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Building an asset management company

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11 July 2000

The primary goal of any asset management company must be to attract and retain assets under management. Without assets under management, there is no business. Great investment talent will not generate any income without fee paying assets. Any company planning to become an asset manager must have plans for attracting and retaining these assets. Getting assets for the company to manage is not enough. If the management and service functions are not performed well, the clients will leave as fast or faster than they arrive.

The draft laws "On Collective Investment Institutions" and "On Non-State Pension Funds" authorize the creation of the asset management business in Ukraine. While the goal of the asset management business is simple to understand, accomplishing the goal will be very difficult. The company must perform many different functions well.

Determining what the customers want

First, the company must attract investment assets by providing a service that people with money need or want. People have many reasons for hiring an asset manager either directly or through different types of collective funds. One of the most important reasons is the desire to have an expert make the asset management decisions. Many fund investors may believe that they do not know enough about managing their assets or they do not have the time to devote to the subject. Often, they believe that their time can be better spent focusing on their own business or profession.

Whatever the reason, fund investors often hand over their money to people they do not know. Few professional asset managers personally know enough investors to build a successful business. These managers must build their business by attracting money from strangers by creating a reputation for competence, reliability and discretion.

Therefore, the company starting up an asset management business must identify which services investors are willing to support and then hire people who can provide these services effectively and profitably. Success will require a good match between the needs of investors and the competence of the asset managers. If the company's managers conclude that investors will buy a very conservative fund with low credit risks, the company should have investment officers who have the ability to make judgements about the financial strength of portfolio holdings. If the company decides to offer high risk products, it needs investment managers who know how to assess the risks and returns of those assets. Without this confluence of market demand and talent, the firm will fail to meet the needs of potential clients.

"Investment styles" is the term used for these different types of investing. Conservative, risk averse funds are managed in the conservative style. Groups of funds invested in a particular style are called fund classes. Thus, all the conservative style funds make up the conservative class of funds. When an asset manager offers a number of funds with different styles, we call that company's funds a "family of funds." The funds in a family may be very different, but they are managed by the same company.

The fund style should be clearly indicated in the documents that are sent to potential clients when they are considering purchase. We usually put this statement prominently in the prospectus. The investment style of a fund is rarely changed. If the style is so unpopular that few investors buy it, the manager may close the fund or offer to merge it into another. No modification of the style should occur without the approval of the fund holders in a formal vote.

Once the asset management company has sold the fund to investors, the investment officers must continue to invest the fund assets consistent with the original investment style. The company has promised to use that style and it must act consistently with that promise.

In the world of investing, the demand for different types of funds changes as market conditions change. When the investment markets have acted poorly, investors flock to conservative funds to reduce their losses. When markets are booming, investors want the more aggressive funds that will increase their investment return. Thus, most successful asset managers offer fund families. When their clients no longer want one type of fund, they can easily switch to another. The variety of funds and ease of changing are very powerful marketing tools and help managers retain client assets.

The current draft law on "Non-State Pension Funds" specifically creates the opportunity for asset managers to offer three types of funds to participants. The investment restrictions for conservative funds, designed for risk averse investors, require a large component of corporate and government bonds. The aggressive funds are quite restricted in the use of bonds, but can hold a larger portion of the fund in equities. Between these two fund types lies the moderate funds.

Marketing the investment service

Asset managers must also decide how to sell their funds to investors. In the United States, the industry has used many different sales techniques. In the early days of the fund business, managers employed sales agents who worked for only one fund company and exclusively sold that company's funds. This model was very successful since the fund company had total control over the sales force and the presentation of the funds to prospective clients.

As the retail brokerage industry expanded, asset managers worked with local salesmen to sell the funds in return for a commission or sales "load" which was as high as 8.5% of invested assets. The commission percentage declined as the amount invested rose so that large purchases had only a very small commission. The commission was deducted from the client's investment so that the client paid for the sales effort.

Asset managers found that selling through broker/dealers was more efficient than having their own employees sell the funds and the direct sales method declined. The brokerage firm assumed all the responsibilities of hiring and supervising the sales people. The sales people also benefited from having a variety of products to offer customers.

