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EPISODE 162:

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**Seeding the Next Generation  
of Asset Managers:  
Hedge Funds, VC, and  
Private Equity Compared**



**Robert Morier:** Welcome to the Dakota Live podcast. I'm your host, Robert Morier. The goal of this podcast is to help you better know the people behind investment decisions. We introduce you to chief investment officers, manager research professionals, investment consultants, and other industry leaders to help you sell in between the lines and better understand the investment sales ecosystem. If you're not familiar with Dakota and our Dakota Live content, please check out our website at [dakota.com](http://dakota.com). Before we get started, I need to read a brief disclosure. Nothing contained herein constitutes an advertisement, an offer to sell, or a solicitation of any offer to buy any securities or investment services. This content is provided for informational purposes, and should not be relied upon as recommendations or advice about investing in securities. All investments involve risk and may lose money. Dakota and Borealis do not guarantee the accuracy of any of the information provided by the speaker, who is not affiliated with Dakota. This is neither a Dakota nor a Borealis solicitation, testimonial, or an endorsement by Dakota or its affiliates. Nothing herein is intended to indicate approval, support, or recommendation of the investment advisor or its supervised persons by Dakota. Today's episode is brought to you by Dakota Marketplace. Are you tired of constantly jumping between multiple databases and channels to find the right investment opportunities? Introducing Dakota Marketplace, the comprehensive institutional and intermediary database built by fundraisers for fundraisers. With Dakota Marketplace, you'll have access to all channels and asset classes in one place, saving you time and streamlining your fundraising process. Say goodbye to the frustration of searching through multiple databases, and say hello to a seamless and efficient fundraising experience. Sign up now and see the difference Dakota Marketplace can make for you. Visit [dakotamarketplace.com](http://dakotamarketplace.com) today.

We have a very unique podcast episode for you today. We went live to the Drexel University boathouse in Philadelphia on historic Boathouse Row to record a live GP seeding panel event. We had three very interesting speakers from three very different asset classes talking to us about GP seeding. Over the course of that conversation, we better understood what GP seeding looked like from a hedge fund perspective, from a venture capital perspective, as well as lower middle market private equity. We were joined by three very distinct voices. Scott Schweighauser Managing Partner and Founder of Borealis Strategic Capital Partners. Scott's a veteran of the hedge fund industry who helped build Aurora Investment Management into a major fund of funds before launching Borealis to solve the early-stage manager paradox. We were also joined by Andrea Lo, Managing Partner and Founder of Main Character Capital. Andrea calls herself a founder allocator, bringing experience from the Stellar Development Foundation and her own startup journey to back VCs with main character energy. And finally, we had Dan Pogue, Vice President at Catalyst Partners, the seeding platform for Moelis Asset Management. Dan leverages an institutional consulting background to professionalize and anchor emerging private equity managers in the lower

middle market. It was a fascinating conversation. We were joined by a live audience of allocators, investors, student, faculty, staff, and administrators as part of this wonderful conversation. So we hope you enjoy it, this special recording of the Dakota Live podcast at a live panel discussion on GP seeding. Thank you for investing your time with Dakota. Scott, before we get started, I asked you to take on the burden of, for the audience, defining, what is GP seeding? What are we going to be talking about today?

**Scott Schweighauser:** GPs are General Partners and are the... it's the nomenclature that people use for people who are directly managing assets, whether it's in private equity, venture capital, or MICE area hedge funds. Seeding entails identifying people who are just starting out and wish to hang out their own shingle and providing them with capital that they're going to need to run their business. There are many ways to do this. You can buy a stake directly in the general partnership of the underlying manager and become an owner. We define seeding... at Borealis, we define seeding as investing capital in the manager's fund and participating in the top line revenue. So there's no ownership involved, but we participate in the growth and success of the manager. In both cases, the capital that we invest is really effectively catalyst capital. You have a very aptly named firm.

**Dan Pogue:** It was intentional.

**Scott Schweighauser:** It was intentional. And so the catalyst is really meant to shortcut the duration of launch to success, and to accelerate it. And we do that in a number of ways. And there are a number of elements to seeding, which we are all going to talk about. The ability to identify this early-stage talent is paramount. And to partner with managers and put them in a position to be successful earns us the ability to benefit from their growth and success. I would describe it as a win-win situation. That's what capitalism is. It should be a win-win situation for all parties involved. And it's exciting. It requires a ton of work. This is not something for the lazy or the people who are used to 9:00 to 5:00 jobs. This is a 24/7 type of industry. But the rewards are immense. They can be substantial financial rewards. But also, the satisfaction of identifying somebody that you think is talented, backing them, having them go on to great success, there's nothing better in my estimation. So for us, that's seeding.

**Robert Morier:** Andrea, you're doing this from a very different perspective. You're looking at early-stage venture capital funds. So based on your background, why did you choose to focus on that particular area of the market as it relates to seeding?

