



FEBRUARY • 2011

Perspectives on the Investment Industry

SUCCESSFUL FIRMS ESTABLISH AND FOLLOW A VISION

20/20 Vision: Firms with Perfect— or Corrected Vision—Can See Their Way to Success

By Janie S. Kass, CFA

Executive Summary

Just as traveling from a starting point to a final destination requires a vision, so does managing an investment management firm. Investment managers— at inception— must decide what they want to be and where they want to go, and stay on track to get there. Investors frequently establish firms with the notion that strong investment skills alone will attract and retain clients. While firms can certainly enjoy a measure of success with this approach, the likelihood of becoming a firm that can weather the natural market cycles is quite slim.

Firms that veer off course because of a lack of vision can course-correct by pausing, analyzing the reality of the business and setting a vision. So, whether the firm is new or established, the key to lasting success in the investment management industry is a clear vision of the firm's mission, value proposition and core competency.

Margolis Advisory Group

T 516.277.1050

F 516.277.1052

www.margolisadvisory.com

While firms often evolve and expand over time, the most successful ones remain rooted in their original core mission, values and competency.

VISION

What the Firm Wants To Be

The investment management industry attracts talented professionals with its prospect of an intellectual challenge, lucrative profits and the freedom to direct an organization. Individuals often set out to create a successful investment firm, relying primarily – if not solely – on their investment skills. Strong investment skills are important, to be certain: however, success also requires a clear vision for the business.

Investment firms that depend on investment skills to drive business can likely survive – and even thrive – for a period for time. In this case, however, the most likely scenario for the firm is that it will generate an impressive track record managing personal assets, and even money of a handful of friends and acquaintances. However, the probability of attracting and retaining a broad client base, and succeeding in the competitive and volatile marketplace, is unlikely.

Gone are the days of the ‘you build it, they will come’ philosophy in the investment management industry. In fact, a significant amount of focus – vision – is necessary to build a sustainable business, whether the firm is in its infancy stage or more established. When a person or people decide to start a business, a series of important questions must be thoughtfully considered, including:

- ▶ What is the firm’s mission/value statement?
- ▶ What is the firm’s core competency?
- ▶ How will the firm add value to its clients?

The answers to these questions will guide the firm from inception – and through the

years. While firms often evolve and expand over time, the most successful ones remain rooted in their original core mission, values and competency.

Simply put, a firm must decide what it wants to be. For example, will the firm manage one local family’s assets, a large pension fund or global institutional assets? With this vision in mind, a firm can target and harness assets in its desired market.

HEDGE FUNDS

A Case Study in the Importance of a Vision

Hedge funds are a prime case study in the importance of a vision to a firm’s long-term success, with many hedge funds riding a wave of success when assets were easy to capture rather than establishing – and relying on – a clear vision. The late 1990s and early 2000s were marked by the collapse of some prestigious hedge funds, followed by the implosion of a couple hundred more to date. Today, many hedge funds are in a precarious position: a fraction of their former selves in terms of assets, revenues, employees and profits (that is, if they are still above a breakeven mark).

When hedge funds were thriving, they merely had to open their doors to accept money. No doubt, times have changed. Against the backdrop of the credit crunch and a global recession, the money isn’t flowing so freely. On the contrary, when not gated, it’s flowing out, forcing managers to scramble to keep clients. At the same time, new flows virtually evaporated. While inflows increased in 2010 and 2011 looks promising, leverage is no longer friend, but foe, and transparency, client communication, risk management and due diligence have become a top priority for investors.

The saying, ‘don’t confuse brains with a bull market,’ is fitting for long-only investors who applaud their investment skills for impressive results during a rising market. Managers that confuse sound vision with favorable market conditions generally experience problems over time. For example, a firm that brings in business through strong performance—with little or no marketing efforts—can be left wondering how to retain the assets and grow the business during times of weaker performance.

