CalPERS Emerging Manager Program Review

Project Scope and Process

- **Objective**
  - Identify lessons learned and adopt any additional best practices for investing in emerging private equity managers

- **Methodology**
  - Detailed review of 10 direct emerging managers and 3 funds of funds

- **Panel discussions**
  - Panel of CalPERS’ senior staff, consultants and 9 external industry experts
  - 3 day-long workshop sessions
Investing in private equity in general is challenging for even the most sophisticated LPs.

The private equity industry is mature and increasingly competitive.

Less information available to prospective LPs.

Greater inherent uncertainty as newer teams learn how to work together and execute their strategy, manage a portfolio, face unexpected developments, and build their organization.

Less proven strategies.

Potential distractions arising from fundraising difficulty.
Given their unique challenges, why does CalPERS invest in emerging managers?

- Access the comprehensive landscape of investment opportunities
- Develop relationships with the next generation of core investment managers
- Generate appropriate risk-adjusted returns
Emerging managers should be held to the same standards as established managers

CalPERS generally should **not** invest in emerging venture capital managers

Selectively invest directly when appropriate, but continue to use funds of funds to gain emerging manager exposure

No “secret sauce” alone can explain the success or failure of emerging managers
The study suggested a number of factors that are particularly important, keeping in mind:

- Sample size not statistically significant and selection relied upon some degree of subjectivity
- Some factors are more important than others, and factors that matter most will vary by situation
- Some factors are correlated and there is interplay between the factors
## Best Practices for Evaluating Emerging Managers

### Most Important Factors

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<th>Attractive investment thesis</th>
<th>Prior relevant investing experience</th>
<th>Team dynamics</th>
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<tbody>
<tr>
<td>- Strategies of scale, and repeatable</td>
<td>- Edge in sourcing and relevant industry networks</td>
<td>- Avoid groups with unchallenged single dominant partners able to make unilateral investment decisions</td>
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<tr>
<td>- Sustainable and growing addressable market opportunities</td>
<td>- Relevant investing experience as principal investors</td>
<td>- Intense cultural focus on introspection and striving for continual improvement</td>
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<td>- Strategy differentiation or deep sector expertise</td>
<td>- Prior fund management experience</td>
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<td>- Previous experience working together</td>
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- Avoid groups with unchallenged single dominant partners able to make unilateral investment decisions
## Best Practices for Evaluating Emerging Managers

### Most Important Factors, Continued

<table>
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<tr>
<th>Clearly articulated strategy</th>
<th>Strategy adherence</th>
<th>GP/LP Alignment</th>
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<tbody>
<tr>
<td>• A clear identity recognized and understood by all team members</td>
<td>• Adherence to strategy that was defined at the onset of each fund</td>
<td>• Meaningful “skin in the game”</td>
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<td>• Explicit and consistent decision-making structures and processes in place</td>
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<td>• Fair economics sharing to properly motivate team</td>
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<td>• Transparency and integrity</td>
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Best Practices for Evaluating Emerging Managers

Other Factors To Consider

- Ensure “critical mass”
- Ability to attract and retain additional talent around key founders
- Early professional turnover can signify deeper problems
- Sponsorship/endorsement/commitment from previous employer(s) or knowledgeable LPs can offer some level of validation
Best Practices for Evaluating Emerging Managers

Other Factors To Consider, Continued

- **Historical performance evaluation**
- **“Hungry” team.** Understand the rationale for the founders wanting to start a new firm
- **Funds sponsored by larger, more established organizations may result in reduced alignment of interests of an investment team with LPs**
- **Though not observed in our sample, the panel believes that unconstrained fund size growth is a negative**