BKCG White Paper
November 2009

Brand Identity for Hedge Funds: Build It and They Will Come

Success for emerging and established managers now demands a polished message

Executive Summary

Investors have become distrustful of hedge funds, and are seeking more than just good performance when choosing a manager. *Reputation* has become a primary consideration, according to recent surveys. And with institutions now representing up to 70% of hedge fund investors, the demand has increased for high-level communications that speak to a sophisticated audience. To gain the trust and reputation necessary to attract and retain assets, hedge funds should consider creating a strong brand identity. Brand identity is the sum total of associations that people have with an organization. Building a brand identity requires producing a distinctive organizational image and character deployed consistently across all communications. If done well, this should evoke specific, positive associations. Professional-level materials that reflect the brand identity can position a fund to take advantage of opportunities in the institutional space and beyond. A strong brand identity can also help funds differentiate themselves in a competitive marketplace, as well as weather severe setbacks. Before embarking on such a program, managers should review the level of detail they are willing and able to communicate, and determine if internal resources possess the skill set or bandwidth to execute.

Highlights

- Performance alone isn't enough to get allocations. Investors want to be able to trust their fund managers.
- Recent surveys of U.S. and European institutional investors find *reputation* has become a primary consideration when choosing a hedge fund manager.
- Industry surveys show that pension funds, endowments, foundations, and governmental authorities now account for up to 70% of hedge fund assets.

- Funds need to promulgate a strong reputation, demonstrate positive intangibles, and communicate firm strengths in a professional, sophisticated, understandable manner to be well-positioned to attract and retain institutional assets.

- A step-by-step program to build a strong brand identity – the sum total of associations people have with an organization – can achieve this. Creating a distinctive image and character employed consistently across all communications can help a fund manager heighten name recognition and credibility.

- A strong brand identity can also help fund managers weather severe setbacks by allowing them to draw on a reservoir of good associations already in place.

- Startup, emerging, and established managers can all benefit from a program of brand identity building, as can service providers.

- Managers often underestimate the importance of marketing communications, and can be misinformed about what they are allowed to communicate. Many lack the internal resources or capability to effectively build a brand identity and get their message out across a spectrum of materials and media.

The Challenge

The severe correction of 2008 and the spate of ensuing scandals made investors highly suspicious of the alternative space. With the turnaround of performance in 2009, hedge funds look inviting again, but investors are still cautious. An October 2009 survey of more than 50 institutional investors by Preqin, a leading information provider to the alternative asset industry, found that in addition to fund transparency and risk management, *reputation* has become a primary consideration for institutional investors when choosing a hedge fund manager.[1] In other words, aside from the operational and risk management check-boxes that prospects insist on, there is now a greater focus on the intangible of a "good name." Indeed, an industry survey of fund managers themselves found that after performance, clients had stuck with them based on a string of intangible values such as "reputation, integrity, trust, experience, pedigree of the principals, relationships, and philosophy."[2] Not the easiest thing to define, package, and promote. Yet that is the challenge now facing hedge funds that hope to attract and retain assets.

Adding to the task is the shift in investor profile that has taken place. Whereas high-net-worth individuals traditionally accounted for most of the assets invested in hedge funds, institutions (defined as pension funds, university endowments, foundations, and governmental authorities) have been steadily increasing their allocation and now account for the majority, according to the Alternative Investment Management Association.[3] The proportion may be as high as 70%, says the Preqin survey, which concludes: "It is vital for managers to understand the needs and demands of these investors if they are to be successful in their search for institutional support." And considering that institutional assets are far “stickier” than private investments, the incentive is even greater. What are the “needs and demands” of institutional investors? Greater sophistication. Fund managers must learn to communicate at a deeper, more detailed level than ever before. This is even more so given the pickup in activity from the consultant community.[4] That constituency also has a high standard for clear, substantive communication.

