

Review of Boutique and Employee Owned Australian investment Managers 2003

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Dr. Steven Vaughan & Associates has recently completed its 2003 review of employee owned Australian investment managers. This research is a core specialty of the firm, and follows earlier studies of so-called boutique managers, which concluded that these firms would be a significant force in the funds management industry in the years ahead.

Commenting on the Review, Dr. Vaughan said "the particular purpose of this review was to examine how these firms will address the challenges faced after successful start-up."

"The in-depth research now covers some 30 equity, fixed interest and listed property managers who fit the employee owned business model. There are many other generally smaller investment management operations which target particular market segments including the high net worth and absolute returned sectors. As we grow our database we will include those firms that meet an initial screening test for investment-grade quality in the institutional and rated sectors."

"The number of new entrants far exceeds the optimistic outlook portrayed at that time of the 2001 review. There is no doubt that the employee-owned sector (boutiques) are here for the long haul."

Vaughan Associates defines the sector to include firms that are partially or fully owned by the investment professionals managing the money. Some have external capital provided by silent partners and some other firms are part of larger multimanager organisations.

"Following our initial research, the broader market started to pay more attention to boutiques and they are now generally recognised as viable competitors to the more well-known brand names" Dr. Vaughan said.

"Many funds now insist that employee-owned firms are included in Australian manager searches. Moreover, this trend has spread to the listed property and small cap sectors, which are particularly suited to boutiques because of FUM capacity constraints in these sectors."

Trends and features of the earlier work by Vaughan Associates, including the size and style influences on performance are now more broadly acknowledged in the industry.

Less so, however, are the important areas of business and people management, and especially strategic planning.

To this end, Vaughan Associates conducted a global research study earlier this year, which covered the history and trends in the United States and Europe on employee ownership in investment management.

Dr Vaughan said that "one surprising feature was the similarity across international borders, with investment in start-up and conversion a strong feature in the US. Calpers, the giant US pension fund, allocates significant monies to fund employee-owned managers with particular niches and skill sets. There is also a strong growth in financial holding company activity in this space."

In a separate research study being conducted by Vaughan Associates into the structure of the Australian funds management industry, it has emerged that employee ownership and business model choice are now central strategic issues for investment manufacturing businesses, at all levels. Dr. Vaughan said "The boutique challenge to larger firms has

caused many to look inward to their internal HR and compensation strategies in order to stabilise their investment teams.”

“Coincidentally, many global firms have recognised that the retention of key investment professionals and the creation of a stimulating and rewarding work environment for their investment staff is now a necessary condition for business success. Increasingly, these firms recognise that giving local teams and business units a degree of autonomy in running their operations, including paying close attention to local market needs is more likely to achieve business goals.”

“Whether it is open architecture will join venture distribution, the specialist manufacturing firms, large and small are modifying or building new operational structures. Some large firms now seek to exploit a boutique-like feel in their operations and even go so far as to offer real equity or shadow equity participation to the employees, linking this to the profitability and success of the particular investment platform.”

“The growth in employee owned boutiques may appear to be a one-way street, but this is far from the case. New challenges lie ahead, which will test some firms. However, we see a bright future for the sector as a whole as the continued entry of new players raises the bar in terms of quality of business management as well as direct competition in exploiting market inefficiencies wherever they may arise.”

“The employee owned boutique is no longer the strong point of differentiation it once was. Success in the investment management business is no easier to find under this business model. There is no substitute for a very well grounded long-term business plan and continual maintenance of both investment and business processes, including paying close attention to managing the investment team dynamics, individual aspirations, career development and equity sharing.”

“In our earlier 2001 review, we forecast that employee owned investment managers would achieve a market share (of the asset class) of over 20 percent by the end of the decade. We now think this is conservative. While forecasting specific market shares is difficult, we think it is quite possible that a 25 percent share will be exceeded by this time. Not all firms will succeed however, as alpha generation remains the most challenging of tasks in this industry. Moreover, some individuals who have been attracted to the employee owned business model may find it disappoints them, so at points of time we may see a flow of investment professionals and business back towards the institutional brand names, particularly if they revitalise their business models and build equity participation schemes to compete with the boutiques on their own terms.”

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