COLLECTIVE INSIGHT

Who should **call the shots**?

Every year, actuarial and investment consulting firm, Towers Watson, publishes a research piece on the world's 500 largest asset managers. In the most recent edition (dated November 2014), there is a chart showing how ownership of the biggest 20 managers has changed over the past decade.

It is clear from the graph that independent managers have been on a relentless growth path (more than doubling as a proportion of the top 20 over the past 10 years) at the expense of investment firms owned by both insurers and banks.

Much has been made of the rise of boutique firms, but this trend in the growth of independently owned asset managers is more than that: you can hardly call any one of the world's 20 largest asset managers a "boutique" (number 20, the smallest one on the list, manages nearly $1tr or R12.5tr today).

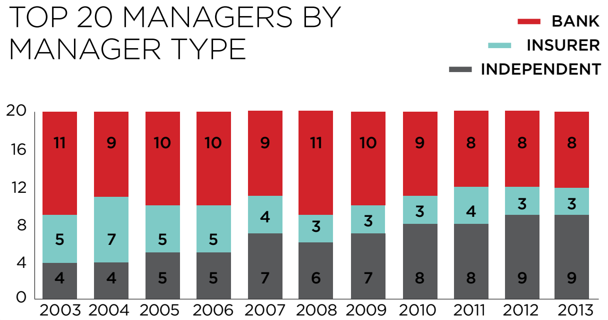
So why do independent firms continue to eat more of the lunch previously enjoyed by their institutional counterparts? The reasons for this are no doubt manifold and it would be presumptuous to postulate any one as the main factor.

I would, however, focus on an aspect I believe is key in the management and success of any investment business – namely the way in which boardroom conversations are conducted.

The boards of directors of the better independent asset management firms are likely to be dominated by senior investment professionals (who are almost always shareholders in the firm, too). Yes, there may be selected individuals from other walks of life, and hopefully they will weigh in with noteworthy contributions on the more general debates, but ultimately they would typically not hold sway when anything really crucial comes up for discussion.

The management boards of institutional investment firms, on the other hand, are by their very nature likely to be populated by senior executives of the parent company (whether that is an insurer or a bank). Only on rare occasions would any of these individuals have specific asset management experience.

TOP 20 MANAGERS BY MANAGER TYPE



This may not matter much when times are good, markets are going up and performance is decent. But the real value of a suitably constituted board of directors will be evident when there is "blood on the streets" (in the inimitable words of Baron Rothschild) and when clients start putting the firm under pressure because of investment performance concerns (whether in absolute or relative terms). In times like this, boardroom conversations are likely to be stressful (and so they probably should be).

Why is the firm underperforming?

> HOW DOES ONE BEGIN TO RECONCILE THESE EXTREMELY DIVERGENT FRAMES OF MIND? AND ARE THEY EVEN COMPATIBLE WHEN PUSH COMES TO SHOVE?

Whose "fault" is it? How does one fix it? Might it be a question of investment philosophy?

These are all difficult questions, and a group of experienced investors would probably come up with different responses compared with a board dominated by professionals of a different ilk.

In the case of an asset management business owned by an investment bank, for example, chances are that the leading voices around the boardroom table will be those of individuals who originally made their mark in a corporate finance environment (or "rainmakers"). My friends from that world may feel slighted when I say this, but I would suggest that it is not the ideal background for contemplating the vexed questions of an asset manager's performance, process and philosophy.

At the risk of oversimplifying it, the typical investment banking deal consists of identifying a problem (or an opportunity), articulating a clear plan to solve or address it, delegating accordingly and implementing it. If necessary, extra resources can be accessed. Those involved will work as much overtime as necessary to make deadlines. Turnaround times are usually weeks, sometimes months, very rarely years. Outcomes are quickly measured, fees and commissions are earned, profits are banked. The next deal looms.

This is all very different from the asset management world, with multi-year cycles and many uncontrollable factors playing their part. For example: is three years enough to measure performance properly? Most experienced investors would probably say no. Five years? Maybe…

How does one begin to reconcile these extremely divergent frames of mind? And are they even compatible when push comes to shove?

Also bear in mind that, with a large diversified institution, one part of the group (for example, the insurance company) is likely to be a key client (if not the biggest one) of the investment business. Not only is it likely that the various people around the asset manager's boardroom table will thus be differently "wired" in such a case (with senior managers and actuaries from the insurance operation going toe-to-toe with the executives from the investment business), but those representing the insurance side will also be somewhat conflicted. This clearly complicates the dynamic, specially in the toughest conversations on, for example, questions of investment performance.

Another point relates to corporate culture. What works in a bank or insurance company does not always work equally well in its asset management subsidiary. Take innovation, for example – often listed as one of the corporate values of modern businesses, especially those in financial services. It may be applicable in a dynamic investment banking environment but, personally, I'd be very happy for my asset manager to shun innovation (collateralised debt obligations, anyone?) in favour of old-fashioned principles based on valuation, diversification and patience.

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CIO, CREDO WEALTH
Deon Gouws joined London-based wealth management group Credo in March 2012 as CIO after a career of more than 16 years in the institutional side of the investment industry. Most recently he was the CEO of RMB Asset Management in Johannesburg. Before that, Gouws qualified as a chartered accountant and lectured in accounting and finance at postgraduate level. He also has an MPhil in finance from the University of Cambridge and is a CFA charterholder. His Twitter handle is @DeonGouws_Credo.

I accept that there are also reasons institutional groups enjoy certain benefits over standalone asset management businesses – the security of having a large captive client being just one such example. This is, ultimately, also why there will always be diversified financial services groups which continue to operate with in-house investment teams – it makes pure economic sense to retain margins by managing this captive asset pool yourself.

Against this backdrop, I do not expect firms owned by insurance companies and banks to disappear from the list when Towers Watson publishes its next research piece on the world's top 500 asset managers. But I would also not be surprised to see independent managers rise even further as a proportion of the largest 20 investment firms in the world. ■