To this imperative, add urgency. An opportunity exists for those hedge funds still standing – both the survivors and the startups – to grab market share. According to Credit Suisse, the industry’s outstanding performance so far in 2009 has resulted in 26% of all hedge funds “fully recovering” their losses from 2008, and an additional 27% needing to recoup only 15% or less to reach previous peak values.[5] With the turn in industry performance, market sentiment has also turned, and “most managers believe asset flows will continue to improve.” The trillion-dollar question is: who will get those assets?

From all these data points, it seems clear that funds that can promulgate a strong reputation, that can demonstrate positive intangibles, that can communicate firm strengths in a professional, sophisticated, understandable manner will be the winners in the coming year. But can it be done?

The Solution: Build a Brand Identity

In fact, those precise goals can be met through a program of building a *brand identity*. Brand identity is the sum total of associations anyone – both inside and outside – has with an organization or product. A successful brand identity evokes specific, positive associations. It is the difference between an iPod and an Mp3 player, between a Home Depot and a hardware store, between a Bridgewater and a stable of generic funds at a large asset manager. In the history of business, a strong brand identity has been a defining characteristic of most successful companies across all sectors.

Building a brand identity is the art of *defining* and *differentiating* an organization, creating a distinctive image and character that are employed consistently across all communications. At its best, this effort ensures that an organization’s core and tactical messages and its graphic identity reflect its business and marketing objectives in the context of its target markets. The result is heightened name recognition, differentiation, credibility – and thus, the ability to more successfully develop its business.

(There is some confusion about the meaning of “branding” per se; many assume it refers solely to the graphical identity of a firm, its look, or even more narrowly, its logo. But while a firm’s logo and the look and feel of its materials are an important element of its brand, they are only the visual piece of the puzzle. Thus, we employ the term “brand identity” to extend the definition to its more important broad business application.)

Why Building a Brand Identity Is So Important

A disciplined, systematic program of brand identity building can help hedge funds address their marketing challenges head on, both the perennial concerns and the new hurdles. In general, a strong brand identity will help firms in any industry define and differentiate themselves in the marketplace. As Michael Dula, a senior strategist at leading branding firm RiechesBaird, has observed, "First and foremost, a powerful and consistent identity is critically important for any company that wants to establish a leader position."[6] Often, just having the goods is not enough. *Cachet* is a competitive advantage. It's why so many funds will choose a Goldman Sachs as prime broker even when there are no operational or cost advantages. They want to be able to say, "I'm with Goldman" – and in fact, it works. Goldman Sachs's brand identity within the sector is so strong that only a mention of its name is enough to generate trust and confidence – and merely associating with it transfers that trust and confidence to its client.

For the investment management industry in particular, a strong brand identity is an advantage. With tens of thousands of asset managers, investment banks, and service providers across the globe, competition is fierce and never-ending. The need to stand out from the pack is crucial for mere survival. In addition, prospective clients and the parties that support them (consultants, advisors, etc.) tend to place the firms they're considering into neat categories. (The nine-box grids in consultant databases are a good example.) It's a way of understanding the alternatives and winnowing down the choices. To ensure they make the cut, investment firms must stand out within their category by leveraging a strong brand identity that keeps them top of mind.

That goes double for hedge funds. Gone are the days when firms could raise assets with some black-box mumbo-jumbo or some good performance numbers alone. By the beginning of 2009, investors were already emphasizing transparency, clarity of strategy, and communications in their allocation decision-making, as reported in our previous white paper.[7] At the close of 2009, *reputation* has become the yardstick. Simply put, investors want to feel comfortable trusting their fund managers. A strong brand identity, which transmits a fund's unique value proposition in a clear, concise, and compelling way, will help it capture and retain assets.

This last point is crucial for hedge funds that have suffered severe setbacks, given the clear cases of how a strong brand identity can protect a firm from even the worst disasters. The most famous example is the Tylenol tampering crisis for Johnson & Johnson in the 1980s. The company got praise for its proactive, consumer-oriented response, and recovered its market share. But Johnson & Johnson had a strong brand identity to begin with, a reservoir of good associations that already existed in the public mind, and their response *built* on it. A generic firm would likely have gone out of business. An example closer to home is Pzena Investment Management, which like so many value investors was hurt by its big bet on the financial sector. With over $30 billion under management at mid-year 2007, Pzena then endured seven straight quarters of underperformance, falling to less than $9 billion in AUM by March 31, 2009.

