There's Something Happening Here

"There's something happening here.
What it is ain't exactly clear.
There's a man with a gun over there,
Telling me I got to beware.
I think it's time we stop, children, what's that sound?
Everybody look what's going down."

"For What It's Worth"
By Stephen Stills, 1967

A world of change is literally assaulting our industry. Although little is clear with respect to future implications, some firms will survive while others will not. Investment return shortfalls batter investors, while more and more investment firms struggle. One can't help but wonder how once thriving firms are disintegrating before our very eyes. Charley Ellis eloquently addresses many investment-related reasons for managers' increasing underperformance of benchmarks in *Symptoms and Signs* in The Journal of Portfolio Management, Summer 2002, and warns investment firms to be alert. We see several organizational factors impacting investment firm success that management needs to be concerned about as well.

Flood of change

Change can be positive or negative, and it is true that every firm needs some change to avoid becoming stagnant. An ongoing flow of acquisitions or ownership changes, however, can create rough waters. Continuous change without assimilating prior change effectively can erode a firm – resulting in both internal and external confusion regarding the firm's identity, mission, leadership and future plans. A damaging corollary to excessive change can be professional turnover in investments, sales, client service and/or marketing, and thus, a vicious cycle begins.

Lack of credible, visionary leadership

Most successful investment firms have strong leadership, both for investments and for the business management of the company. With retirements and ownership changes, and in many cases, ownership from afar, many clients' worst fears related to succession have come true. Cultural clashes arise. The clarity and purpose of the firm become clouded. Investment disciplines are left to the discretion of individual portfolio managers, product focus dissipates, internal politics mount and investment results melt down. Leadership changes have been particularly challenging in the sustained bear market environment of recent years, a time when less experienced investors need involved, hands-on leadership from individuals in whom the firm's professionals trust. Trust is important, again both internally and externally. The credibility and cultural compatibility of the leaders are key to whether a firm has a chance at successful change of ownership.

Emphasis on profit growth versus on investment results

Many new owners are public equity companies, and the impetus for ownership of investment firms is often attractive profit margins and growing cash flows. The owner's vision of healthy

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cash flows can supercede the legitimate needs and rights of the clients and employees, especially in the face of the worst bear market since The Depression. The time frame of many new owners is quarterly, or at best, annually, while the investment industry tends to run in cycles of three to five years or even longer.

As a result, major differences between what an investment firm can deliver and what the owner wants or needs because of its own public equity position surface. Management is then forced to focus on profit growth and cost cutting versus strategies to improve results, assure excellence in client service, and attract and motivate investment talent. When cost-control measures drive investment resource decisions, levels of client service, product offerings and staffing frequently suffer.

Marketing unaligned with client expectations

As assets under management grew and firms evolved to offering multiple products to multiple markets, investment companies became enamored with the allure of retail marketing, and brought on marketing chiefs with experience in a host of industries other than investment management services. Branding became one of the Holy Grails. The assumption was made that if you had the correct brand, all else would fall into place and assets would grow at 25% to 40% per annum from here to infinity. Institutional investors, however, place brand at the bottom of the criteria for which they select investment management firms. And they don't want their investment managers to grow "from here to infinity." Other marketing chiefs built marketing plans based on mathematical formulas that proved unrealistic and unsustainable. Some insisted on communication platforms that failed to address client interests and investment and sales professionals' needs, and consequently, were ineffective and often costly.

What does this mean for the future?

It is a good news/bad news scenario. First – the bad news. Profits are under pressure, growth is increasingly challenging and some firms are failing. Second – the good news. It is becoming easier to stand out from competitors as fewer firms are distinguished by clear standards of excellence across their organizations, their investment capabilities and their communications. Many previously successful firms are falling by the wayside, dragged down by one organizational change after another, ineffective leadership, overemphasis on profits, and marketing unaligned with the real needs of the buyers. Talent moves to firms that understand and support the real business of investment management and service.

Opportunities for the survivors

Just as after a fire clears a forest of dead wood, or a flood subsides, new growth appears. There will be many opportunities for those who are astute enough to build on quality, deliver on what they promise, and avoid the sirens of greed and growth from here to infinity.

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