**Andrea Lo:** I've spent the last 15 years as a startup founder, venture capitalist, startup operator, and now allocator. So I've lived and breathed venture capital for

most of my career. I'm from the San Francisco Bay Area, so I grew up with a lot of founders as well. Naturally, based on my background, most people thought I was going to start a venture fund. But I actually was interested in seeding, because I think this next decade is going to bring about a lot of uncertainty and opportunity with AI, geopolitics, a lot of other trends. And so I personally think half of the venture funds are actually going to go out of business and need to evolve, and that this is really the perfect time to pick the next generation of talent. And because I've also helped launch and turn around various venture capital firms and helped build out new markets and new asset classes, this really seemed like a fitting next step for me, rather than focusing on just one specific industry. So it's still more nascent in venture capital, so I'm learning from these guys, but it's an exciting time for us as well.

**Robert Morier:** Thank you so much. And Dan, again, last but not least, when you think about lower middle market private equity, you've talked about the chicken and the egg problem. So these managers that need that early-stage seeding capital in order to get started, what does that process look like for you as it relates to your role?

**Dan Pogue:** Yeah. So we essentially want to be a day 1, at scale LP partner for these managers. So we initially help them with our capital, and then that's probably about half of what we do. And then the other half is, what can we do beyond our own capital to help them be successful throughout the raise in Fund I, and then much longer term across multiple funds as a franchise? I think what we've found is there's a lot of LPs, be it institutional or otherwise, who buy into the alignment, the focus, the specialization, the alpha potential that you can get from backing emerging managers, and within that subset, specifically Fund Is. I think a lot of LPs see that opportunity. But there's not too many LPs relative to the number of first-time firms that are trying to launch and scale. We find that there's still relatively little at-scale capital who wants to consistently be first money in the door to help those managers get from A to B and actually get the wheels turning. And so when we think about solving for that chicken and the egg issue, there's two legs to the stool. There's the initial working capital piece. We tend to not do explicit working capital deals for the managers. It tends to come, frankly, with a different set of risks, and therefore cost of capital. That doesn't necessarily jive with what we want to achieve, and potentially not best for the manager. By coming in day 1 at the right scale, paying fees on an LP commitment, we find that we can essentially get them to a similar spot in terms of solving for some of those working capital needs, but effectuate it through that day 1, at-scale LP commitment where we're ultimately securitizing that by owning assets in the fund. And it comes with a more prudent cost of capital for the manager. So we want to give them that day 1 working capital, because a lot of times what you see with these founders is... at least the ones that we try to partner with... they're generally not taking a salary, so there's an opportunity cost economically for them. And they're typically investing significant

working capital to get the man co off the ground... the management company... the firm itself. They're typically making some initial hires. And so by giving them working capital through our commitment, we can essentially help them more efficiently and in a less stressful way, hopefully, make those initial reinvestments in the firm that later close institutional LPs will ultimately want to see in place. That's kind of piece number 1. But piece number 2 is... and I don't care if it's a Fund I or a Fund V, but I think especially in Fund Is where theoretically things are less proven, even if they have a track record from a prior firm, LPs want to at least in part know what they're going to own. They want to have a seeded portfolio, seeded portfolio being the manager has actually made at least an investment or two in the fund that a later close LP can see. They can underwrite, they can get comfortable with and ultimately build buy-in as a team and as an organization. And there's other benefits to that. But again, you need capital to do that. So we solve for the working capital piece, help them make some of those upfront investments in the team, the infrastructure, all of those things. But we also, because we're making an LP commitment to the fund, we give them at-scale, discretionary dry powder to go off, get a deal or two done, provide them ample runway to support that initial portfolio. Then they have most, if not all, of those critical day 1 pieces in place so that when they broadly go to the market, they've checked all of the boxes and they've de-risked the strategy and hopefully made it a lot more obvious to the rest of the institutional LP community. And hopefully, that makes the broader fundraising effort beyond our capital more streamlined, more efficient, more effective.

**Robert Morier:** Dan, what you've talked about sounds like it's highly dependent on the people. So how do you go about evaluating the people behind these efforts, particularly in early-stage? One of the things we tell our students at the beginning of early-stage venture is that one of the things that's nice about the course is its less math and more people. We're really thinking about how these founders are approaching their businesses. But it's an art, so how do you approach that art?

