



BKCG White Paper
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The New Transparency: Words

Clients are demanding that investment managers communicate more than just data

Executive Summary

Transparency has typically been equated with access to data (trade, exposure, valuation, etc.), but the financial crisis and fund scandals have led clients, investors, as well as regulators to demand more. Major surveys and anecdotal evidence indicate *communication* is now in demand. Clients want managers to put the numbers in context, to explain what they're doing, to communicate on a clear and meaningful basis. This expanded transparency can help retain clients and strategically position a firm for future asset gathering, both by building a brand associated with full transparency and by ensuring that all touchpoints – from pitchbooks to websites to personal contact – are fully in place and high quality. Investment firms must carefully examine how they currently communicate, decide on any adjustments that must be made, and determine whether they have the internal capabilities and resources to execute on those adjustments.

Highlights

- Communication is the new transparency. Data alone is no longer sufficient. Clients want managers to put the numbers in context, to explain what they're doing, to communicate on a clear and meaningful basis.
- SEI/Greenwich Associates' global survey of institutional investors finds investors will "intensify their scrutiny of investment processes" and increasingly emphasize client reporting and communications.
- Prequin's survey of 50 institutional hedge fund investors finds that events of the past 12 months have led 43% of respondents to expect "increased transparency and understandable strategy."
- Providing full transparency can be a way of helping to retain clients and strategically position a firm for future asset gathering. McKinsey & Co's major report ("The Asset Management Industry in 2010") concludes that "winning asset managers will

be those who forge a superior reputation and capabilities for service and sophisticated advice.”

- Communications transparency can be approached strategically, to ensure an investment firm’s brand is associated with openness and clarity, and to establish a reputation for thought leadership, as this is associated with mastery of core competence.
- Communications transparency can also be approached tactically by making sure that all touchpoints – from pitchbooks to websites to personal contacts – are fully in place and high quality.
- Many investment firms are shedding internal resources that are not profit centers, including communications personnel, or are hesitant to bring on those resources – leaving them without the necessary skills, or bandwidth, for an appropriate level of communications.

Background

Historically, the hedge fund industry has been “secretive, cagey, and cloaked,” as Eurakahedge’s *Hedge Fund Monthly* put it: “The less said the better, with information being given behind closed doors, in private marketing presentations, to the elite high-net-worth or sophisticated institutional investor.” That was just fine with most investors, who bought into the black-box, clubby cachet. In fact, a 2003 survey of U.S. hedge fund clients indicated they demanded transparency only if it didn’t impinge on the proprietary nature of the fund – and of course, most fund managers lay claim to a proprietary approach.

Then came the worst market downturn since the Great Depression, and greed quickly turned to fear. Investors went running to scrutinize fee structures and risk-management processes that hadn’t seemed so important when returns were positive. Then came Madoff. And Stanford Financial. And Westridge Capital. And a dozen more penny-ante scandals amounting to only hundreds of millions. And investors began to wonder, did they *really* know enough about their investments? *Could* they know enough?

Investor Outcry

Clients are increasingly demanding full transparency from the investment industry – hedge funds, traditional funds, and private equity funds alike. Of course, transparency has typically been equated with access to data – for instance, trade, exposure, and valuation data. This data is used by investors to help identify and assess risks inherent at the fund and portfolio level. And this is the transparency with which the industry is most comfortable. In fact, the February *Institutional Investor* carried an article on the growing success of software packages that automate hedge fund and fund-of-funds due diligence, standardizing data and making it accessible.

But this is no longer enough. A survey conducted in January of 50 U.S. institutional hedge fund investors by Preqin, a leading information provider to the alternative assets industry, revealed that most investors are “satisfied with the quality of information on liquidity and fund reporting.” So, what kind of transparency do they want? “Investors want to know what managers are doing on a more frequent basis, and to have a better understanding of how their returns are being generated.” When asked specifically if the events of the past 12 months had changed their demands of fund managers, almost 43% said they expected “increased transparency and understandable strategy.”

A major global survey of institutional investors conducted by SEI/Greenwich Associates this past January also confirmed investors’ intention to “intensify their scrutiny of investment processes,” and unsurprisingly ranked portfolio transparency as the criterion that would receive the biggest boost in emphasis “in light of recent market conditions.” But significantly, survey respondents also indicated that client reporting and communications would receive increased emphasis as well.

In other words, data is no longer sufficient. *Communication* is in demand. Clients want managers to explain what they’re doing, to put the numbers in context, to communicate on a clear and meaningful basis in order to comfortably understand investment strategy and, even more important, investment risk. The question is, how can they accomplish that?

