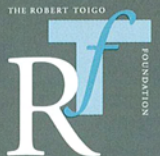


# Achieving Market Share Growth

## Through Investment Consulting Relationships

*An Action Plan for  
Minority and Developing  
Investment Managers*





#### *Survey Composition and Methodology*

The Toigo Foundation study is based on a survey of the largest investment-consulting firms in the United States, with a focus on public market strategies. The survey respondents advise institutional clients responsible for investing over \$2 trillion in assets, according to data from Greenwich Associates. Respondents include the following firms:

Buck Consultants / Mellon Financial  
Callan Associates  
Ennis, Knupp & Associates  
Evaluation Associates  
Hewitt Associates  
Mercer Investment Consulting  
New England Pension Consultants  
Pension Consulting Alliance  
Rocaton Investment Advisors  
Russell Investment Group  
Strategic Investment Solutions  
Watson Wyatt Investment Consulting  
Wilshire Associates



In Spring 2004, the ROBERT TOIGO FOUNDATION conducted a survey to identify the opportunities and challenges faced by minority-owned investment firms and developing investment managers in increasing their market share of institutional assets under management.

Many institutional investors, including defined-benefit pension plans and endowment funds, have established policies to encourage the allocation of assets to minority-owned and woman-owned investment firms, as well as developing (or emerging) investment managers. The purpose of these policies has been to encourage entrepreneurship and to maintain a high level of competition within the financial services industry while upholding fiduciary responsibilities.

Despite these policies, many such investment managers comment that the process of appointing investment firms seems impenetrable. Similarly, many institutional investors, particularly public pension funds, continue to cite difficulties in finding qualified minority-owned and woman-owned investment firms.

Given both demand-side and supply-side constraints within the industry, the Toigo Foundation survey focused on the role of the investment consulting firm—an intermediary with a unique perspective on the practices and policies of all constituents. Investment consulting firms are highly influential participants in the institutional asset management industry, with a key role in allocating funds among investment managers.

The survey project was generously underwritten by a grant from Watson Wyatt Investment Consulting. Findings from the survey were first presented at the PLAN SPONSOR AND MINORITY MANAGER CONSORTIUM in New York in June, 2004.

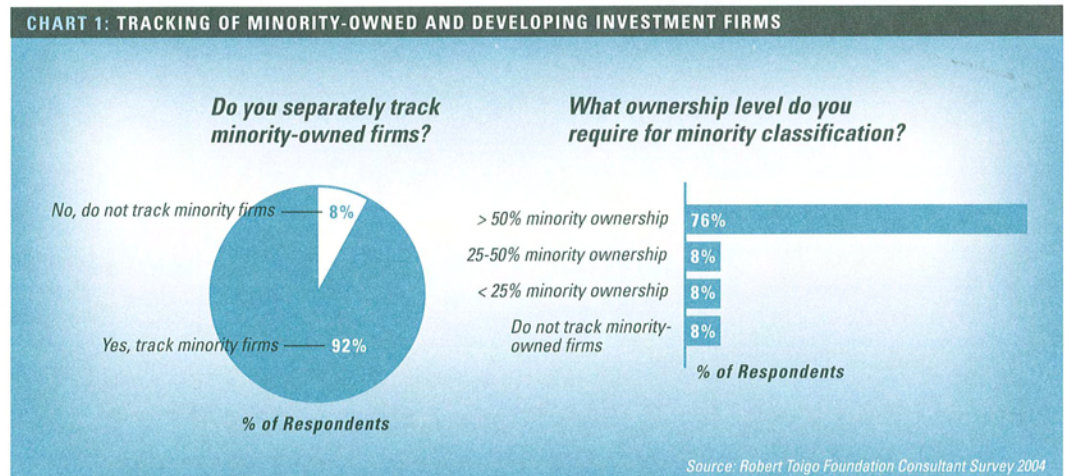
### Identification and Tracking of Minority and Developing Firms

The survey focuses on minority-owned investment management firms that have limited exposure to the institutional marketplace. We did not focus on minority-owned or woman-owned firms with an established market presence and asset base in excess of \$2 billion, although many of our findings are also relevant to this sector, which Pensions & Investments identifies as 75 to 80 "established" minority-owned firms.