Unsurprisingly, net outflows in its sub-advised accounts (not counting performance) were significant, at 25% – retail investors have always chased return and run from losses. But far more significant is that during more than a year and a half of severe under-performance, institutional assets saw a small, *positive* net inflow. Indeed, following Pzena's worst quarterly performance ever (at the end of 2008), when much of the market was anticipating a global depression, there was on average *no* outflow of institutional assets. Clients declared their trust in the firm, its process, and its personnel. They had been persuaded by Pzena's long-term efforts to build a strong brand identity through a superior track record, a good story, clear messaging, and persistent and compelling communications. (Both client and manager were rewarded for the constancy, with the best performance in Pzena's history for the second and third quarters of 2009, and an increase in AUM of 62% from the trough.)[8]

Why Brand Identity Is So Important Right Now

There are important industry factors aside from disaster recovery that spell urgency for a program of brand identity building. The demands brought about by the shift in hedge fund asset allocators from private to institutional are a case in point. A major global survey of institutional investors by SEI/Greenwich Associates in early 2009 found an increasing concern with the "institutional quality" of managers under consideration. Overall, "pedigree and reputation" were the top-ranked factors, named by half of all the respondents. U.K. and continental European investors in particular made this a top priority. A strong brand identity that conveys those qualities can help win business. In addition, materials aimed at the institutional base must speak their sophisticated language. That translates to the need for professional-level communications at every level.

Finally, it is crucial for hedge funds to be properly positioned in order to take advantage of the imminent opportunity represented by all the cash that's been sitting on the sidelines for the past year. In a feeding frenzy, the sharks go after the most eye-catching prey. Raising a firm's profile will be a crucial determinant of success. In its major report, "The Asset Management Industry in 2010," McKinsey & Co. wrote that "winning managers will be those who forge a superior reputation and capabilities for service and sophisticated advice." It won't do managers any good to have the capabilities if they don't have the reputation.

The importance of brand identity applies to startup, emerging, and established managers, particularly if they're breaking into a new market or rolling out a new product. Startup and emerging funds must overcome the skepticism that now permeates the space. Established managers must be careful not to hurt their brand, or must burnish it further to be more competitive. Service providers must play by the same rules and speak the same language to compete for business in an increasingly crowded and demanding environment.

Get Past Those Cultural Hurdles
Unfortunately, managers in the alternative space are often resistant to such a philosophy. They fall prey to several common obstacles:

1. They give marketing in general, and marketing communications in particular, short shrift, assuming their strategy or track record will entice investors, or beyond that, that with all the money out there, simply hanging up a shingle entitles them to a piece.
2. They recognize the importance of communicating their message well, but lack the expertise, bandwidth, or resources to properly execute a cogent, effective program.
3. Their concern for holding onto proprietary information – in an attempt to protect their trading advantage – prevents them from providing any detail, or worse, getting out any message at all.
4. They misunderstand what they're allowed to communicate under current or pending regulations.

Managers must overcome these cultural hurdles to be successful. They must recognize that building a brand identity and communicating their message is essential to building their business – and thus, allocating the necessary time and resources is equally essential. They also should know that it is possible to provide a certain level of detail and hence – most important to investors – a level of *reassurance*, without giving up proprietary information or cachet. And they should learn the specific parameters of what regulatory agencies allow them to say – and when and in what situations. The restrictions are actually looser than many believe, and are designed only to protect potential investors, not to inhibit legitimate communications.

Building a Brand Identity
Managers faced with the task of building a brand identity – or for established managers, reevaluating and burnishing their brand identity – should take a methodical, step-by-step approach.