**Dan Pogue:** Yeah. I mean, there's different personality traits, I guess, that... I wouldn't say we systematically test for. But by spending a lot of time with the manager... I think we talked about this. We spend probably 200-plus hours with a manager over a six to 12-month diligence process. That's a lot of time in rooms over dinners, at cocktail parties, things like that to see how these folks interact, how they think. I think a big thing that we look for, regardless of personality trait, is just team continuity. And this goes back a little bit to definitionally, what is PE seeding? It's different to different folks. For us, even though it's a first-time fund being raised by the manager, this is not a first-time team, so we're not taking nearly as much team risk as private equity seeding would suggest. These are teams... especially if you look at the founding partners, there's typically going to be two, maybe three initial founding partners who are very accomplished, very experienced, and have real track records together building successful investment portfolios, building the right culture, building the right teams at their prior firm or

firms. And so it's not a personality trait, but that team continuity is something that we look for. And sort of a derivative of that is we're probably backing two or three initial partners to start. But again, we want to support them. And through that support, we want to see an intelligent, kind of cogent roadmap for how they build a thoughtful team around them. And we want to see them build additional continuity as they think about hiring a VP, a principal, a CFO, things like that. And so one thing that's telling to us... again, it's not a personality trait, but it speaks to the team, the culture, the non-investment things that they're able to do and how they're able to pull together is whenever they make calls to people, a VP, a principal that maybe they've worked with in the past, they probably have a good, kind of safe job today, good current cash comp. Can they convince those people to ultimately come take a career risk, leave their safe job today, do something more entrepreneurial, and buy in to the culture, the vision of this new entity that they're trying to build and trying to scale? And I think some managers are very good about connecting those dots and attracting the right talent and furthering the team continuity. And I think that speaks a lot to the culture that they were able to set at the prior firm and what that kind of version 2.0 culture will look like. Some managers aren't as good at it. And if they're not that good at it, they can't convince people they've worked with before to come and join them. I wouldn't say that's a grave concern, but it's certainly a red flag and something that we spend time on and that we want to understand. I think one other thing that we look at... and this is really just around desire and their willingness to bet on themselves... is we'll see situations sometimes where managers will come to us. They're still gainfully employed at their current firm. And they say, hey, I'm thinking about doing something. If I decide to do something, can you promise me a check at the end of the day? And our answer is, like, no, we can't, right? Because that's the wrong tone of partnership and alignment from our perspective, day 1. We're very willing to help a team transition kind out of their current firm, into new firm, and help them scale that day 1. Like, we will literally be a day 1 partner for them, but only if they've proven to us that they're willing to take a calculated risk and actually make that leap and have meaningful skin in the game before we actually write them any sort of check and effectuate a partnership. So again, not a personality trait perspective other than I think it's a unique individual who's willing to have the confidence, the belief in their ability to ultimately make that leap and have it be successful. And hopefully, we can be their partner from day 1 moving forward.

**Robert Morier:** Thanks, Dan. Andrea, how about from an early-stage venture perspective, your firm is called Main Character Capital. So how do you identify who the main character is, whether they're the right person for the part?

**Andrea Lo:** So when we started Main Character Capital, it was very intentional to build a next-generation firm that's going to last and appeal to the next generations. So when we came to the name, it was really, who do we not want to fund? And so how many of you what an NPC is? Ok. Some of the students know. So NPC

stands for non-Player Character. This is a gaming term. When you play a game, there's always those characters in the background running around, looking very busy, and not doing anything. We think some of the industries are full of NPCs. And we don't want to fund them, right? There's usually one main character, one hero or heroine in the game, and so that's who we want to back. Now, it's very hard to pick who that person is, specifically in venture capital. There's a lot of challenging dynamics to venture capital, which make it even more challenging or different than buyout and hedge funds. In venture capital, it takes seven to eight years for you to just see the results of your investment, right? So you could, in theory, be on your second or third fund, and people still don't even know if you're good or not, right? And then the other thing is, even if you're good, sometimes you're lucky. We see some of the best investors not be able to repeat that kind of success. So there's a lot of chaos. And so when outsiders look in at venture capitalists and venture allocators, they sometimes think it's very subjective and it looks easy, right? But it takes kind of developing a strong pattern recognition over time. And so specific to main character energy, what does that mean, and how do we look for it? I like to say... and this will be proven, that I was a main character and I am a main Character... I was early to several industries myself. And when you're early to an industry, everyone looks like maybe a non-player character. Everyone looks kind of dumb, right? And again, it takes a decade to know who's going to win. Main characters, in our opinion, tend to set the storyline and the pace for everyone else to follow. And so today in venture capital, one of the biggest challenges is there's only five companies that go public every year, and everyone's trying to front-run everyone else. Is that investing? No, right? We don't need more followers. We need more people creating the narratives. And so you can find a main character in any industry, whether it's crowded or not, but we specifically look for specialists. Again, as Dan mentioned, even though they're starting new firms, they have decades of experience, whether they're founders, operators, have been in investment roles as well. And so we believe that there's a gap right now in the market, specifically in venture capital for specialist investors as we move towards needing to fund very technical things from semiconductors to robotics, from solving really large challenges in energy infrastructure to AI infrastructure to true health care challenges. Like, you can't always just be a generalist. So we're looking for people who deeply understand their segment but are still very commercially driven. It's not just academic. And then have they been able to evolve? Because with technology, it just evolves so quickly, and it's evolving even more rapidly with AI. And so we look to see, do they have unique insights on the market? But it is hard. We spend, like Dan says, a lot of time with the managers, and it helps that we've been there ourselves. So it's really seeing how people navigate challenges and if they have unique points of view of the market. And are they usually, right? Or if they aren't right, have they learned from it, and are they able to pivot?

