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Opportunities and challenges for the asset management industry

Singapore Management University

OPPORTUNITIES AND CHALLENGES FOR THE ASSET MANAGEMENT INDUSTRY

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With the secular rise of Asia and a deluge of capital inflows, amid a backdrop of battered global financial markets, bankers, asset managers, academics and investors gathered to hear and discuss the opportunities and challenges facing the asset management industry in Asia. Organised by the Centre for Asset Securitisation and Management in Asia(CASA), under SMU's Sim Kee Boon Institute for Financial Economics, the inaugural asset management conference hosted a panel of experts.

Gerard Lee, CEO of Lion Global Investors, outlined some growth strategies for Singapore-owned asset management companies (AMC). Setting the background of the asset management environment in Singapore, Lee noted that while the country had often been the recipient of accolades lauding its excellent business environment, open economy and high standards of living, local managers have not been getting the lion's share of funds for asset management.

“Why is it that in this country, that despite being called a little red dot, it can typically punch above its weight? Why is it that in asset management, it’s not the same?” Lee asked. The top ten AMCs in Singapore are dominated by foreign names, with only two Asian ones, Nomura and Lion. The biggest providers of unit trusts have the same profile, with only UOB and Lion in the top ten.

Lee readily admitted that Lion had made it to the list only because it now manages the assets of Great Eastern Holdings. Scale is important in the business – more assets under management (AUM) leads to higher AUMs managed per staff, a lower cost-to-income ratio and hence higher profitability. He noted that in Asia, the top ten AMCs account for 80 per cent of the business.

Local firms lagging behind

Despite Singapore-owned AMCs having a head start by establishing its business in the 1980s relative to foreign ones who only begun in the 1990s, local AMCs have relatively low AUMs, leading to low AUM per staff, a higher cost-to-income ratio, and lower profitability. “By no means are we start-ups; by no means are we infants,” Lee lamented. With almost all global top ten

AMCs having a Singapore office, the competition for funds is stiff. BNY Mellon is the only exception, and they were also on their way to getting an asset management license to operate in Singapore.

While there are strong mutual fund flows to Asia, Lee observed that little of these flows were captured by local managers, with the bulk of the funds domiciled in the US and Europe. Explaining why local firms were lagging behind, Lee said that the business development activities of local AMCs tend to focus primarily on Singapore and the South East Asian region, manufacturing only Asian products. Investors however typically invest in emerging markets as a bloc, making little distinction of the sub-blocs within. There is thus a misalignment between the product and the demand. Also, Singapore AMCs are relatively unknown globally.

Lee believes there are many untapped opportunities for local firms. After all, Pricewaterhouse Coopers projects that Singapore will be the top wealth management centre by 2013, overtaking important centres such as Switzerland and London. “Today the top 40 private banks are in Singapore, but the local players have not capitalised on this phenomena,” Lee said, adding that local firms should sell to where the demand for Asian products arise, namely US, Europe and Japan. They should also consider mergers and acquisitions with firms elsewhere, to gain scale and be closer to its foreign customers.

All the right ingredients

Alex Ng of BNP Paribas Investment Partners presented a Chief Investment Officer’s (CIO) perspective on the opportunities and challenges facing the industry. In what he termed as the Asia Pacific’s circle of growth, there is interdependence between the continental economies of China, India and Indonesia, the financial services centre of Hong Kong and Singapore, the technology centres of Japan, Korea and Taiwan and the natural resources centres of ASEAN and Australia. The rise of the continental economies is phenomenal, with more than half of global IPOs in 2009 and 2010 occurring in China and other emerging market exchanges, and a rapid expansion of economic activity now happening in these countries.

Ng observed that mature markets such as Japan, Australia and China have stocks represented in every industry segment of the MSCI indices. He added, “Our domestic market is not very rich in the diversity of its offerings to global investors”, where we have representation in only five out of ten segments. A large hinterland also creates an economic base to grow from. “There is a natural home base advantage to having a continental home economy as your playing ground,” he said. This was the case for the US, Europe and now resembled what was happening in China, India and Indonesia.

Innovation was another important factor for growth. “I think there’s no time in history when a country has become a world economic leader without also being the innovation leader,” he said. Using patent registrations as a proxy for innovation, the rise of Japan and the US ran in tandem with a sharp rise in the number of patents registered. China now shows similar characteristics, with a steep increase in the rate of patents registered since 2000.

However, where the asset management industry is concerned, Ng mused, “A good thing about crisis is that they make one reflect back on to the basics.” Noting that dividends and interest payouts typically constituted a significant proportion of returns, with lower volatility compared to the capital gains component of total returns, he highlighted that Asian bonds today have a high risk adjusted return relative to other global bonds, and that the complete spectrum from AAA rated to high yield bonds were available in Asia.

In terms of the opportunities available to AMCs, Ng advocated that they shift away from products, and instead, to instead provide solutions. “It’s the asset allocation and advice that is valuable, products can literally be bought,” he said, especially since Singapore is going to be the foremost centre for private banking.

Smooth operations

Mark Dalton, a managing director and hedge fund specialist at Cambridge Associate's Singapore office, provided an investment consultant's view of the industry. Some challenges for raising institutional capital stems from the physical distance between Singapore and the major funding sources of the US and Europe. He pointed out that while language difficulties could be overcome, the lower transparency and the weaker operational infrastructure of Asian firms could hamper fund raising from developed world institutions. "Existing institutional investors in the US and Europe might redeem from Asian-based firms for uneconomic reasons during significant market downturns," he added.

For these reasons, AMC principals should make it a point to bridge the distance by travelling to meet with prospective and existing investors in US and Europe at least once a year, participate in international conferences and create a representative offices in major centres like New York and London. He added that gatekeepers such as consultants could help make the process of identifying strategic investors more efficient, saving both time and money for the AMCs.

Keeping in mind that a long-term view of relationship building is required to manage institutional money, he suggested that Asian firms needed to engage in knowledge transfers and be a part of the education process for the institutions.

Communication is crucial. A knowledgeable investor relations team can not only communicate with investors, but also save investment managers' time, since they can do the explanation work in the absence of the fund managers.

On operational infrastructure, Dalton said, "Post-2008, institutions have placed much greater emphasis on institutions maintaining robust operations." Costs have increased in the face of additional regulatory requirements, with more staffing needed to administer compliance requirements and third party administration.

The relationship between investors and investment managers is one of partnership, which means one of well-defined expectations, clear communication, fair compensation and mutual respect. This is precisely where transparency in how funds are being managed, equitable terms such as lock-up periods, and co-investment by managers alongside their investors have become especially important.

Melvyn Teo, professor of finance at SMU's Lee Kong Chian School of Business, shared some insights gleaned from empirical research. The literature shows that overconfidence leads to too much trading, which is deleterious to returns as transaction costs eat into profits. Research has also shown that geographic proximity matters. Hedge funds located close to their investment targets outperform the distant ones. The likely reason is the informational advantage gained from being connected to the boards, and the removal of language and cultural barriers. "Information matters and it's good to be close to your investment targets," Teo observed.

In an interesting study by Grinblatt *et al.* on Finnish investors, those with high IQs clearly managed to enter and exit technology stocks around the 2000 technology bubble in a timely and profitable manner, while those with low IQs got it precisely wrong. Hedge funds with high performance fees and a high water mark to beat also outperformed those without these characteristics. Teo concluded, "Make sure that your manager is smart and well incentivised to invest on your behalf so as to minimise any agency problems."