This survey considers the investment firms that meet ethnicity, gender and development stage classifications, although it is necessary to determine the level at which each of these attributes is tracked. We found that most consultants track minority-owned firms, but relatively few track developing investment firms as a separate attribute.

#### TRACKING OF MINORITY-OWNED AND WOMAN-OWNED FIRMS

Our survey indicates that 12 of 13 respondents track minority-owned firms as a distinct firm attribute, which makes compiling data on such firms relatively simple. Minority-owned firms are typically defined as having "greater than 50%" minority ownership, with some consulting firms allowing smaller ownership level thresholds. Notably, one consulting firm indicated that it was willing to consider a portfolio or product managed by a minority professional within a conventional firm as a "next best substitute." We also found that classification of criteria for woman-owned firms mirrors that of minority-owned firms.

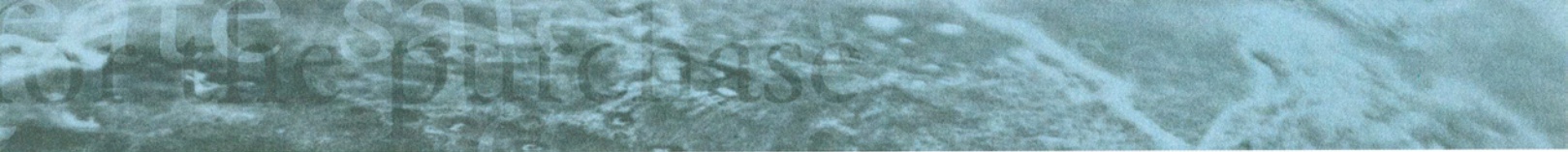


#### INCONSISTENT TRACKING OF DEVELOPING FIRMS

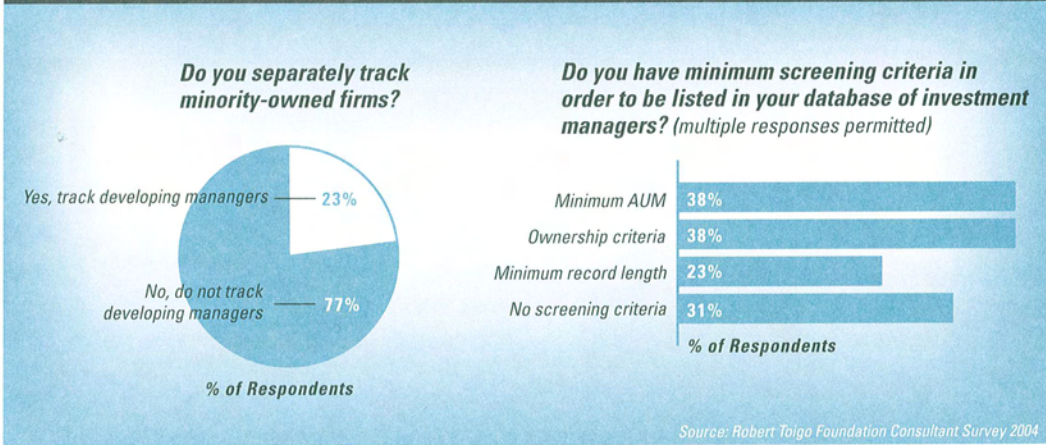
Developing firms, by contrast, are much less likely to be tracked as a separate investment category. Survey results showed that only one-quarter of investment consultants classified developing firms (exclusive of minority ownership). In addition, the survey identified a wide range of criteria for such classification, including small asset size, short track records, and employee ownership.

The majority of consulting firms, 9 of 13 respondents, employ some minimum screening requirements to limit the number of investment firms under consideration for client mandates. These criteria commonly include minimum assets, length of record, or financial requirements. Almost by definition, the category of "developing managers" comprises those firms that do not neatly fit into the conventional consultant selection criteria.

