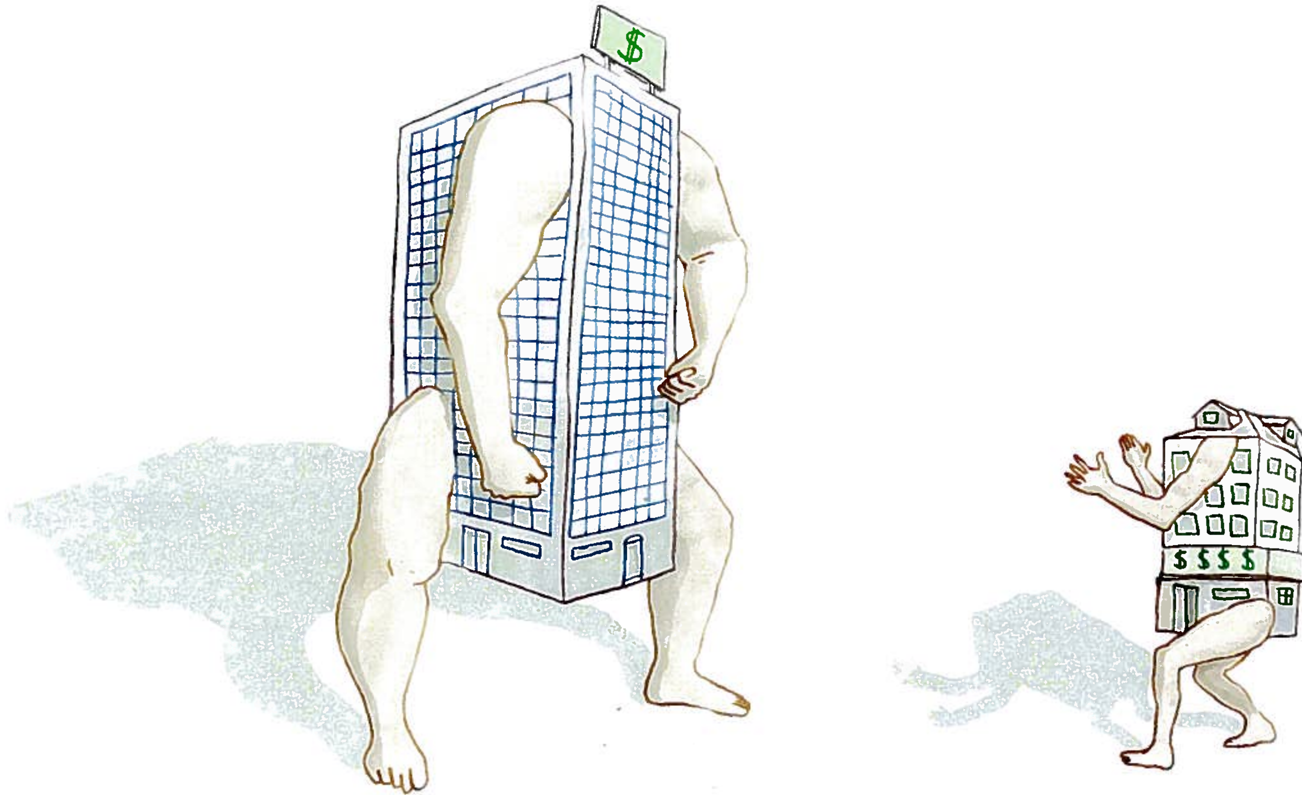

MONEY MANAGERS

The boutiques and behemoths of investment counselling.

by **Keith Sjögren** / illustration by **Leif Parsons**

If you go to the 27th floor of one of the major towers in downtown Toronto, you will come across the office of AllianceBernstein Canada. Not exactly a household name, but if you ask a few questions you'll discover that the office is a portal to an investment management behemoth that looks after $813-billion through offices in 48 cities in 25 countries. About five per cent of this total is represented by Canadian-owned pension assets. To put that in perspective, the total amount being managed by AllianceBernstein is larger than the GDP of Australia and not quite double the foreign exchange reserves of Russia.

When you get to the corner of King and University, you can see the UBS building. Globally, UBS manages slightly more than $2-trillion. UBS's claim to be the world's largest private bank is not likely to be disputed.

Tucked away in more modest accommodations are a growing number of Canadian investment firms, such as Galileo, Dixon Mitchell, and Cougar. This is the world of boutiques. These firms and others like them across Canada are in the bloom of youth, vigorously building assets and claiming to offer unique investment solutions. Boutiques, by definition, are local, or highly specialized—something that none of the behemoths can claim.

That's the emerging money-manager environment in a nutshell. Over the next few years, it is likely to come down to a clear division between giant global and national firms that offer a broad range of services (either directly or through third parties) and boutiques focus on specific markets or segments, and may offer only a limited range of investment solutions.

TREACHEROUS MIDDLE GROUND The danger lies in not fitting into either camp. In the investment management world, the middle is a dangerous place. It usually suggests that a firm has no clear business strategy to deal with a changing competitive climate, or that its performance has missed the mark more than once, or, simply, that it has no competitive advantage.

An increasing number of firms risk getting stuck. They are not winning as many new client mandates as they used to; they find it hard to recruit counsellors; the phone calls from the once-friendly accountants have dried up; and the guy who started the firm doesn't get in until after 10 a.m. At one time, passing the first

part of the CFA course, hanging out a shingle and sponsoring a table at a fundraiser was enough to build a sustainable business. Those days are over, and the business of money management is experiencing multi-dimensional change that will prove to be not just uncomfortable but indeed fatal to firms that fail to establish a competitive edge.