The New Transparency

This expanded definition of transparency represents a seismic shift for most managers, a big change from business as usual. As EurekaHedge put it, transparency now means “relevant, useful, concise, and timely information in an appropriate framework and format that is easily accessible.... It means a comprehensive and clear communication of what the fund manager seeks to achieve for investors and the progress being made towards those goals.” That’s not your father’s transparency. It goes far beyond the numbers and into written and spoken communications that can put the numbers in context. Words, when they’re used to help explain numbers and processes, can be a powerful way of providing added comfort and confidence for a firm’s investors in particular, and its investing world in general.

That’s a tall order. But the risks associated with *not* making the change could be serious. The SEI/Greenwich survey reports that among those participants planning to decrease allocations by at least 10%, the top-ranking reason was lack of transparency.

In addition, the regulatory and legal environment has become increasingly stringent over the past few years, and will become even more so in response to the current financial crisis. Already, governmental agencies had been expanding their watch to include client communications, advertising, even boilerplate website text. The content, format, and frequency of such communications have also been the subject of lawsuits – often turning on what was said to whom and when. So the definition of transparency had already been evolving, even if the term itself was not being applied.

Transparency as a Competitive Advantage

Providing full transparency – i.e., a spectrum of information that covers everything from portfolio data to an explanation of portfolio performance – can be more than just a tactical response to the current crisis, however. It can be a way of helping to retain clients and strategically position a firm for future asset gathering. In its major report, “The Asset Management Industry in 2010,” McKinsey & Co. wrote that of the eight trends sweeping the industry, one of them is the increasing role of marketing and client service:

“Winning asset managers will be those who forge a superior reputation and capabilities for service and sophisticated advice.... Asset managers that excel in client service and retention management are often highly successful in retaining assets in both retail and institutional settings, even when investment performance is less than stellar. Our research shows, for example, that firms with an above-average spend in client service experienced outflows... that were a full 4 percentage points lower than those firms with a below-average spend. At the bottom of the bear market, that gap was even wider, at 10 points.”

Thus, expanding transparency to include all communications can be an important *business* strategy. As transparency shifts from being solely associated with the traditional due diligence process to being part of marketing and client retention efforts, investment firms will be better able to allay fears and ensure that their value proposition is heard.

There are early signs that the investment world has heard the call. Five of the nation’s most successful hedge fund managers were called before a Congressional committee in November and voiced support for efforts to force the industry to become more transparent about its holdings. Former Morgan Stanley International Chairman Sir David Walker asserted that private equity firms also recognize the “benefits of transparency and disclosure.”

Implementing the New Transparency: Strategy

Investment firms must take both a strategic and tactical approach to communications transparency. Making the establishment of a reputation for transparency a strategic goal can produce tangible benefits, as potential clients, consultants, and other referral sources associate the firm with openness and clarity. Likewise, establishing a reputation for thought leadership can achieve a similar result. That’s because thought leadership is associated with mastery of core competence. Put another way, if you can’t clearly explain what you’re doing, perhaps you don’t understand it yourself.

An example of strategic communications transparency might be a fund of funds that is already well regarded for its attention to the traditional check-boxes of process-monitoring and portfolio data checking. Now, the firm could choose to initiate a series of position papers on the subject, which would serve the purpose not just of educating clients and others on these crucial issues, but to demonstrate the firm’s core competence

in them. (It would also provide the fringe benefit of focusing and clarifying for internal staff what they already knew but weren't necessarily able to communicate in a structured, lucid way.) This would be a way to leverage and publicize the firm's due diligence expertise using communications transparency.

An investment firm's core messages and how they're delivered should also be analyzed to ensure they address investors' concerns about transparency, as well as any adjustments the firm has made to deal with those concerns. (Core messages are those packets of information that define the firm, its brand, the things that will always be true about it, e.g., "XYZ Investments is a long/short market-neutral hedge fund based in Arizona, whose partners' experience in buying distressed businesses has been a hallmark since its founding, along with a steadfast commitment to client communications.") Once core messages are well-defined and clearly articulated, they should be consistently deployed in everything from the basic "elevator" pitch to the firm's website to its marketing pitchbook.