The survey found that the quantitative requirements set by consulting firms as minimum acceptable levels were wide-ranging. For example, one consulting firm established its asset-size criteria at less than \$500 million, while another set its bar at \$2 billion.



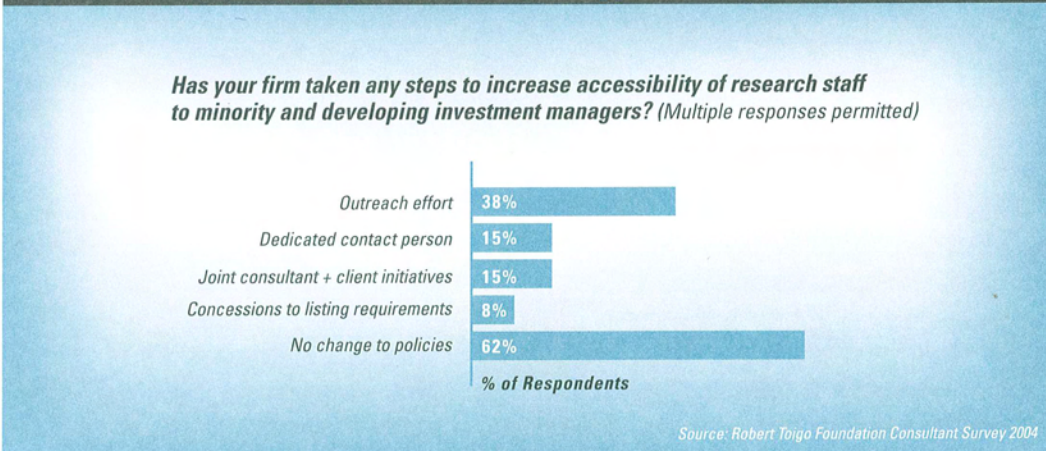
**CHART 2: CONSULTANT SCREENING REQUIREMENTS FOR DEVELOPING FIRMS**



### FEW CONCESSIONS TO SEARCH CRITERIA

Only 1 of 13 consultants in the survey indicated they were willing to make concessions in their standard screening criteria in order to specifically include minority-owned and developing investment firms in their manager searches. However, 5 of 13 respondents have established programs to improve the accessibility of research staff, such as development programs for up-and-coming managers. We found that the majority of firms—8 of 13 respondents—do not make any concessions or changes in their established search policies in order to specifically include minority and developing managers.

**CHART 3: OUTREACH EFFORTS BY CONSULTING FIRMS**

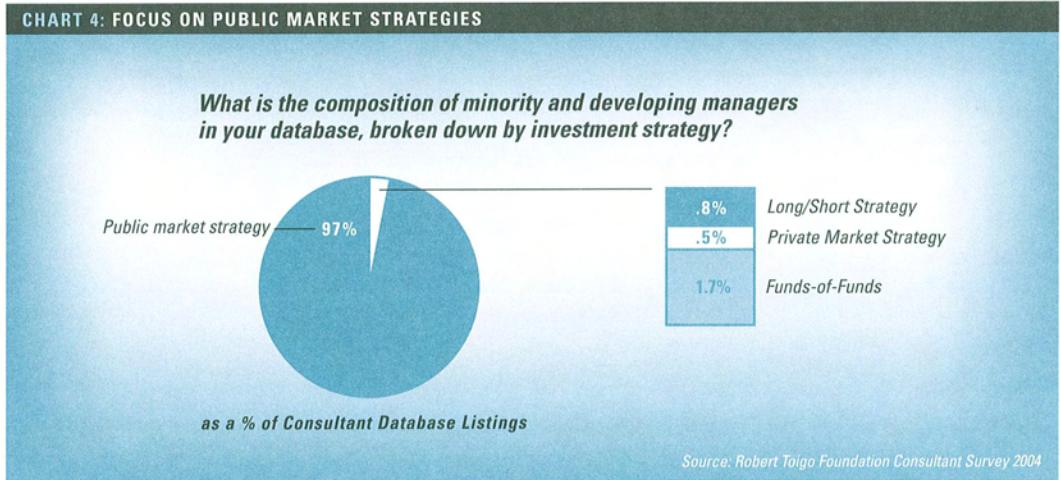


### INVESTMENT STRATEGIES COVERED

Consultant research into minority managers focuses primarily on public market managers, as demonstrated by the vast majority of database listings. Virtually all minority-owned firms—or 97% based on the listings in the consultants' databases—focus on public market strategies. Other strategies represented only a combined 3% of total database listings, including private market strategies (such as private equity, venture, and distressed debt), as well as hedge funds, and Fund of Funds.