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public company, and more, all of that data that you've grown to know and love within Dakota Marketplace right from your Google Chrome browser. This way, as you're browsing, researching, prospecting, or looking for the newest deal target, you have all of the high-quality and curated data that you need to do your job right there in the same window. You can learn more today on our website at [dakota.com](http://dakota.com).

**Robert Morier:** Scott, investment talent, though, doesn't always necessarily translate to business acumen. So you have a good investor who comes out of a shop that you admire. They're bringing that track record potentially. But now they have to launch and manage a business. So how do you analyze whether or not the business acumen is there for them to actually be able to go forward and start a business itself?

**Scott Schweighauser:** Yeah, I think that's the most critical element of what we do, is taking people who are very gifted from an investment point of view and evaluating that, because that's the core of what our returns are going to be based on. And then look forward and evaluate, I'd say, the nonquantitative, more qualitative elements of their background to determine, can they be a business leader? And the qualities of a business leader are vastly different than a good portfolio manager or a good analyst. So we spend a lot of time literally from day 1 doing reference checks on the managers that we have an interest in. So typically, our very first conversation with a manager is, tell us about yourself. Where did you grow up? What was your pathway to where you are now? We want to understand the ecosystem in which they develop their talents. So the very best training grounds are mid-sized hedge funds where they have a touchpoint to every element of that business. So not only on the investing side, but also client relations or investor relations. Understand how the back office works and how important it is to have a very good, efficient, well-run back office. And be a good leader, and to be able to connect with everyone. Connect with investors, connect with employees, connect with the outside world to develop the sustainable process to generate returns and have a sustainable business. I would say that the number 1 element that we evaluate is grit. And grit is perhaps an overused term. We think it's probably the most critical element that we're trying to discover in each of our managers, is, look. Anybody can face a welcoming market. A bull market makes geniuses of everyone. It's really the bear market or the more challenging market that provides an opportunity to discover what people are really made of. And how do they confront challenges? We want to identify people who have faced challenges in their life. The backstory for us is really important. We love a good backstory, kind of a Horatio Alger type of story, because those people know how to succeed. They've faced challenges, and they've surmounted them. And that is a winning attitude that is hard to replicate and really hard to learn... sorry... hard to learn in the classroom. And you need to go out and experience it. So people who

have lived through challenges, personally or professionally, are generally really good business leaders, and so that's what we look for.

**Robert Morier:** Once you have that conversation, you've sourced the manager, you know who you want to make an investment with... and this is really for all of you... structure. Structure is a big, open-ended question in all three of your respective areas of the market. So how do you structure or approach the structure of these deals to align incentives with these founders?

**Scott Schweighauser:** Yeah. The key... and I think both of you will agree with this... alignment is everything, making sure that you as the sponsor and the manager, the GP, are aligned, and you're rooting for the same thing. And how do you eliminate through the relationship, that legal document that is going to govern your relationship, how do you create as much alignment as possible and eliminate the frictions? Inevitably, the pathway to success is not a straight line. People are going to encounter many, many challenges along the way. When we're pretty sure that we want to provide someone with a term sheet, we're at that stage where we're excited, and we're 60%, 70% of our way through the due diligence, but things are lining up nicely. We have what I would term the conversation, which is a sit-down. It's kind of like parent to child. And you say, ok, we're on a good trajectory here, but you realize that no matter how difficult you think this is going to be, it's going to be twice as hard as you imagine. Twice as hard, if not more. It's going to take longer for you to build a business. Are you prepared to deal with, instead of, say, a three-year trajectory, are you prepared to deal with a six-year trajectory? Do you have the internal intestinal fortitude to be able to deal with that? Do you have the resources to do that? Do you have the support from your spouse to be able to do that? And really, put them to the test. Say, this is going to be really hard. And sometimes the answer is, I have no reservations whatsoever. I know it's going to be hard, and let's go. Actually, to Dan's point, I loved your description of the guy who said, I'm thinking about leaving, but can you write me a check if I do leave? It's like, I would never back that manager, right? Because he doesn't have that intestinal fortitude to just say, screw it, I'm going to leave, and this is what I want to do. If you want to come along, great. If you don't, that's fine too, but here's my path. Those are the guys you want to back.