Implementing the New Transparency: Tactics

On a tactical basis, no communications medium should be disregarded as a potential tool to enhance transparency. Communications in general covers a broad spectrum of media – spoken, written, and increasingly video and audio – and each of these can play a role. A bare-bones website and a one-page tear sheet may not cut it anymore. Vehicles of communication that any firm trying to be more transparent might consider are:

- Distribution of a periodic newsletter – or an increase in frequency if already in existence
- Consistent website updates of new, meaningful content
- Development of white papers to demonstrate expertise on issues of concern to clients and prospects
- Proactive client meetings, i.e., not only in response to a client request
- Events, whether firm-specific or participation in industry venues
- Conference calls
- Webcasts/podcasts/Brainsharks

Of course, these are just a few examples. The point is that there are many touchpoints in the relationship between firm and clients/prospects/colleagues, not all being thought of presently or being actively employed. Investment firms must think long and hard about the quality and quantity of these touchpoints to ensure that those relationships are strong and continue to be so.

Determining the Necessary Resources

Investment firms hoping to capitalize – or simply feeling compelled to act – on the new paradigm of transparency face a crucial choice: to draw on internal resources to develop and execute the communications or to turn to outside help. Managers may feel their investment strategy and firm culture are too proprietary to entrust management of

communications to an outside resource. Many managers may also feel that they have the capability in-house to develop, execute, and manage their branding and messaging, both strategic and tactical. Nevertheless, even if that is true, there may be gaps in that capability. For instance, a manager adept at producing a quarterly portfolio and market commentary may not have the time or expertise to produce a webcast. Another manager may be highly skilled at one-on-one meetings but inexperienced in presentations to an audience.

In other instances, many investment firms are shedding internal resources that are not profit centers. That often includes communications personnel. Firms may find that their remaining personnel either do not represent the necessary skills for a particular communications effort or, because of increased workload, do not have the bandwidth to execute.

A third situation is one that may be the most difficult because it conflicts with a manager's nature. Increasing transparency, ramping up the breadth and depth of external communications, goes against the grain for many managers, particularly in the hedge fund space.

As EurekaHedge put it, "These requirements must be tempered with the knowledge that the ability to achieve the stated investment goals may necessitate sacrificing timeliness and completeness of shared information." Striking that balance between being open and forthcoming with investors and, at the same time, not compromising fund performance for those very same investors, is a legitimate challenge. In addition, core competence for most managers is investing, not communicating. They must make a philosophical and behavioral adjustment to begin speaking about their funds, their firms, and even themselves in an open and lucid way.

In each of these cases, investment firms must carefully examine how they currently communicate (or how they don't), what their new goals must be with regard to communications transparency, and whether they have the internal capabilities and resources to execute on those goals. If there are any gaps, they must consider either bringing those resources in by hiring new employees, augmenting the capabilities of current employees, or engaging outside service providers. It appears that what they cannot do – at least at the risk of their business – is nothing.

Takeaways

- Investment managers must address client dissatisfaction with data-only transparency. They should seek to put the numbers in context, providing clear and comprehensive communication of what the manager hopes to achieve and the progress being made towards those goals.

- Transparency (data and words) should be included as an essential part of investment manager’s marketing and client retention efforts, which will allay client fears and ensure that the firm’s value proposition is heard.
- Brands must be examined and analyzed to ensure they are associated with openness and clarity. Firms may also seek to communicate mastery of core competence by establishing a reputation for thought leadership.
- Core messages must be well-defined, clearly articulated, and consistent in every communication, from the basic “elevator” pitch to the firm’s website to its pitchbook.
- All touchpoints must be reviewed, regardless of the specific message, to ensure they are fully deployed and high quality.
- A review of internal communications resources must be made to ensure they are sufficient to meet the new transparency demands. Firms should consider bridging any gaps through new hires, augmenting the capabilities of current employees, or engaging service providers.

For further information, please contact Kevin Kasper at kevin@bkcomgroup.com or 973-393-6266.

About BKCG

BK Communications Group provides outsourced marketing and client communications solutions for the asset management industry, helping investment firms define and craft their message – from strategizing the theme to polishing the content – and executing in every medium from pitchbooks to investor reports to websites. BKCG’s principals have over 20 years of combined industry experience developing and implementing marketing deliverables for private and institutional clients across all asset classes, including alternative investments. BKCG employs a flexible, scalable approach, managing a team of top-tier strategic partners (in branding, graphic design, financial writing, and website development) to allow for seamless solutions tailored to a client’s specific requirements. BKCG takes a consultative, collaborative approach, seeking to understand the specifics of the client’s business and market, and developing deliverables that reflect both the unique brand and value proposition of the client, as well as industry standards of design and content. For more details, please see www.bkcomgroup.com