SOME BASIC FACTS Other than the insurance distribution business, the private-client side of the business is probably the most fragmented sector within the financial services industry. There are limited barriers to entry, low capital requirements, modest needs in terms of premises, and an ability to outsource just about every function, save for meeting and retaining well-heeled clients.

But despite the fragmentation, the assets are unevenly distributed. Those firms managing more than $5-billion in individual assets (the behemoths) represent only five per cent of firms—but 41 per cent of assets. At the other end of the scale, those managing less than $500-million (the boutiques) represent approximately 55 per cent of firms and manage a mere 10 per cent of industry assets.

It is one of the few sectors that has yet to fall into the clutches of the banks. Banks dominate the brokerage and trust sectors, but so far they have failed to establish an oligopoly in money management. Two-thirds of the firms active in the business of managing on a discretionary basis are independent, although this share may be threatened as institutional predators seek to boost their asset base and broaden their networks.

It is also a sector that flies the Maple Leaf. Despite the invasion of foreign pension managers, the private client business is still very much in domestic hands, with more than one foreign firm having packed its bags and left the building in the last few years. Only five per cent of private client managers are foreign owned.

Finally, the sector has whopping potential. The latest projections have the industry growing from $140-billion at the end of 2006 to $560-billion by 2016, enough to whet the appetite of many an aspiring Stephen Jarislowsky or Ira Gluskin.

CHANGE DRIVERS Why the potential, and why the turmoil? On a macro level, factors such as economic strength, the performance of the TSX, the strong loonie, and record prices for gold, oil and wheat have forced the global spotlight to shine on Canada. Global investors and managers have woken up to the fact that this is a growing market on a firm footing.

If you want to make an impression on private investors, flying visits are not the answer. No surprise, then, that two European financial giants have recently acquired a presence in the high net-worth sector. In October 2007, the Swiss-based EFG Group completed the acquisition of Bull Wealth Management Group of Toronto, and in November 2007, Société Générale of Paris (a behemoth with 120,000 employees) acquired 100 per cent of CWM Group, a Calgary-based manager.

The opportunity for foreign managers is strengthened by the fact that Canadian holdings of foreign assets are expected to increase from 14 per cent of total investment assets at the end of 2006 to 21 per cent by 2016. Most Canadian managers have found it difficult to perform in international markets, and the shift away from domestic investments represents another challenge to the status quo.

At an industry level, the rise of bank-owned firms and the arrival of foreign competition will likely encourage a new wave of consolidation among investment management firms, particularly those who recognize that they are in that dangerous middle ground. Firms with weak performance, limited capital or no succession plan will be courted by peers eager to expand.

BANKS After a decade of inaction, banks have come to realize that their competitive advantage is not in being a pure counsellor, but rather in being a broadly based private wealth manager. Banks currently control 42 per cent of the investment-counselling market in terms of assets, a position likely to increase as their direct sales and referral programs begin to pay dividends.

In the medium term, the integrated wealth offer has the potential to become the standard against which others will be judged, and it may encourage single-purpose investment managers to adopt a different approach. The example of Fiduciary Trust Company of Canada, which combines investment and trust services, is evidence of a new business model that may emerge, as the desire of the high net-worth client to centralize dealings with a single provider becomes an important influence. Recent research suggests that there has been a decrease in the number of advisers used by affluent Canadians, and an increase in the percentage of assets held with the client's primary adviser.

BROKERS Full-service brokerage is the other group that is exerting influence on the investment-counselling industry. At one time, full-service brokerage meant dealing with a stock jockey and paying high commissions for the privilege of mediocre performance. Recognizing the need to fend off investment counsellors who were beginning to attract some of their best clients, brokers have fought back through a range of new products and a more flexible approach to pricing.

Today, a wealthy investor can remain with their broker and have access to an array of investment managers and styles through a variety of programs. A growing number of full-service advisers are able to personally manage client assets on a fully discretionary basis.

The distinction between brokers and counsellors is becoming blurred. RBC Dominion Securities recently disclosed that $15-billion of client assets at the firm were managed on a discretionary basis. Put another way, Canada's largest brokerage firm is also Canada's leading private-client discretionary manager.

Leading brokerage firms are not only winning at the counsellor's game, they are also going beyond the services offered by more traditional firms. Firms like Richardson Partners Financial, in addition to discretionary management, offer comprehensive wealth planning, access to hedge funds, private equity opportunities and advice on philanthropy. When was the last time your investment manager asked about your interest in a private infrastructure pool, or the possibility of funding research at a local university?

The result of this convergence is the arrival of a new breed of boutique counselling firms, usually with a regional focus, that is discarding the traditional approach and reinventing the business model to closely align with the needs of its clients. Firms like Nicola Wealth Management in Vancouver and McLean & Partners Wealth Management in Calgary don't fit neatly into the traditional model and have set out to meet the needs of a changing affluent community, and to lead change in the industry.

THE NEW CONCERNS OF THE WEALTHY Canada's wealthy families are looking to use fewer and better advisers. Expertise and experience count for a lot, but so do innovation and global thinking. Risk management has replaced asset management as the main focus, and aging boomers are thinking more about the future of their wealth than about their own future.

Who will react to the changing needs of the wealthy? Will it be the banks, the brokers, the behemoths or the boutiques? It's too early to tell, but it will be fun to watch. ●