Eventually, the larger brokerage companies decided to sell their own funds through their sales force. They acquired existing asset managers and/or built their own. As a result, many of the largest asset managers selling through brokers are owned by these brokers. Nevertheless, some large very successful managers remain independent and appeal to investors who want their money managed by people not affiliated with brokerages.

Overtime, clients became more sophisticated and resented paying large commissions. They believed they could decide which funds to buy without the help of salespeople. These people sought out "no load" funds that were sold direct to the customer without salesmen or commission. No-load funds have now become a very important segment of the business.

The new asset manager in Ukraine needs to determine how best to market their funds. Different marketing schemes will work with different types of investors. There have been many successful marketing models used.

Servicing the customer after the sale

After the sale is made, clients can be retained by providing quality service. They will want help with adding to their accounts, redeeming some or all of their holdings, or obtaining account statements. All of these services are routine services asset managers provide, but they must be provided efficiently and pleasantly. Success at customer service is a very effective tool for building loyalty with clients. They are much more likely to forgive investment mistakes than service problems that become difficult for them to resolve. When clients have to call or write repeatedly or follow difficult procedures, they will be easily alienated.

To reduce problems, the asset manager should allow only authorized and well trained people to talk with clients. Untrained personnel, no matter how well intentioned, will make unnecessary mistakes. The service people do not need to be top managers, but they must know what they are talking about and they must be able to solve any problems that develop. Their ability and willingness to work with people in a pleasant manner will be very important to the success of the service program.

To do their jobs effectively, the service representatives must have accurate and current information. When clients call, the representatives should be able to immediately answer as many of their questions as possible. They should also have the authority to fix many problems, such as obvious errors, as defined by company management. However, serious problems involving significant amounts of money or very ambiguous situations should remain under the control of more senior officials.

Another aspect of customer service that can help retain customers and encourage them to place additional assets with the manager is an active communications program. When the asset manager sends out annual and other reports, it should use the opportunity to provide customers information that will help build the long term relationship. Certainly, a frank discussion of the recent investment results, good or bad, will be useful to the customers. Anybody can communicate well when things are going well. The firm that can explain its shortfalls in a way that enhances the customer's respect for the manager enhances its own position in the marketplace.

Client communications should be well written, informative and consistent. Many firms have a few key themes they emphasize. Every message from the firm will mention those themes. For example, the Vanguard group of mutual funds in the United States uses low cost as a marketing tool. They argue that it is almost impossible to outperform other managers with a similar investment style on a consistent basis and, thus, the manager with low fees will return a greater net return for its clients. Every time Vanguard sends information to their clients, there is some mention of the low cost theme. This practice represents a very effective use of communications to support the marketing and retention effort.

The importance of investment results

The last point in attracting and retaining assets under management is also the most important: earning good investment results. During the first few years that the asset management business exists, no Ukrainian firm will have much of a record of results to show customers. However, after a few years some firms will clearly show better results. The reasons may be more luck than skill, but customers will, nevertheless, flock to the firms with the good figures. After all, the number one reason investors choose an asset manager is investment performance.

One strategy for building a good investment record is taking enormous risks in the hope that the investments will produce high returns. If this strategy works, the firm can realize large fund sales. However, most high risk strategies do not work or, if they do, they only work for a short time period. When they start failing, the outflow from the asset manager will be quick.

The asset manager who is trying to build a good long term business has a better probability of success by taking moderate risks with the goal of earning consistently good returns. The manager with the more consistent results will attract much more money in the long term and can build up a strong business than the high risk manager. Most investors, particularly pension investors, should have long term investment goals. Two good years of spectacular returns followed by terrible results do not build up money for most investors' goals.

The asset manager should relate the investment strategy to the types of customers being sought. The firm should then communicate the strategy clearly and consistently to current and potential clients, to the sales people and to the customer service representatives. Everybody involved in the asset manager's business plan should fully understand the manager's strategy and goals.

Building an asset management business in an emerging market economy will be very challenging. In this paper, we have discussed some of the concepts that have worked elsewhere and that could be applied to Ukraine. The entrepreneurs and institutions trying to build their business should take some of these ideas and modify them as necessary to fit the situation in Ukraine. The successful asset management companies will be those that make the right choices.

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