

by Bruce Frumerman, CEO, Frumerman & Nemeth Inc.

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Taking Care of Business: What Family Offices Need Emerging Managers To Tell Them



There is a conversation that takes place in the due diligence meetings of family offices, as they vet emerging manager hedge funds, for which you, the portfolio manager, may be wholly unprepared. It is not a question about the Sharpe ratio or drawdown recovery time. It is not even a question about the manager's pedigree or the fund's track record length.

It is this: *What is your business plan and what steps are you taking right now to grow your business?*

The portfolio manager who stumbles at responding to this question — or worse, who answers it by pivoting back to restating performance or pedigree — has just told the family office everything it needs to know. And not in a good way.

Two Risks Family Offices Are Always Weighing

Sophisticated investors considering an allocation to an emerging manager are evaluating two distinct categories of risk simultaneously, whether or not they articulate them as such in your meeting.

The first is strategy risk. This is the risk most portfolio managers spend the majority of their preparation time addressing. Can the investment process generating performance be explained? Will the process hold up across different market environments? Is the risk management methodology credible and consistently applied? Can the manager demonstrate the discipline to following the process when the market makes it uncomfortable to do so?

The second risk — and the one that sends many an emerging manager meeting off the rails when it surfaces — is business risk exposure. Here the family office is asking from its core: *Is this firm going to be around long enough for us to benefit from an allocation to the strategy?*

The fewer outside investors a young manager has, the more business risk exposure each early allocator carries. The math is simple. If the manager has a handful of friends and family as investors and the family office writes a relatively sizable check, a meaningful portion of this boutique's revenue base is now dependent on one relationship. If something goes wrong — performance dips, a key hire departs, the manager becomes distracted — the family office has very little buffer. They are not just an investor at that point. They are, effectively, a life raft.

Family offices know this. What they are trying to determine in vetting you is whether *you* know this — and whether you are doing anything purposeful about it.

The Question Behind The Question

When a family office investor asks about your business plan and how you will grow the business, they are assessing whether you have a small business owner's head on your shoulders in addition to that of a portfolio manager.

These are not the same thing. Outstanding portfolio management skills do not automatically translate into the ability to run and grow a business. Many smart stock pickers or macro traders have launched funds and found, to their considerable surprise, that attracting assets is a job every bit as demanding — and intellectually rigorous — as running the portfolio. Some have found it more so.

The family office allocator sitting across the table from you has likely seen the pattern before: The manager who views business development as something to address *after* they have landed two or three large anchor investors. The manager who, when asked about the asset raising plan, responds with something along the lines of, *We're focused on performance right now, and we believe allocations will follow.* The manager who has no marketing collateral beyond a deck, no content marketing outreach program, no defined target investor type and no realistic timeline plan for reaching sustainability.

These are red flags, not signs of discipline. The sophisticated, prospective investor reads them as evidence of a portfolio manager who either does not understand how investment boutique businesses work, or who understands but is unwilling to invest his or her own resources in the effort. Neither interpretation leads to an allocation.

If you want their capital — and their confidence — you can't just talk about performance. You have to both talk like a thoughtful business owner and show you are taking care of business.

Business Plan Detail That Matters

Here are four key topic areas you should be prepared to address.

- 1) **Revenue growth timeline and milestones.** The family office wants to know that you have thought about the economics of your firm with the same analytical rigor you apply to portfolio positions. That means being able to speak to what AUM level covers your firm's operating expenses, how long your current operating capital will sustain operations while you pursue that level, and what intermediate term milestones you are setting and tracking along the way. A portfolio manager who can discuss a position sizing thesis for a biotech holding down to the detail of phase three trial timelines, but who cannot tell you at what AUM threshold their management fee revenue breaks even with their overhead, is communicating a lopsided set of skills.
- 2) **A defined target investor universe.** Saying *we're open to all investor types* is the equivalent, in investment terms, of saying your strategy has no particular thesis and you will buy anything. The sophisticated investor wants to know you have identified who your currently ideal investor is, what investment challenge you can help them solve, what allocation bucket(s) you do or could fit into, and how you aim to reach such prospects and stay in touch with them over a period of time as you hopefully convert them from prospect to client. When you can speak to this, you sound like someone who has mapped the terrain. When you cannot, you sound like someone wandering into uncharted territory.
- 3) **Active asset raising outreach efforts already underway.** This is not the time for telling prospects what you might get around to sometime in the future. They will want to know *What are you doing now?* Have you developed the range of marketing collateral needed to help educate and persuade people to understand and buy into how you invest? How are you using letters to investors to communicate transparency and how you think? Are you publishing thought leadership content that demonstrates your intellectual edge and gets your ideas in front of a growing audience of prospective investors? Are you attending and presenting at industry events targeted to the investor community you are seeking to reach? Assuming they are appropriate for your strategy and firm, have you built relationships with fund-of-funds or seeder platforms? The family office is looking for evidence of action.
- 4) **How you plan to reinvest management fee revenue as you grow.** Emerging managers who show they have thought carefully about the reinvestment of management fee revenue into business infrastructure are managers who show they are running a business, not just a fund.

What does reinvesting in the business look like? Hiring a CFO or COO. Bringing onboard an analyst or person to train to become co-portfolio manager. Hiring an investor relations staffer once at a large enough client base. Upgrading data and reporting capabilities that will be expected by larger institutional investors down the road. Building out compliance systems before they become bottlenecks.

Become a Storyteller of Business as Well as Strategy

Running a hedge fund is not just about generating alpha. It's also about building a business that can exist, compete, and thrive over time. Family office investors know this, and they judge emerging managers accordingly. If you pitch them only on performance and pedigree, you will be seen as one-dimensional. Instead, articulate a compelling revenue growth plan, operational roadmap, and investor diversification strategy — in writing and in person. Demonstrate exactly what they're looking for: a portfolio manager with a *small business owner's head* on their shoulders.

Done right, this taking care of business communications is not boilerplate business-plan fluff. It is the narrative that bridges investment skill with business credibility, and that is what converts family office due diligence into allocations.

One final point: Can you correctly guess who should be the first to bring up the subject of business plan details for your investment management firm — you or the prospective investor? Hint: It's the one who's self-employed — you, the portfolio manager and emerging manager firm owner.

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About the author

Bruce Frumerman is CEO of Frumerman & Nemeth Inc., a 39-year-old financial communications and sales marketing consultancy that helps financial services firms create brand identities for their organizations and develop and implement effective new marketing strategies and programs. Frumerman & Nemeth's work has helped money management firm clients attract over \$7 billion in new assets, yet they are *not* third-party marketers.

The firm has decades of experience as professional storytellers, content strategists and content creators. Frumerman & Nemeth is internationally recognized for its work in crafting for clients the beyond-the-numbers story of how they invest — content that investment committees actually discuss, debate and vote on behind closed doors when considering firms on a short list for potential investment. Importantly, this is required due diligence content that cannot be communicated in pitchbook format.

The firm's work also includes providing strategic consulting on product and strategy-specific branding, crafting the required strategy-specific content detail and designing and producing the marketing tools needed to make it through the two-month to two-year institutional selling cycle. Clients also employ Frumerman & Nemeth to help promote the intellectual acumen of management — helping them get speaking opportunities, write and give speeches as panelists or stand-alone speakers at industry conferences, and through media relations marketing services.

Mr. Frumerman can be reached at info@frumerman.com, or by visiting www.frumerman.com.