

Excess Returns

Monthly insights for investment marketing and sales professionals



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“What is your competitive advantage?” This often is the toughest question that investment companies must answer in their quest to build assets under management – even if the question is not posed explicitly. Yet many investment managers do not provide an answer or, worse, answer in a way that makes them appear naïve. This issue of *Excess Returns* explores the challenge of competitive differentiation.

With best wishes,

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Alpha Partners is an investment marketing firm specializing in research and presentation strategy. Our goal is to create alpha (excess returns) by helping investment firms win, keep and diversify assets under management.

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The Toughest Question

One of my clients told me this story and I will never forget it. “We were competing in a final for a significant piece of business,” he said. “We had prepared carefully and we were well into the presentation. We had covered the philosophy and process and I thought things were going well when one crusty old guy in the front row took off his glasses, leaned forward, looked directly at me and asked, ‘*That’s all well and good. But tell us, please, what makes your firm any different from the other firms that are here today competing for our business?*’”

My client said he was taken aback and fumbled a bit because he thought he already had answered that question. Based on this client’s experience, I wrote an [article](#) several years ago about strategies for competitive differentiation. **The discipline of investment marketing has come a long way since then, but differentiation still remains a major challenge for many firms.**

Sources of Uniformity

There are several reasons why differentiation remains a sizable hurdle for investment managers:

Investment professionals often do not grasp the difference between what is required to win versus what is required merely to compete. Attributes such as “opportunistic,” “benchmark-agnostic,” “bottom-up” and “fundamental research-driven” are not reasons why your company should win the business. They are merely why your firm qualified to compete. And yet, incredibly, even in a business as competitive as asset management, some professionals simply do not understand this distinction. **If you define your firm’s competitive advantages with a string of adjectives that echo those of your competitors, then you get the T-shirt and you get to go home. But this is not an amateur sports competition.**

There is real money on the line here and enumerating the reasons why you qualified to compete is not a winning strategy.



When it comes to defining their competitive advantages, investment managers communicate with a relentless uniformity typically rivaled only in the natural world.

Investment managers all sell the same thing: performance. Yet investment returns are so fickle that investment companies are forced by law to wear the warning label “Past performance is no guarantee of future results.” Investment professionals often mistakenly use the word “unique” (as in “one of a kind”) to describe what they do, but they all operate in a sophisticated world where, if there is anything truly unique, it is quickly arbitrated away. How then can an investment firm claim any form of enduring competitive advantage? The answer usually is, “It’s all in the execution” and execution, for all its merits, is a much tougher sell for investment managers than it is for, say, athletes. **With a stunning net shot or slam dunk, one can see brilliant execution in action. Not so with inspired portfolio construction or a judicious sell decision.**

Important marketing decisions are frequently made by committee. The originality required for true competitive differentiation starts with individuals who believe in the investment philosophy and process. **As marketing decisions are removed from those individuals – by size, bureaucracy or organizational structures that segregate the marketing and investment teams – competitive differentiation suffers.** This is particularly true in larger companies where too much valuable time is spent on describing the identity of the parent company as opposed to the investment strategy under consideration by a prospective client. (Sure the identity of the parent is important, but it should not take up the first five minutes of a 20-minute final competition for a small-cap value mandate.)

Written communications fail to capture the subtleties and nuances of in-person delivery. I recently asked one of our new clients to send her presentation book, as a first step in learning about her strategy. The book checked all the required boxes (philosophy, process, people, performance and so forth) yet failed utterly to convey even one-tenth of the intellectual ingenuity driving this particular strategy. **The energy, conviction and clarity with which the portfolio manager told her story in person were completely absent from the story told on paper.** Hearing her present and reading her presentation book, I never would have put the two together.

