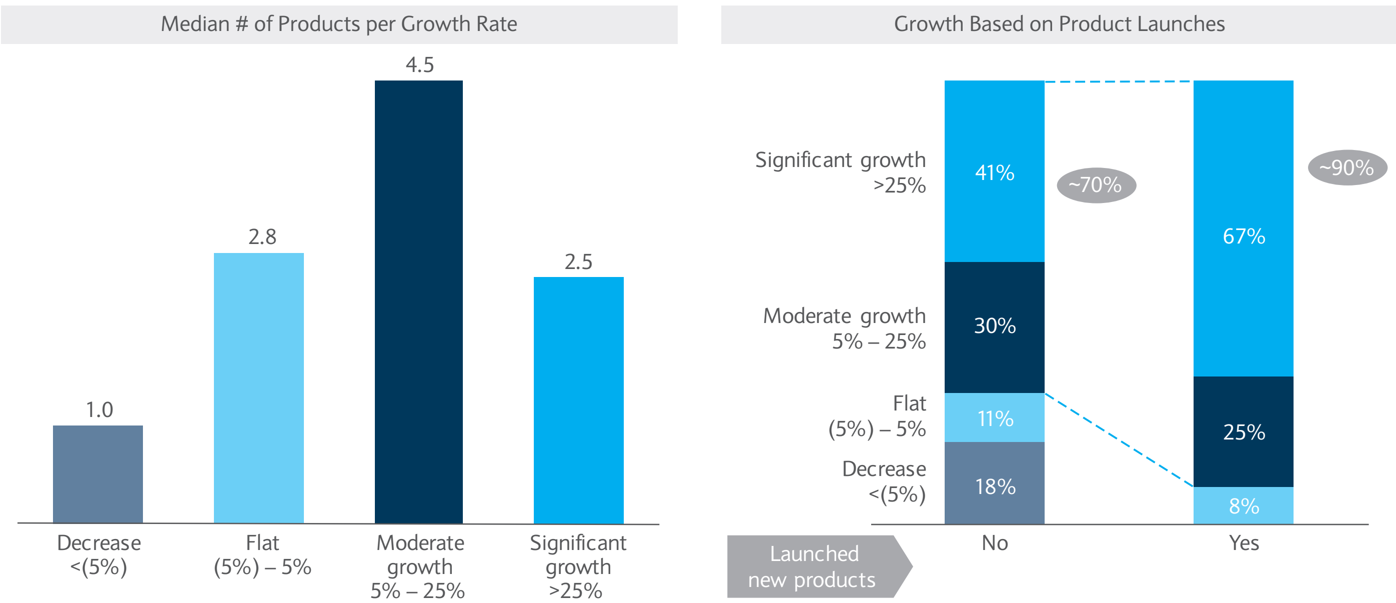
Strategic Consulting

- Development of industry-leading content, driven by primary analysis, on the HF industry and its participants (e.g., HF and FoHF managers, institutional investors, investment consultants).
- Provision of management consulting services to HFs, asset managers, institutional investors and internal management on a wide array of business topics ranging from the launch of a new strategy, marketing effectiveness, product development and organisational efficiency.
- Acting as an HF competence centre internally for Barclays.

Capital Introductions

- Maintenance of ongoing investor dialogue to provide valuable feedback to HF managers.
- Introducing HF managers to a select number of interested investors. Hosting events that provide a forum for knowledge transfer and discussion / debate on industry issues that helps educate and inform both clients and investors.

FIGURE 26: Expand Product Offering



Source: All figures refer to Barclays Strategic Consulting survey and interview results only.

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