**Dan Pogue:** There's different types of seed structures. I would say increasingly... like, you'll still see some permanent equity stakes, although... we'll probably talk about this... I think you see that much more consistently in the larger cap GP stakes market, which is really focused on larger established managers. For true private equity seeding... and I think you alluded to this, it doesn't even have to be specific to private equity... I think some version of a revenue share structure is much more common and permeates the market today. And so at a high level, that's what we use. I think it has a number of benefits in terms of driving alignment with the manager. I think it also can drive pretty good alignment with investors,

especially around things like liquidity. Rev shares tend to have more of a self-realizing feature versus an equity stake. You have to sell it at some point. And how are you going to sell it? How does it get valued? Who's going to buy it? I think the depth... like, the true depth of that market isn't as proven today, frankly. And so we like rev shares for a whole host of reasons. In terms of how we talk about it with the manager, a little bit to your point, but maybe to build on it. One, we broach that topic very early. We are a higher cost of capital than a 2% and 20% LP. If that's an issue, we can agree to disagree. We respect what you're doing. We'll be your biggest fan, but we're probably not the right partner for you. But if we can have a collaborative conversation around, yes, we're a higher cost of capital, but here's what you get for that, value add-wise, both today and throughout Fund I, throughout Fund II, and long term, if we can see eye to eye on that value proposition, then that cost of capital in the eyes of the manager, I think, gets mitigated, because they're getting much more value out of our capital than maybe they would out of a similar day 1, 2, and 20 LP who may not lean in to some of the capital formation, the back office things that we're able to support them and be an extension for them on. So one, we're very transparent on it. We broach it early, and we make it very collaborative. So as with anybody, you always have a framework for what your structure at the end of the day is ultimately trying to solve for from a risk return standpoint. But how you get to that end goal can look, and often looks, very different on a manager-by-manager basis, because every manager's trying to solve for slightly different things. Some care less about the cost of capital, and they really care about upfront working capital. Or they really need to get a deal done, and we're one of the only people that can move fast enough to help them get it done. And so cost of capital is less of a concern. Others don't need the stuff as much. They still see value, but maybe they already have enough working capital, so we're not able to lean in as much there. And they really care more about cost of capital. So what we do is we lay out a general framework for them, and then it becomes a very iterative, collaborative conversation around, within this framework, tell us what you need, whether it's working capital, deal related. It can be all of the above. Maybe you need us to help bridge you to a full-time CFO. Whatever it is, walk us through what that story and that glide path looks like. Help us understand the cost requirements, the budget constraints around that. And then within our typical deal framework, we'll pull different levers and mold our structure to best match what you're ultimately needing to be long-term successful. And so it's a lot less rigid, I think, once we get into it than maybe a lot of managers would initially believe.

**Andrea Lo:** From a structure standpoint, no one's really done GP seeding at a large scale specifically for early-stage venture. It's not popular. In fact, on the West Coast, most people don't even know what GP stakes is. So when we started Main Character Capital, a lot of the starting time was spent on just perfecting the structure. So we actually studied what was done in the hedge fund industry and the bio industry. And you have to realize; there's two characteristics of venture capital

that make it entirely different than the other two. The AUM doesn't scale as high. So for example, in hedge fund, maybe you're going from... or buyout, you're going from \$2 billion to \$40 billion. That's not the case in early-stage venture. You can't even deploy \$40 billion in that industry, right? So we're saying, ok, let's try to find managers under \$100 million. How do we scale them and help them institutionalize to \$1 to \$2 billion. Because that's still a really interesting multiple, but that preserves a range where maybe their fund is \$250 million from Fund I to Fund IV. That still allows them to return their fund in multiples and deploy that capital into these smaller companies. So really looking at where... the size of the fund was really important to start. The second thing is there is a predominant belief that you get adverse or selection. The question is, wouldn't the best manager... why would they take your deal? Shouldn't they be able to raise capital? And so we saw that there was a lot of nuance in the structuring around that, because it sounds like a lot of the industry has moved towards revenue sharing. But a lot of the traditional seeders would take a cut of your management company, which is ownership and perpetuity of anything you ever launch. This was very scary for a lot of the managers who've done very well. And so we structured it so that we put a large anchor LP check, and that gets them started. Because very few people are willing to put in more than 10% of your fund. We aim to be 20% to 30% of that fund. And in exchange for that, we also get admitted to their GP, and we act as fractional GPs to help them get started. So we are not passive at all. We are very active. I'll give you an example to the point of how active we are, where this week I was helping one of the GPs structure an SPV for one of their winning deals, and figuring out what the right fee structure is in this market. And not only advising but helping introduce them to investors. That's the level of value-add that we're providing to win these people over. When do we even broach the conversation? We're adding this kind of value before we even close them. Otherwise, they would never consider. And this is what allows us to get a seat at the table with an LP check and a GP stake, whereas other LPs are writing sometimes even bigger checks. They're really looking to us for the value add. But it's a very delicate threshold of the give and take. You can't take too much. They still need to have enough for their firms. And this in particular is really important for venture, because it takes so long for that asset class to get liquid, having additional streams of capital is really important and more interesting for our LPs as well.

**Dan Pogue:** And I would just add too, it's alignment between us and the managers, but it's also alignment with other LPs. If you don't have the right structure, I don't care if it's rev share or equity. If it's too onerous for the manager, you can't be short-term greedy. Because at the end of the day, I think we all want to be value-add on the capital formation side. Now, we may do it slightly differently in terms of how much we lean in, where we lean in, whatever. But at the end of the day, the end goal is the same. And if you don't have the right structure with thoughtful alignment, it can actually be an inhibiting factor for a manager whenever they go out to the rest of the market, because they're going to have to, with certain

LPs, explain the structure, why they took it, what it costs at a high level. Like, certain LPs are going to want to understand at least the high-level kind of framework for what that looks like. And how is there still a big enough pie, both today and down the road, for you to continue to attract and retain the right talent? And so we're also very cognizant of, we don't let the tail wag the dog, but we need to make sure that we're properly supporting the manager with other LPs as well.