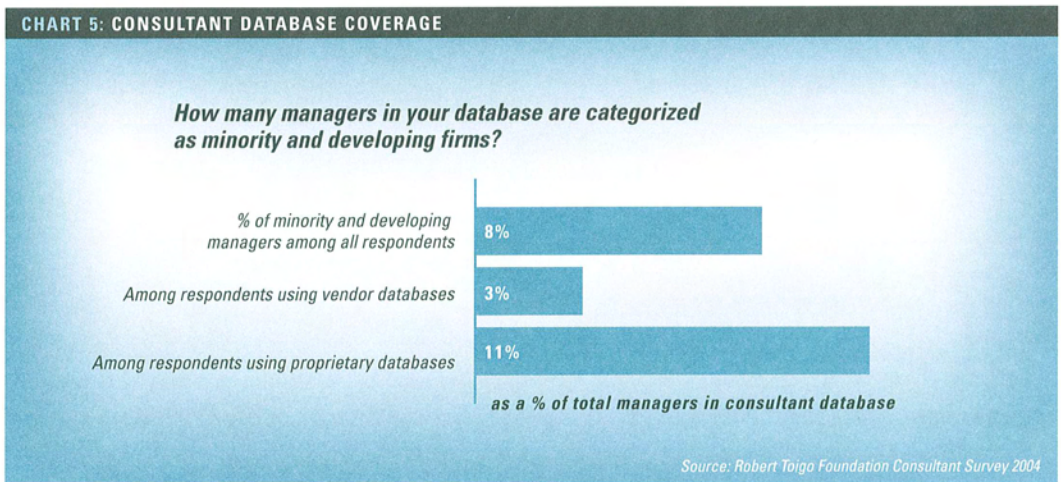
It is important to note that this concentration into public market strategies reflects consultant tracking of minority-owned and developing investment firms within their databases, not the actual number of investment

managers pursuing such strategies, nor the market opportunity available to minority and developing managers in non-traditional, non-public investment strategies.

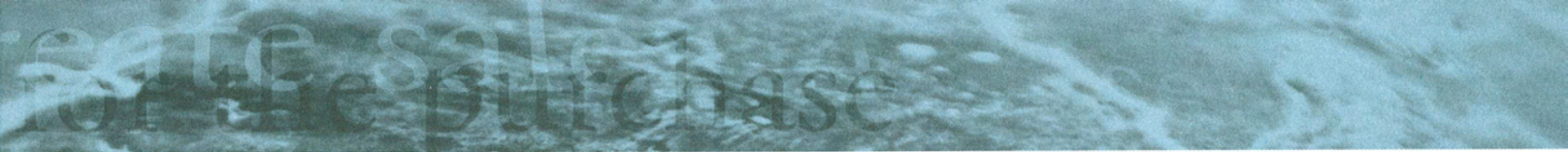


**INCLUSION IN CONSULTANT DATABASES**

Minority-owned and developing investment firms represent 8% of all investment firms included in consultant databases, which are the primary tools used to source and identify suitable managers for a client mandate. This 8% inclusion rate is an average among all responding consulting firms. Individual firm responses ranged widely, with minority-owned and developing investment firms representing from 1% of total database entries to as much as 18%. Database sizes were also quite varied, ranging from about 850 total listings to as many as 3,500.



