Seizing New Opportunities

BY JOHN CASEY AND YARIV ITAH, CPA

In our work with leading investment managers around the world we have observed that while this industry remains inherently local, several key trends that embrace the globe are in place. This changing landscape offers substantial opportunities for managers who can identify these trends and who recognize that in an industry where the barriers to entry are generally fairly low, success is size-neutral. Biggest need not be best.

Some of these drivers of change already are apparent: The underfunding of retirement systems is endemic to most developed countries. The shift of retirement risk to the individual has been underway for some time in the United States and the United Kingdom while in other countries, such as France, Germany, and Japan, this issue is creeping into the political agenda.

We also know that our industry faces maturation in the form of slower growth, increased competition, and increasingly professional management. Whereas between 1975 and 2000 investment managers grew assets significantly through major flows and a prolonged bull market, in the current decade we are seeing both greatly reduced inflows and far lower expected returns.

However, the following other developments are afoot:

More complex investment tools are becoming better understood and more readily available because of the pressing need for higher returns. Corporate finance and capital markets skills are being built into the mix, complementing the manager's vertical capabilities with horizontal ones. Financial engineering is here to stay.

Many large firms now are vulnerable and require radical restructuring. They are suffering from operational inefficiencies, poor management, depressed cultures, and inadequate alignments and therefore are likely to lose both talent and clients.

Views on what constitutes investment quality—a firm's ability to consistently meet stated client objectives across the organization—are standardizing across countries and markets.

With slower industry growth and growing rates of manager turnover, client retention is key.

The opening up of distribution platforms across the world is hurting mediocre manufacturers that were shielded from competition by strong captive investment organizations. The same trend is benefiting strong manufacturers with limited distribution resources.

So what does this mean for investment managers?

Change creates opportunity and our industry is no exception. We suggest that investment managers consider the following very viable options.

Helping investors expand their efficient frontier. Desperate for returns, investors are willing to take more risk. Recent investor interest in unconstrained portfolios, emerging markets, and alternatives is a manifestation of this broader trend that is likely to continue.

Going global. Most investors still maintain a strong home-country bias, but the move to diversify is underway and allocations to nondomestic markets will grow substantially. To succeed, managers must be structured to distribute their products globally, regardless of manufacturing location. Going global is becoming easier with the growth of international distribution agreements. These partnerships enable manufacturers to access new markets globally with lower risk and cost than ever before, while satisfying demand for investment quality by international intermediaries.

Offering customized solutions. To directly address investors' problems, managers will need to acquire two important sets of skills: 1) sophisticated distribution to understand their clients' challenges and 2) nontraditional manufacturing skills to engineer investment solutions.

Employing stronger client retention techniques. With slower industry growth and growing rates of manager turnover, retention is key. Leading managers will expand their client service capabilities to include thought leadership, education programs, and interactive product development.

Targeting the vulnerable giants. This could be the most straightforward opportunity of them all: Identify the vulnerable by the characteristics listed above, develop products that replace theirs, identify their clients, and then educate those clients.

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Addressing the needs of individuals that are largely retirement-driven. More retirement risk is shifting to the individual, who in reality is least equipped to manage it. Products and services that reintroduce certainty and stability to retirement planning will see great demand.

Targeting the individual through strategic partnerships with advisory networks. Focusing on the adviser market has required increasing investment sophistication and service. Now advisory networks are looking for partners who can provide a wide array of products and vehicles, educate the adviser, and become a strategic partner in growing the adviser franchise.

Ensuring interest alignment. This is not solely about monetary incentives but rather an alignment of strong values, good economics, and fairness in human relations across the organization. As the industry now is facing a headwind rather than a wind at its back, this opportunity could bring the greatest reward.

Leading managers already are realigning their objectives, skill sets, and the way that they conduct business to meet the unprecedented challenges faced by investors. These managers, and those who will follow over the next few years, will realize a great opportunity and become true global industry leaders.

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