**Robert Morier:** Thank you for that. We're going to open it up to the audience in a minute, but just one more quick question. Just looking at the market landscape today... Scott, starting with you... have the barriers to entry gotten too high for these small, emerging managers? It's expensive to launch these businesses. So while they're waiting, while they're going through 200 hours of due diligence, they're looking at their checkbooks and they're talking to their families, and they've got soccer club dues that are due. How do you think about those barriers to entry today? Is it too high? And where's the right level for you to consider where we are going?

**Scott Schweighauser:** Yeah, it's a great question, because it's why we exist. The barriers are pretty high, so there's a need for somebody like Borealis to exist to be able to get over that initial chicken and egg dilemma that a lot of managers face. And so without those barriers, we probably wouldn't exist. That's the good news for us. The barriers themselves, I think, are probably a result of anomalous concerns, particularly coming from the regulators about what needs to occur to provide good stewardship for hedge funds. I would say it's an over-regulated... massively over-regulated industry. The reasons hedge funds existed is because they were allowed to operate under the 3(c)(1) exemption and 3(c)(7) exemption, which provided them a lot of freedom. A lot of those freedoms have been usurped by subsequent rules that have made it really, really difficult. We can get into a philosophical argument about free enterprise.

**Robert Morier:** It sounds like a second podcast.

**Scott Schweighauser:** It's a second podcast. So I would say it would be better for everyone if we had fewer regulations and more people doing real due diligence as opposed to saying, ok, the SEC or whatever is relying... or is overseeing those activities. But I think it's a benefit for us in the long run.

**Robert Morier:** Andrea, where are the uncrowded trades today? Where are those areas of the market that you're looking for those main characters?

**Andrea Lo:** So I want to set a backdrop for where venture capital is today first. The industry was a cottage industry that got started in the 1940s. At that time, there were less than 100 firms. During the dotcom boom in the 2000s, this ballooned to maybe 3,000 to 5,000 firms. And then fast forward 20 years now

maybe in the AI revolution, you're seeing that number triple to 5x, right? The piece that a lot of people don't know is the number of exits, which still drives all of our businesses, is there's generally only been 20 IPOs that are of the scale that we need to return capital, and that number has been fixed for the last 20 years. So you're seeing one of the most crowded markets ever to date in what started as a cottage industry, so competition is fiercer than ever. And it's the same number of deals you're chasing, so differentiation is so, so important. And so when you look at that, the odds get even worse when you look at the company level. One out of 180 startups now are considered success. I think that used to be maybe one out of 100. So now it's even harder to pick a winner. Not to mention, you're competing with more dollars for the same number of deals. And so this is when it makes it even more important to be looking elsewhere, right? And so in venture capital, we like to say you have to pick the right market at the right time, and that allows you to pick the right team and the right product. All of those things have to go right for you to win. And that's not even enough sometimes. And so picking the market and timing is really important and very hard, and so we look at markets that are growing. Now, we could be investing in those markets before it's obvious to everyone, or we could be investing in a very crowded market that is just obviously going to be right. So the first one is being called contrarian and right, and the second one is the consensus and right. You would be a bit foolish not to be investing in AI right now, so we can't not invest in AI. But there's also more contrarian ways to think about AI. So using AI as an example, we get asked every day, are we in a bubble? Is this the right time to invest? In venture capital, you have to consistently invest through every period. You just never when the returns are going to come. Certain vintages bring the lion's share of returns. So if it's a hard market, you can't suddenly exit. You may miss the one or two years where all the returns accrue. So using AI as an example, if you look at AI today, it could be kind of six layers of investment. At the very bottom, you have energy infrastructure. The second layer is maybe chips and semiconductors. The third is what gets the lion's share of the news, which is the large language models like ChatGPT and OpenAI. And then above that, you have software infrastructure. How do engineers actually use AI? And then at the very top, real-world applications that you and I or businesses use, right? Right now, the media is dominated around that third part of the stack, the large language models. That's where a lot of venture capital dollars have been going in. You don't have to invest in that portion of the market. You can still win by looking at different parts, right? And so we have two AI manager bets already, and one of them invests exclusively at the application layer. That was very unpopular when we backed him. He was struggling to raise because all the dollars were pouring into the LLM bucket. And so there's still thoughtful, contrarian, mispriced ways to trade an obvious trade. But of course, there's more obvious industries. Like, I was early to the blockchain industry, and we all looked like idiots to everyone for the longest time. But I picked out two use cases, the only use cases that are now still working, that I thought value would accrue to. And you wait it out as well. So there's different ways to play that. But right now we're really

leaning into AI, because we truly think it's going to change every single industry. So all of the funds we look at are specialist. Whether in health care, whether they're looking in quantum computing, they all have an element related to AI. That's just part of the narrative we believe is dominant for the next decade.