Interestingly, the survey identified a material difference in the inclusion rates among database types. Minority-owned and developing investment firms represented about 11% of proprietary database listings, on average, but only about 3% of listings in third-party, vendor-provided databases. The two most popular vendor databases cited by respondents were eVestment Alliance and Plan Sponsor Network (PSN). In our view, this



disparity between vendor-provided and proprietary databases represents an opportunity, since these third-party databases are growing in use by both consultants and institutional investors. It appears that these vendors do not yet have the depth of data representing small firms. Since these third-party databases are often used by many consulting firms, we believe that an effort to get listed here is likely to have a leveraged result.

Investment managers of all types should make every effort to keep database information up-to-date. Significant events, such as changes in investment staff or the introduction of new products, should be reflected in the consultants' databases and represent a good opportunity to maintain an ongoing dialogue with consulting firm staff.

### Investment Mandates and Manager Searches

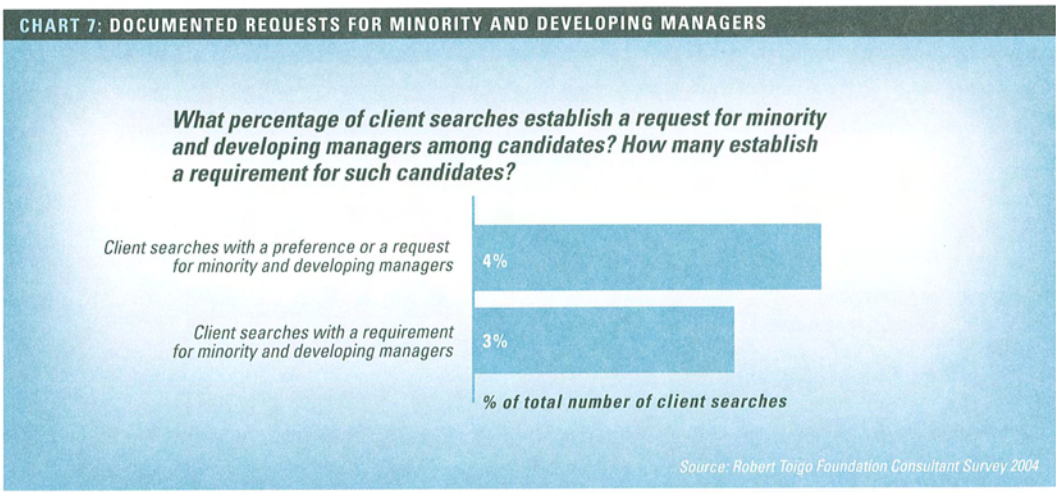
Overall, about 7% of all investment mandates in the past three years included a minority and developing manager among the candidates, with about 2% of all searches resulting in a final award to such managers. Results in the last year are slightly higher but remain consistent with the three-year results. This data reflects 76 final awards to minority and developing managers across 4,655 total client searches during the past three years, based on data analyzed from the ten consulting firms that responded to this question.



The success rate (an average of about 2% of searches resulting in selection of a minority and developing manager) had a fairly wide range, with respondents reporting between 0% to 10% of all client mandates being awarded to a minority and developing manager. This disparity in success rates could reflect each consultant's institutional client mix (public, corporate, non-profit plans), which in turn may dictate different levels of demand for minority managers.

