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Chasing the Inflection Point

By Mona Aboelnaga Kanaan
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The inflection point for money management firms is that instance when their asset flows suddenly increase, giving the business solid credibility in overcoming concern about operational risk and feasibility of its investment capability and business. Reaching it provides new momentum, means to achieve even stronger results and access to the wide-range of marketing channels, especially consultants and larger plan sponsors, who will start paying attention now that a firm has reached minimums in terms of assets under management and track record. I call this the “Cinderella” moment when an unknown firm jumps from relative anonymity to become the belle of the investors’ ball. Investors “discover” a firm as a great manager that has been building an enviable record quarter after quarter.

But that inflection point is becoming harder to achieve. As competition has increased and the markets have institutionalized, it has become more difficult to cross the inflection threshold, which continues to drift higher — currently around \$500 million in assets — depending on strategy.

Data show that more than 70% of asset flows are now being directed to the largest players. Even as the money management industry, particularly hedge funds, continues to grow with many new entrants, asset flows, the percentage captured by the largest asset managers is growing. Institutionalization of the investor base gives rise to an appetite for funds that can absorb hundreds of millions of dollars at a clip.

Yet, investors remain interested in “discovering” managers.

Standout performance used to be sufficient to achieve commensurate asset growth. Today, not only do managers need to possess a definable investment strategy edge, delivered in an institutional, repeatable investment process, but they must also meet the higher due diligence and compliance requirements of professional business and operational management.

Larger organizations certainly benefit from greater marketing budgets and brand recognition, but they also offer investors advantages of operational and investment scale, such as a large family of portfolios in wide-ranging asset classes. These factors can be especially important to the defined contribution channel, where plan sponsors tend to prefer large providers.

To benefit from the continued interest in discovering new managers, investment advisory firms must marry alpha generation capability to operational ability. To achieve the success most fund managers want, it is now imperative to dedicate significant resources to design and execute a long-term strategic growth plan customized to the strength and capabilities of the firm. Professional business management — not just a notable investment record — has become essential to cross the inflection point. The critical factors to cross this threshold will be strategic thinking, capital and marketing. Consider the following:

- **Scale matters.** Particularly in times of volatility and uncertainty, investors seek to minimize risk. Larger firms offer scale and resources which are perceived to provide greater stability in terms of product offerings, strategy execution, retention of investment professionals, and so on. Smaller firms

will need to prove that not only are they focused and nimble but that they too can compete on an operational basis. They can mitigate questions about operational risk by having a business model that is feasible and capable organizational structures and systems in place.

- Differentiation is in demand. In this competitive environment of depressed returns, investors are seeking alpha and are happy to pay for it. Likewise, market returns have become commoditized. Even in the hedge fund arena, beta replication products are starting to acquire market share. Differentiated, specialized products — the appealing characteristic of smaller firms — remain in demand. This differentiation includes emerging managers — such as those that qualify as female- or minority-owned. Firms can take advantage of this by defining and marketing their edge. Yet, while programs specializing in funds of emerging managers are an important target niche to pursue, they are a small niche relative to the total available investment dollars and cannot alone provide the means to reach the inflection point.
- Don't neglect consultants. Consultants have a reputation of being uninterested in smaller managers, but in reality are incited in the marketplace to differentiate themselves. One way of doing this is to "discover" emerging managers. A key to cultivating consultant relationships is addressing operational and business stability issues up front as well as methodical coverage and information flow.
- Marketing matters.. Correctly solving the distribution challenge is critical for the success of any firm. Executing a strategic, long-term sales strategy can be more difficult and costly for firms than actually creating the product. Internal marketers are expensive and hard to retain, especially when there is limited product to sell. Third-party marketers can prove expensive and do not have a long-term strategic interest in the business. No matter what path is chosen, investors typically prefer to meet with managers rather than marketers.
- Marketing doesn't end with a sale. Communications with investors must be continuous and frank — in good times and bad. In surveys, investors say that it is often poor communication rather than performance that has led to firing managers. High-touch client service breeds trust which stabilizes and lengthens account relationships. Given the high cost of client acquisition, the resources spent on retaining clients can yield the most attractive returns.

Mona Aboelnaga Kanaan is president and CEO of Proctor Investment Managers LLC, a New York City - based firm that makes strategic private equity investments in the asset management industry.