**Narrator:** If you've ever been frustrated trying to build custom reports in either Dakota Marketplace or Salesforce, we have introduced Dakota Joe for you. Dakota Joe is a natural language report builder native to Salesforce, built inside of Dakota Marketplace. For all of our Dakota Marketplace users, you can find Dakota Joe today and start running reports on accounts, investments, contacts, and a whole list of other objects. For Salesforce users, we have Dakota Joe coming soon to your internal Salesforce logins. You can learn more about both today at [dakotajoe.ai](http://dakotajoe.ai).

**Robert Morier:** Thank you. And Dan, just where do you see the market today, your market in particular? Maybe also in the context, something we could probably talk again about with a separate panel is the democratization of private markets, more retail money going into private as it relates to opportunities that you're seeing.

**Dan Pogue:** The retail opportunity, I think, will mostly accrue to managers that are more candidates for GP staking strategies, the mid, large-cap-type managers, because retail money tends to flow to more obvious established opportunities where there's a long-term, durable track record, probably multiple strategies that you can leverage one firm for. Absolutely nothing wrong with that, although I think obviously concerned around supply, demand, what happens with returns as a byproduct of that. But that's its own topic. I think where we see a lot of opportunity today... and this actually ties a little bit back to the concept of barriers to entry... I would argue that the cost required to successfully start and scale a private equity firm is still potentially prohibitive, depending on the background and the experience and the success of the team. I think what's changed, though, in terms of maybe lowering the barriers to entry is the influx and the institutionalization of the independent sponsor market. So it's now a lot easier, or more accepted maybe is a better term, for teams if they can't or don't want to move straight to raising a blind pool of capital, they will become an independent sponsor where they essentially invest outside of a fund. They find a deal. They raise money exclusively for that deal. They form an SPV around that deal. And then they can do one of those. They can do five of those. It just depends on ultimately what the team and what the firm wants to achieve. But that has created, I think, a more cost-effective, efficient way for spin-out teams who may ultimately aspire to launch kind of a full-scale, multi-fund institutional platform, but maybe they need to check a couple of boxes and walk before they run. That creates a more natural on ramp for them. Then this is where the opportunity comes in. The issue with that is as there's been more capital from an institutional LP perspective focused on that market, it's created a

proliferation of teams who think they can be an independent sponsor. So theoretically, any one of us could decide tomorrow that we're just going to quit our job, become an independent sponsor, because when we find a deal, we'll raise money. What could go wrong? I think there's a wide range of quality in terms of the types of groups that you see doing that, and so there's a lot of noise in that market. And if you can sort through the noise... and this is where our platform, being solely focused on small buyout and growth equity within a pretty tight framework or strike zone, we spend all day, every day focused on a very particular end market within small-cap private equity. And so are we perfect at sorting through the noise? No, but I think we're pretty well positioned to be able to, through pattern recognition and a lot of dedicated resources, be able to pick through a very interesting market like that where there is a lot of noise and find the diamonds in the rough and find the groups that truly have institutional experience and pedigree. And yes, they're an independent sponsor today. But they, if they haven't already, will very quickly earn the right to go off, raise a true fund. And if we can find them today, foster that relationship over a year, two years... sometimes it's three years or more... we can be in full position then to hopefully have that partnership conversation whenever they cross the chasm and decide, I'm going to raise a fund and build this thing out.

Participant: I think this question is for Andrea. So Andrea, I'm a colleague of Rob's. I'm working with and advising a startup accelerator program based in Eastern Europe. It's looking for scale-up opportunities. If I were to talk with them about the pros and cons of the traditional... and they're thinking of raising a fund next year or the year after... the traditional approach, GP/LP approach versus the GP seeding approach, what would be some top talking points if I was to advise them in terms of thinking about how they might want to go about fundraising?

**Andrea Lo:** Absolutely. So the first thing I'd preface is GP stakes is not that common still. So there's definitely going to be more general LPs than stakers as well, so it may not be easier to get someone to seed you. So that's part of the question. If they do have offers on the table, I think it would make sense to really think through that fund in particular. The geography, right? Is it an easy time right now for a European venture to raise? For us, we only back 10 funds, so we're very concentrated, because they need a lot of help. And we have a 70% focus on the US and 30% focus on the non-US. We have looked at European funds, but those funds are still even harder to pitch to US LPs. And when you look at where the allocation dollars are, a lot of it for venture in particular is still coming from the US, right? So you have to think about, where in the market are we for European venture? I've heard it's quite hot right now, so you may be lucky there. But geography is one piece that's really important. If it is harder for them to raise, I do think having a good seeding partner would be a very valuable benefit from day 1. Hopefully, the GP is thinking about their business as a franchise, like beyond just this fund. And so the pros of partnering with a CDAR today is that they are helping you think through the future. And so I like to say, some of our GPs are actually the

most ambitious. When people say, oh, it's adverse selection... because they're thinking through Fund IV, and they have the foresight to be like, I'm happy to sell 20% of my business if you can help me get there. Who knows what's going to happen in the market. Maybe one month, European's in, one month it's out, right? So I think market conditions are a big piece. I think the second is really alignment with CDARS. There's a lot of different types of CDARS, and you really need to know who you're partnering with. This is a 20-plus-year relationship, right? And so I think those would be the two things I'd focus on to start, but it's not easy getting a CDAR either.