### REQUESTS FOR MINORITY AND DEVELOPING MANAGERS

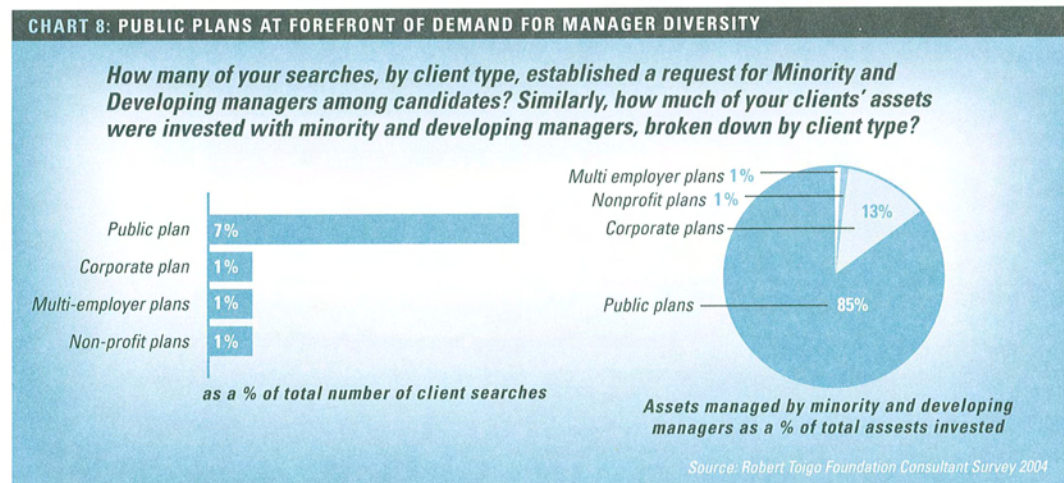
A relatively small number of investment manager searches, about 4%, establish a preference or a request for minority and developing managers to be included among the candidates. Moreover, a similarly small number of searches establish a requirement that only such firms be considered among candidates.



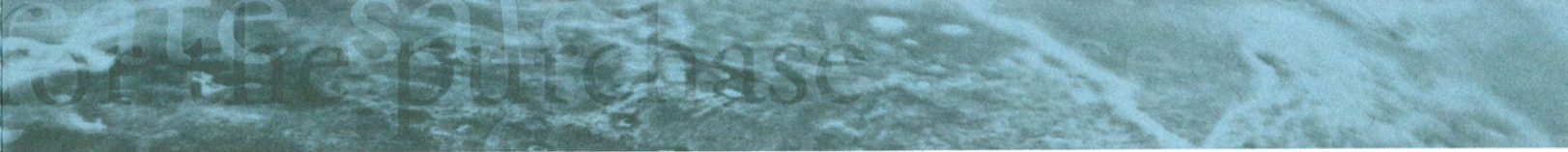
One respondent commented that this data probably understates actual demand for minority and developing managers, noting that informal requests for such managers to be included among candidates are very common (as much as 50%-75% of that respondent firm's searches), although not part of the formal search criteria guidelines and, as a result, not tracked.

**MANAGER SELECTION BY INVESTOR TYPE**

Not surprisingly, public plans such as state pension boards appear to be at the forefront of demand for greater diversity in investment management. Corporate plans also represent a solid opportunity for minority and developing managers.





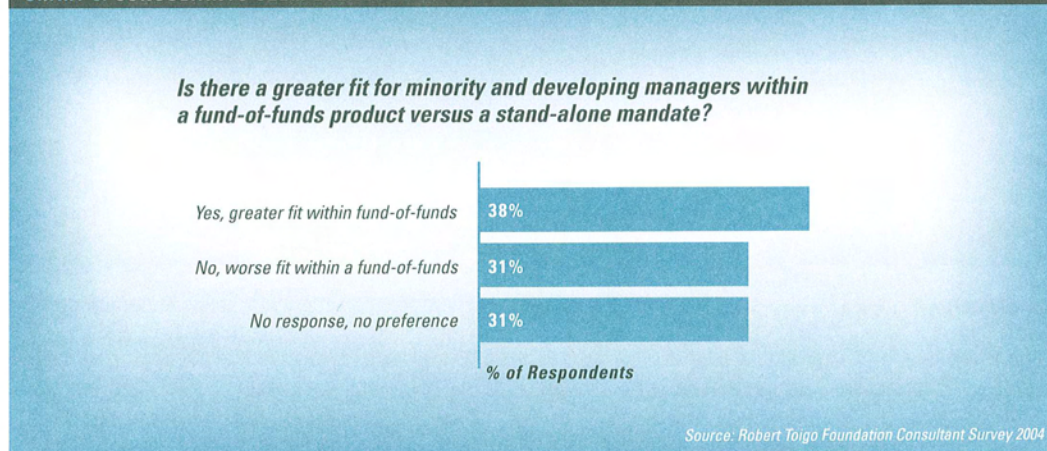


## OPPORTUNITIES WITHIN FUND-OF-FUNDS

Respondents to the Toigo Foundation survey were evenly divided on whether participating in a Fund-of-Funds (or Manager-of-Managers) product is a preferable strategy for achieving greater investment manager diversity. Comments to this question reveal polarized viewpoints:

