Buyouts

By: Staff writer
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FIRMS & FUNDS

Q&A with Whit Matthews: Fundraising has been 'especially difficult' for emerging managers

HighVista Strategies' Whit Matthews describes which traits the LP looks for when investing in a small manager.

For Whit Matthews, managing director at HighVista Strategies, investing in emerging managers is a core element of the Boston-based LP's focus. Over two decades, the team has made more than 150 fund commitments predominantly in first, second and third-time vehicles in the lower mid-market, as well as investing in secondaries and co-investments. It also actively supports independent sponsors, which Matthews notes are "a significant part of the emerging manager ecosystem."

Whit Matthews

Q How would you describe market right now for emerging fund managers?

From a fundraising perspective, the market's been difficult for everyone and especially for emerging managers. We've seen a skewed barbell phenomenon play itself out where for every small manager that successfully moves through the market in less than six months, there's probably another eight to 10 managers that are taking a year or two years to hit their fund targets. That's been pretty consistent for the last two-plus years.

Q What differentiates a successful manager from the rest of the pack?

Top of the list are sector specialization and the ability to apply operational expertise at the portfolio company level. Differentiated sourcing and the ability to convince a small business owner to hand over the keys to a company they've spent their life building, winning them over, is a unique skill. Having a differentiated story to tell sellers, as well as LPs, determines the managers that win.

Q What new strategies or niches are emerging managers exploring?

More groups are pursuing the independent sponsor model over an extended period of time in advance of raising a traditional fund. Given the difficult fundraising environment, it makes sense that more groups would invest deal-by-deal for longer to prove out their model, rather than trying to raise a blind pool fund and it taking a while to get there. At the same time, the independent sponsor model is becoming more institutionalized.

And, it's early innings, but over the last few years, some groups have raised capital from asset manager programs through structures that look like something in between a quasi-independent sponsor model and a traditional blind pool fund. Those typically result in slightly more concentrated portfolios and potentially more advantaged economics from the LP perspective, including opt-out rights on deals. Family offices are already active investors here and we are seeing more traditional LPs consider this avenue.

Q When allocating capital, what do you look for?

It's a mosaic of considerations. At the top are prior track record and relevant investment experience. Are managers' historical deal sizes consistent with their new strategy? Many new teams have spun-out of large-cap firms. It's difficult for a manager to transition from a $5 billion vehicle to one investing $150 million-$300 million in significantly smaller transactions. We focus on fund size and why a manager wants to raise a specific amount of capital, and we focus on portfolio construction philosophy.

We spend a lot of time looking at team dynamics, complementary skillsets and whether the team understands its blind spots. Alignment of incentives is important too. We want conviction that a group can not only make great investment decisions but has resources to put in place appropriate operational infrastructure. There's a lot of non-investment related work and acumen that goes into managing an emerging fund.■