There is no objective foundation for claims of competitive differentiation. Most investment managers will tell you that their primary competitive advantage is the quality of their research: how broad, deep and insightful it is. **In the vast majority of cases, however, when one asks if the manager has conducted research on its own competitive advantages, the answer is “no” or “not lately.”** According to an ongoing survey on our website, 19 out of 129 — or approximately 15% — of respondents (as of this writing) checked “yes” when asked if they conducted systematic client satisfaction surveys and win/loss analyses. So how do companies know that their claims about competitive advantages are grounded in reality? Either they don't or they possess a purely anecdotal sense of how they are different. (For more on market research, see the [April issue](#) of *Excess Returns*.)

I asked my client who fumbled the “what makes you different” question what the outcome was. The hiring entity decided to pass on all contenders. Maybe this organization felt like the insurance company board member I once interviewed for a client. After an extensive search, his company decided to keep managing their investments internally. “We didn't come away from the meeting,” he told me, “with a clear sense of how we were going to be better off after hiring them than we were before.”

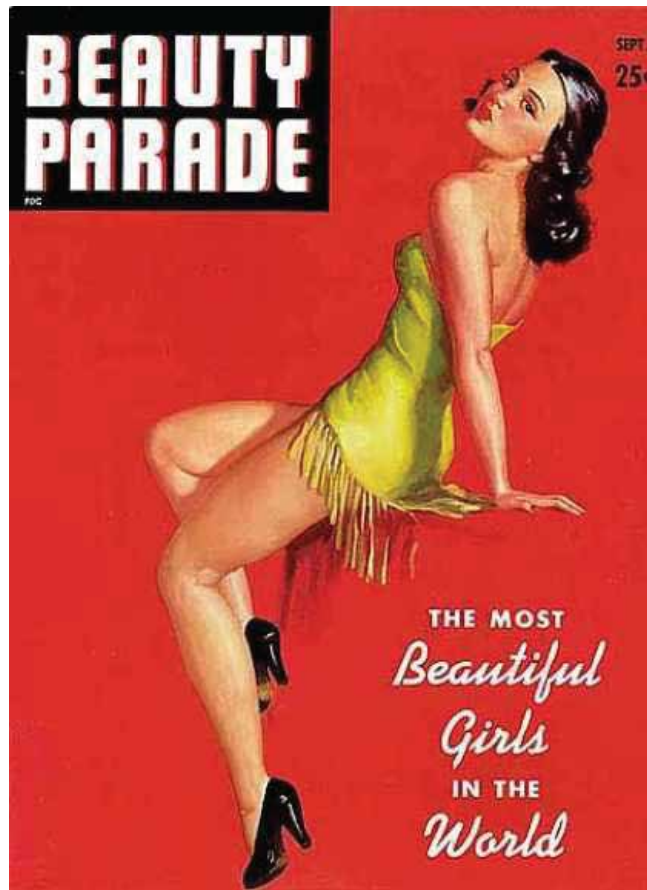
Who Doesn't?

- Who doesn't take a long-term investment approach (i.e., investing over a three- to five-year time horizon)?
- Who doesn't avoid fads and trends?
- Who doesn't avoid market timing?
- Who doesn't practice intensive bottom-up fundamental research?
- Who doesn't hit singles and doubles, not home runs?

I have yet to meet an investment professional who claims to have a short-term, market timing-oriented approach and claims to swing for the fences based on purely top-down calls. A good rule of thumb in defining competitive advantages is to ask the question, *Who doesn't?* As in who doesn't make this exact same claim? Research may well be one of your firm's strengths, but it's not a competitive advantage if it fails to pass the *Who doesn't?* test.

Beyond the Beauty Parade

Investment management professionals sometimes refer to the final presentation as a “beauty parade.” This implies that the process is all form and no substance. On the contrary, the purpose of a final is to better understand how the investment strategy works and, perhaps most important, find out what the investment team would be like to work with. An [article](#) in *Engaged Investor* magazine, a UK publication for pension trustees, notes that trustees for the Civil Aviation Authority pension fund are “always on their guard against style over substance during presentations ... the key challenge is to prevent trustees being over impressed by polished, professional presentations which might disguise a range of shortcomings.”



The dismissive term “beauty parade” belies the importance of the final presentation in hiring an investment manager that represents the right cultural fit.