- Advocates for the Fund-of-Funds strategy cite the benefit of a specialist in identifying promising investment managers who might not otherwise meet consultant or client criteria. For example, an FoF strategy enables small investment managers to meet some size-related criteria that would otherwise disqualify them from participating in the institutional market. Advocates also point to more intensive research necessary to identify talent. Manager selection can be particularly important among developing managers, where (by definition) the firms do not meet conventional investment criteria such as size or track record length.

CHART 9: CONSULTANTS SEEM EVENLY DIVIDED ON FUND-OF-FUNDS



- Detractors cite another layer of expenses for the Fund-of-Funds manager structures, which can erode the potential for above-average investment returns. One respondent commented: "Fund of Funds performance has not been particularly compelling." Moreover, several consultants noted that their own research was sufficient to identify small, high-performing investment managers without the need for another consolidator.

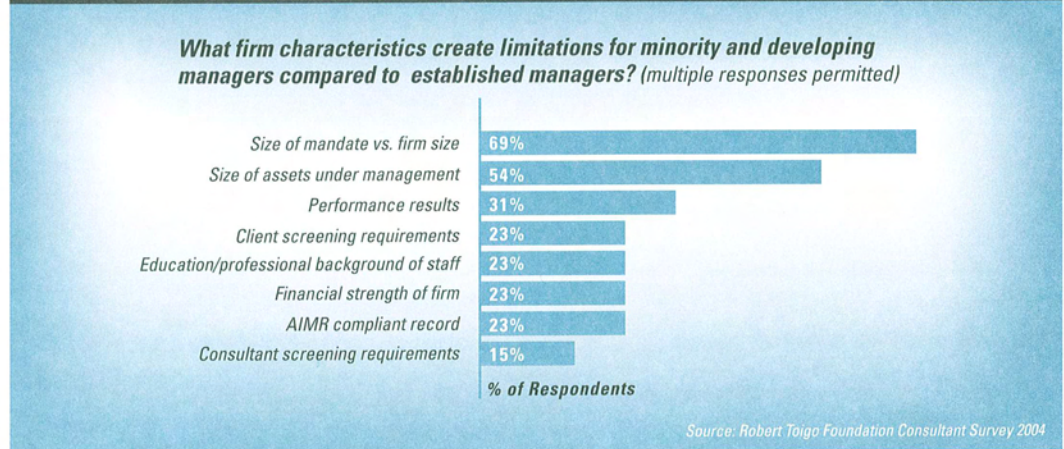
Responding to concerns about a high fee burden, one consultant noted that the concept of a Fund-of-Funds strategy is relatively new, indicating that the "first generation" of such funds was invested in relatively low risk investment styles, which mimicked the Russell 3000, where it was difficult to generate sufficient excess returns to justify another layer of fees. The current "second generation" of Fund-of-Funds, the respondent noted, appears to be invested in higher risk, higher return strategies which require a more intensive manager selection process, but are also better suited to absorb the additional layer of fees.

Moreover, one consultant commented that "Manager-of-Manager" programs might represent another avenue for growth. Traditional Fund-of-Funds generally create a single "off the shelf" portfolio for all clients. A MoM fund, in contrast, puts together a completely different program structure for each individual client, based on specific requests and requirements. These MoM funds might have more flexibility to highlight minority or developing managers for those clients who request such characteristics. Some firms that are known for developing Manager-of-Manager funds are Progress Investment Management and Northern Trust.

**LIMITATIONS TO GREATER USAGE BY INSTITUTIONAL INVESTORS**

The most common limitation faced by minority-owned and developing investment firms is the concentration of assets in the proposed mandate, cited by 9 of 13 respondents. Many consultants advise clients against having a single mandate representing an outsized proportion of a manager’s total portfolio. This limitation was commonly cited as a reason to diversify mandates among a number of managers through a Fund-of-Funds strategy, discussed above.