Set a Strong Foundation. The first step must be to lay the groundwork that will determine the direction you take, assures a consistent message, look, and feel for all your communications, and keeps everyone from internal staff to strategic partners to outside media on board. That means conducting an internal audit of your current marketing communications efforts, materials, and resources. It means crafting a core message that reflects the purpose, character, and value proposition of the firm, and identifies what sets it apart from competitors. The driving question must always be: what do you want people to think about your firm? A core message document should be circulated to all personnel. Guidelines should also be established and circulated for the firm's graphical identity (logo, materials design, typefaces, etc.). These tools will ensure consistency in all the firm's communications, and will brand it as capable, professional, and credible.

Implement Across the Board. Next, a fund should build on this foundation to assemble the materials it needs to gets its message out. No medium should be disregarded as a potential tool: spoken, written, and increasingly video and audio communications can each play a role. A bare-bones website and a one-page tear sheet may not cut it anymore. The language, tone, and look of the materials must be *clear, concise, compelling, and consistent.* Done well, they will serve not just to inform, but to build trust and encourage action. Again, the focus in building your brand identity must be: what do you want people to think about your firm? Once established, a strong brand identity can be leveraged in many ways, for instance to establish thought leadership (through white papers, webinars, and the like) and mindshare (through public relations).

(Note that these are only general guidelines for building a brand identity. A detailed description of a comprehensive program will be the subject of the next BKCG white paper.)

Determining the Necessary Resources

If building a brand identity is a key strategic goal, then it must be a budget item as well as a scheduling item. Resources and attention must be allocated. Consideration must be given to whether current internal resources can execute, and if not, how best to execute. Our experience has been that bringing outside expertise to bear on marketing content adds great value. Aside from experience with the relatively esoteric and specific task of brand identity building, outside expertise can ensure that fundamental elements are accounted for (core message creation, story structure, industry best practices, etc.), as well as more creative elements (writing style, high-end design, arbitrating choices of graphic versus textual story-telling, etc.).

Managers must carefully audit their internal resources to determine both skill set and bandwidth. If there are any gaps, they should consider either bringing those resources in by hiring new employees, augmenting the capabilities of current employees, or engaging outside service providers. In the current environment, with all its challenges and opportunities, the lack of a strong brand identity, or worse, a brand identity that is negative or weak, is a business risk for any hedge fund.

[1] "Preqin Survey Results: Have Hedge Fund Investors Recovered from the Crash?" Preqin Ltd., October 2009

[2] "Survey of Hedge Fund 'Success Factors'," Ulicny, Inc., August 2007

[3] AIMA press release, March 2009

[4] Monthly Hedge Fund Market Update, Credit Suisse, April 2009

[5] Third-Quarter 2009 Credit Suisse/Tremont Hedge Fund Update, October 2009

[6] Semantic Argument branding blog, June 5, 2009

[7] "The New Transparency: Words," BK Communications Group, June 2009

[8] Company reports, Pzena Investment Management

Takeaways

- Managers can address investors' distrust of hedge funds by promulgating a strong reputation, demonstrating positive intangibles, and communicating firm strengths in a professional, sophisticated, understandable manner.

- The growing importance of institutional investors in the alternative space demands professional-level materials speaking a sophisticated language.

- A disciplined, systematic program of brand identity building can help hedge funds define and differentiate themselves in a crowded, competitive marketplace. This applies to startup, emerging, and established managers, as well as service providers.

- Building a strong brand identity requires that core messages reflect the purpose, character, and value proposition of the firm, and identify what sets it apart.

- Spoken, written, and video and audio communications can each play a role in a brand identity program, serving not just to inform but to build trust and encourage action. All materials – pitchbook, website, strategy pieces, etc. – must be clear, concise, compelling, and consistent.

- Managers should accept that they can provide details without giving up proprietary information or competitive advantage. And they should learn the specifics of what regulatory agencies allow them to say.

- Internal resources should be carefully audited to determine where there are gaps in skill set or bandwidth, and the necessary time and resources must be allocated for a successful effort.

About BKCG