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Why the JOBS Act may mean nothing to hedge funds

Much has been made in recent weeks about the passage and adoption of the JOBS Act, which at its core has been crafted to assist small businesses in raising capital and help stimulate job growth and the economy. More specifically, there are changes to alternative investment managers and their funds, notably surrounding the ability of hedge funds to now market themselves to accredited investors. For decades, marketing was not permitted for hedge funds, so the JOBS Act marks a substantial change with respect to what hedge funds can and cannot do with respect to external communications.

There have been more articles written on this topic than one could ever hope to read and for good reason: the concept of hedge fund advertising is an entirely new idea and could potentially create an entirely new industry. Given the trillions of dollars in alternative investments around the globe, the sheer scale is mindboggling and many are seeing enormous potential.

The reality, however, could be quite less than anticipated.

It would not be surprising if the industry sees little to no change in the general solicitation of hedge funds and other alternative investments. Though this runs somewhat contrary to current opinion, there are a number of reasons why hedge fund marketing may not be the bonanza that many foresee.

First, many hedge funds simply do not need to advertise in order to attract capital or increase their profile. The largest funds managed by well-known, proven managers not only often have more than enough capital, they frequently must *turn away* new investors or new subscriptions into their fund. Similarly, some funds have been turning away capital due to restrictions on the size of their portfolio; for some, there is a sweet spot for assets under management in order to enact their strategy and they have already hit that target.

Many alternative investment managers may choose to avoid marketing in order to keep the spotlight away from themselves, their employees, and their performance. Alternative investment managers have often preferred to avoid unnecessary attention so they can operate in private and focus on delivering returns to their investors. In a time when the top 1% is being chastised by protestors and the government is seeking to increase their taxes, it would be nonsense to think that many of these individuals would actually want to court more attention.

Moreover, alternative investment managers also must keep the desires of their investors in mind when it comes to general solicitation. Many of these investors prefer confidentiality and secrecy and would more than likely not want a public broadcast of their investment managers. Even if the investment manager may want to solicit in general, objections raised by their existing or prospective investor base may put any further exploration of marketing on the shelf. To be sure, few investment managers would ever want to jeopardize their existing asset base for an uncertain raise of capital through general solicitation.

In addition, one has to think of how the industry has operated up until this point. Alternative investments, more than most, is a sector built upon relationships, networking, and connections. This by definition was the way in which hedge funds have raised capital since their inception: they gained the trust of high net worth individuals and institutions through existing relationships in order to increase their asset base. Why, all of sudden, would the industry abandon this time-tested method simply because they can advertise now? It is highly unlikely that seven, eight, or nine-figure allocations of capital to an investment manager would occur because of anything other than long-standing, trusted relationships.

Another reason relates to the costs associated with advertising. Any marketing costs are extremely likely to be borne by the investment manager and not the funds themselves. In a time when compliance, legal, infrastructure, and technology costs are all increasing for an investment manager (and their management company), it may be difficult to justify additional money spent on marketing. If an investment manager had to choose between advertising their fund or upgrading their technology, the latter would nearly always be chosen over the former.

Finally, we arrive at branding. Let us use cars as an analogy: we see marketing for Ford almost everywhere these days, but how often do you see advertising for Rolls Royce? Alternative investment managers are extremely protective of their brand and very few ever want to be viewed as a Ford when they must compete against Rolls Royce when it comes to raising capital. Many may view widespread, or even targeted, advertising as a cheapening of their particular brand and, as such, may be wary of going down that road.

While the restrictions on hedge fund marketing may be lifted with the adoption of the JOBS Act and the corresponding changes made by the SEC, the impact may be noticeably diluted due to items such as costs, branding, current industry norms, and privacy. General solicitation may help some alternative investment funds raise capital and will almost certainly change their businesses for the better, but more than likely the impact of the JOBS Act will be minor for the industry as a whole, at least for the foreseeable future.