**CHART 10: SIZE IS MOST COMMONLY-CITED CONSTRAINT**



**INVESTMENT STRATEGIES WITH GREATEST OPPORTUNITY**

Many consulting firms say equities overall offer the most potential for minority-owned and developing investment firms, probably because most institutional plans are most heavily weighted towards public market equities.

- Some 7 of 12 respondents specified specialty equity, such as specialty growth or value strategies, mid or small cap, as well as long/short market-neutral strategies.
- About half of respondents considered manager of a Fund-of-Funds a good opportunity, (Note: this is a role as Fund-of-Funds manager, not as a fund participant as discussed earlier).
- One-third of consultants commented that core equity offered potential for minority-owned and developing investment firms. The Toigo survey respondent noted that core equity was often viewed as a safe place for pension plans to try out a manager while he established a reasonable track record. Conversely, it is hard to “knock the ball out of the park” without a differentiating (read: specialty) strategy. It is also difficult to compete with low fees charged by index and enhanced-index strategies, which require significant scale.
- Only 3 of 12 identified fixed income as a good opportunity, probably due to the scale and resources necessary, to make a meaningful contribution to an institutional fund’s fixed income investment segment unless through a very differentiated strategy.
- Alternative asset classes were least often cited as having potential for minority-owned and developing investment firms, with only 2 of 12 respondents citing strategies including private equity or hedge funds. The bearishness among these asset classes likely reflects the small amount of assets allocated by most plan sponsors.



## **Consultant Comments to Drive Success**

Finally, the survey asked investment consulting firms to identify success factors for minority-owned and developing investment firms. Given investment consulting firms' involvement with so many investment managers, ranging from marginal firms to the very successful, their insights offer a valuable perspective for both sides of the table. The following recommendations, largely unedited, fell into four central themes:

- Develop institutional client and asset base
- Target reasonable-sized clients relative to your asset base
- Introduce key investment professionals to consultants
- Establish direct contact with consulting firm clients
- Call on us (consulting firms)
- Develop relationships with Fund-of-Funds managers or Manager-of-Managers
- Get listed in vendor databases—they're used by many consultants to leverage resources
- Maintain database information

### **INVEST IN HUMAN CAPITAL**

- Hire experienced investment professionals
- Outsource non-essential functions to focus on priorities
- Understand/articulate strengths and weaknesses of professionals
- Gain experience prior to starting firm
- Build firm with partners so there is an established team in place

### **DELIVER INVESTMENT RESULTS**

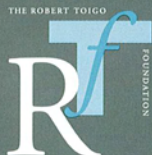
- Provide proof statements for claims
- Follow a disciplined investment process
- Follow best practices w/ rigorous buy and sell process

### **STRATEGIC FIRM PLANNING**

- Outline a clear plan for asset growth
- Develop a business plan to support and protect alpha generation
- Focus on strengths with one or two products before branching out
- Articulate how the firm will manage a larger asset base
- Offer an investment strategy where size is less important (e.g., small cap)
- Build ownership expansion and transition planning
- Don't neglect strategic planning
- Identify a comparative advantage and focus on it

### *About the Robert Toigo Foundation*

*The Robert Toigo Foundation is the premier organization supporting the ongoing advancement of exceptional minority business degree students and alumni within the financial services industry. The Foundation seeks to foster diversity in the global marketplace and promote ethics, integrity, community service and business leadership skills through the careers of highly talented minorities. The Foundation's Alumni network now numbers more than 450 professionals pursuing careers in finance. The Foundation works closely with its sponsoring firms, including global and emerging financial services firms in all areas of finance, Fortune 500 corporations and minority-owned and developing investment firms, to foster diversity and inclusion within their organizations and the industry as a whole. For more information on the Robert Toigo Foundation, please contact Nancy Sims at (510) 763-5771 x10 or via email at [nancy.sims@toigofoundation.org](mailto:nancy.sims@toigofoundation.org).*



1211 Preservation Park Way, Oakland, CA 94612  
510-763-5771 tel 510-763-5778 fax  
[www.toigofoundation.org](http://www.toigofoundation.org)