TARGET MARKET

A Firm Should Hone In On Its Ideal Clients

In the “new normal” environment, significant effort is required to grow a business, which includes a plan to target prospects for long-term relationships. This starts with a vision—the foundation that will guide important decisions around the firm’s structure, staff and marketing efforts. The upfront work to craft a vision will pay large dividends down the road because decisions grounded in an established vision will be more accurate and effective than those made on the spur of the moment.

Let’s take a look at a manager with roughly \$1 billion in assets. This manager is considering some key questions, which will impact the trajectory of the firm:

- ▶ Do we need to talk to consultants outside of our local area?
- ▶ Would a large, sophisticated institutional prospect with several billion dollars in assets actually hire us?

The answer: it depends on who you are and what you want to be (or as one might ask a child, “What do you want to be when you

grow up?”). If a firm’s principals desire to be a small firm, in which they and their staff maintain a light, local travel schedule then it’s not necessary to cast their net more widely. However, they should acknowledge their business’ reality, understanding that they won’t suddenly and out-of-the-blue attract more assets.

It’s important to note that visions are not one-size-fits-all, so each firm should customize a vision and actively pursue it. What’s most essential to success is that a firm’s management is confident in and committed to their vision from day one. This will influence the type of business they target and accept, and the channels of distribution they utilize.

Even with a vision, firms should expect stepping-stones in the process of growing the business. A likely scenario for a firm with a goal to manage commingled funds is that it will initially manage smaller clients before combining them into commingled funds. The idea being that the firm is addressing its target market from the start. Another example: a firm looking to manage large pension funds. In this case, the manager will need to develop relationships with specific consultants and prospects, as well as an understanding of the realistic timeframe to acquire business.

STRATEGIC MARKETING

A Plan Rooted in a Vision

In today’s environment, many firms have landed back at square one. Those firms that enjoyed a level of success without a vision must now regroup, establish one and determine a strategic marketing plan to move toward stated goals. New firms should know their vision out-of-the-gate. A carefully developed plan will help a firm to:

The upfront work to craft a vision will pay large dividends down the road because decisions grounded in an established vision will be more accurate and effective than those made on the spur of the moment.

- determine the right path to desirable clients
- ascertain which meetings and assets to accept or decline
- evaluate progress, and make adjustments necessary to achieve established goals

When a firm knows what it wants to be, implementing the plan (and making difficult decisions) will be easier than plotting the course blindly. These questions are the basis for a reliable litmus test:

- ▶ Is this action moving the firm toward its goal?
- ▶ Are the time and resources spent in marketing positively impacting or distracting from the business?
- ▶ Are the investment professionals fully vested in the vision?

To turn our attention back to hedge funds, a common speculation is that given the recent economy the market may be saturated, with many hedge funds likely to collapse in the foreseeable future, particularly given investors' recent tendency to allocate primarily to the largest hedge funds. While hedge funds typically are headed by smart, experienced people, today's markets call for more than that.

At the same time, traditional (long-only and public security) firms are experiencing the challenge of the ever-changing demands—and fickle nature—of investors. Long-only U.S. equity shops have been caught in the middle of a perfect storm: a combination of the demise of defined-benefit plans; an increased interest in liability-driven investments, causing fixed income to erode equity allocations; an increase in foreign and emerging equity allocations; and, a shift from active to passive large-cap stocks. In this climate, allocations from institutional investors have declined.

Ultimately, a firm that operates with goals in plain view will be less likely to face hard decisions about staff lay-offs, salary cuts, and are more likely to enjoy longer-term success. Conversely, its path will be less bumpy.

Conclusion

A vision enables a firm to customize an action plan—including staffing, compliance, auditors, legal and other providers, and financing—in order to achieve both short- and long-term goals. Bottom line: know what the firm wants to be and where it wants to go, and importantly, stay the course. ■

For additional information,
please contact:

Janie S. Kass

T 415.990.7356

E janie@margolisadvisory.com

Jeffrey Margolis

T 516.277.1050

E jeff@margolisadvisory.com

Margolis Advisory Group, Inc.

85 Barberry Lane

Roslyn Heights, NY 11577

www.margolisadvisory.com