**Jesse:** Hey, I'm Jesse Erman currently a third year studying finance. When we're kind of in this environment as DPI and TCPI are like in this decay over the past 10 or so years, I kind of want to know about the general... how do you structure these deals, if you're willing to talk about that? But then to focus on Andrea, going back to founder conviction, manager conviction... I know everyone just saw that whole news about a16z doing \$15 billion raise. As we have this massive influx of capital, and from a student perspective, kind of... I mean, I'm a finance, so it's not really my dream. But everyone's kind of aspiration now is not big tech. It's like, I want to be that Stanford kid who dropped out as a freshman and get YC-backed. And so now that you have such an oversaturated market, but obviously that's downstream to where you're at, how do stay nimble in the experience that you've had over the past five, 10 years to still have that conviction in the managers that when it's such a noisy market, they're going to still be able to decipher the signal?

**Dan Pogue:** When it comes to the seed structure, I think we're thinking a little less about DPI. It would more so be around current cash flow and working capital from that perspective. And in particular... because the way that we think about rev shares is there's loosely two types of revenue for a firm. There's incentive-based revenue... think carried interest. So they generate good returns. They take care of your profits on those returns. And then there's the asset-based revenue, which can include things like transaction fees, but think of it as management fees, right? And when we think about the topic of working capital, that applies, I think, much less to long-term performance, a la carry, and much more to asset-based revenue from management fees today. And so in the context of structure, we don't tend to think as much about DPI. It's more around helping them manage the upfront or trying to optimize that initial working capital via the management fee revenue that they bring in. I think a more... this isn't exactly what you asked, but it's tangential to it as we think about DPI. One thing that we've observed, both in our own manager portfolio but also for the market, is at the margin, emerging managers from our experience tend to generate higher, faster DPI than larger, established managers. There's probably a whole host of reasons for that. I think a very simple one is larger, established managers have a number of ways... they're very profitable organizations. And a lot of that profitability... frankly, the carry is meaningful, but a lot of the profitability comes from the multi-fund cross platforms, very sticky

management fee revenue stream that they bring in. And so at the margin, I think that can influence how they think about hold periods, when to sell, when to hold. If I sell, I crystallize some of the carry, but I lower my fee-earning AUM. Like, there's some trade-offs associated with that, and it can skew incentives. Not in every case, but in some cases. I think what we tend to see with smaller emerging managers is they're not making money. I think best case scenario is the management company for an emerging manager is maybe turning a profit in Fund III. They're playing for the carry. How do you ultimately generate carry? You generate really good returns, and you have to realize those returns. And so I think what that leads to is a different set of incentives where they're not selling just to sell. They still need to optimize and make sure they're honing in on the right return for the asset that they own, and making sure that it aligns with the target strategy, LP expectations, all that stuff. But I think all of those incentives lead to emerging managers are more inclined to crystallize returns, lock it in as carry and performance for LPs than sometimes what you see upmarket.

**Andrea Lo:** We tend to look for DPI in track records from venture capital managers that we back, because as I mentioned, a lot of folks don't see any results until seven to eight years. And so having managers that have returned DPI is actually important to us, because it proves that at least they've known when to sell secondary, for example. That's very important, specifically in early-stage venture capital, knowing when to sell the stake even before exit. And we also look for managers that are innovating on delivering DPI more consistently and quicker back to LPs. So we're working with the health care manager right now that has a unique way to hopefully deliver 1x DPI back to LPs by negotiating rev share and qualified dividends with their underlying companies, so they're thinking really outside of the box on how to pay back capital. So we like that. But again, what someone did historically doesn't mean they're going to do it again, right? But we like to see the signals there. And then in terms of overall multiples, it's hard. Like I mentioned multiple times, it takes a decade to really see the results. You don't even settle into your final quartile of performance until year 7 or 8. And so early years, we like to see people at least top quartile. There's studies showing if you're not in the top quartile... you still have 50% of falling out of top quartile. But if you're not in top quartile, it's really hard to get into top decile.

**Robert Morier:** Well, thank you all for making this a good day. This was a great day. Thank you for being here at Drexel at the boathouse. Thank you to our audience, our staff, our deans, our students, our allocators for being in the room. Thank you for taking part of this as well. And most importantly, to our panelists, thank you for being here and providing your thoughts.