The Fund Manager of the Future

Fund Management through the Looking Glass

A look at the traditions of the fund management industry are a portrait of the rich getting richer. The inevitable future of the fund management business, however, is about inclusion and expansion. For investors, inclusion means that a wider range of investor profiles (i.e. retail investors) will be eligible to participate in returns on alternative assets. For alternative investment managers, expansion will allow new classes of investors to participate in their fund offerings. Participation by retail investors will crucially broaden the capital markets available to these managers. However, from a supply and demand perspective, the future for both investors and managers hinges on innovation.

Wherefore the Innovation, Broseph?

Historically, the investment management industry has not been at the forefront of innovation. Privacy, regulatory mandates, and the responsibilities of fiduciary stewardship have been moderating innovation in financial services for a very long time. For example, the ability of financial services firms to experiment with software platforms or technology has been limited by concerns around the security of sensitive information (whether at the firm or individual level) and protecting critical financial data.

For these reasons, technology serving the financial services industry has not advanced at the "move fast and break things" pace of other industries. Beyond regulatory hurdles, very real and practical concerns about privacy, proprietary information, and preserving commercial advantage have kept the industry opaque and confined.

Likewise, a lack of innovation in policy and business models alike have meant that retail investors have been locked out of the private equity industry for the entirety of its four-decade history. On the surface, financial education, access to information, and a lack of short-term liquidity have upheld the mandates around excluding retail investors. Accordingly, private equity (and indeed most alternative asset classes) has been the preserve of institutional investors and individuals at the highest brackets of personal wealth - ultra-high net worth individuals.

The ultra-high net worth individuals involved at the inception of private equity as an asset class also coincidentally included the most informed individuals with respect to the investment strategies undertaken. These investors profited from being on the right side of many information asymmetries that the average citizen did not have insight into, and were deemed sophisticated investors because of their access to such information,

Information can be a significant mitigating factor against risk. So, historically, we erred on the side of protecting the less knowledgeable citizen.

Converging Trends: A Different But Inevitable Future

The old model of supervising the financial decision-making of anyone who is not classified as an ultra-high net worth individual is less appropriate in today's environment. Leaps and bounds in our social, economic and political organization in the last four decades have dramatically expanded and validated the average citizen's access to information.

In parallel, technology has also made the distribution of information radically easier. Whether searching for business intelligence online to back up an investment thesis, or receiving investor reporting materials through a web portal, the retail investor today is situated very differently than in the past. Accordingly, for those who are not ultra-high net worth individuals, but are holders of wealth nonetheless, the ability to manage risk has also notably improved. Individuals are more empowered than ever to understand the financial strategies available to cultivate wealth.

Still, the rights of the ordinary citizen trying to grow their nest egg are constrained by outdated regulatory dynamics. A sizable number of potential investors remain restricted from participating in the risk-adjusted returns available in alternative asset investments relative to other asset classes. Accordingly, they remain curbed away from private markets in their path to long-term wealth.

Structuring considerations and short-term liquidity are additional impediments to "democratized" access to alternative investments. At the same time, the "hippest" of the alternative asset classes, venture capital, has made the most progress in innovation. Innovation in the venture industry extends not only to incorporating the most investment process automation and online capabilities of any alternative asset class, but also by being more inclusive of retail investors, most notably by advocating for and passing the Jobs Act.

The rise in popularity of web services such as AngelList and crowdfunding is a testament mostly to the technological innovation and inclusiveness of venture as an asset class. The democratized access in this area is juxtaposed to the reality that venture investing (also known as investing in companies at their earliest, and most commercially vulnerable, stage), presents the least favorable risk profile among the alternative asset classes.

In contrast, investing in late-stage corporate private equity or real estate private equity, for instance, would require the higher standard of Qualified Purchaser status, though typically offering a more favorable risk and return profile.

Step into Retail: The Sidecar Strategy

Notably, the more conservative the asset class, the more conservative the approach to innovation on any front, and, as previously acknowledged, this is at the detriment of the retail investor. A less conservative approach would also put both retail investors and fund managers at risk. For these reasons, a tested, out-of-the-box solution for the retail market is part of a sensible roadmap. In-house development of this capability is not one that fund managers can reasonably shepherd themselves from the perspective of time, cost and maintenance.

With this in mind, Sidecar built the roadmap for every fund manager's retail strategy. Sidecar has solved for the industry innovation lacking in this area, putting in place best-in-class legal structuring, safeguards, and administration, along with technology toolsets to serve retail investors.

Having successfully created employee co-investment programs for retail investors inside the largest global investment managers, Sidecar's user base is inclusive of thousands of retail investors in over 25 countries. Sidecar has, it seems, cracked the code on seamlessly allowing these investors to access opportunities uniquely suited to them within their own firms, while allowing the firms themselves to bypass the heavy administrative burden of managing a successful employee co-investment program for their global employee base..

Sidecar's offer to fund managers and retail investors alike is unique: not only does the platform eviscerate the cumbersome manual processing and paperwork that would normally be required for employee co-investment, it makes available off-the shelf structuring, feeder vehicles, leverage options, tax servicing and fund administration – serving retail investors throughout the lifecycle of a fund. Sidecar is already operating across a number of worldwide legal jurisdictions, enabling fund managers in those jurisdictions to implement a turnkey employee co-investment program without the hassle of designing or executing it themselves.

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The triumph of Sidecar's employee co-investment programs is not limited to the rewards afforded employees. While a fund manager's employees are now able to get into the firm's own investment products which were previously unavailable to them, a number of benefits are also extended to the sponsoring firms. To start, participation by employees in the funds of their firms has proven to be an excellent way to align employee interests, provide incentives, and promote retention and teamwork.

Employee co-investment also presents fund managers a way to regain the attention of elite graduates and workers lured in recent years by the equity compensation packages of Silicon Valley technology companies. Employers have long been eager to accommodate the requests and expectations of employees to invest and share in upside, and can now house that need in a cost-efficient manner.

Positioning For More Retail Investment Dollars

The most tantalizing aspect of launching such programs is that the fund manager themselves is positioning for the inevitability of a future inclusive of retail investors. Fund managers can now leverage the end-to-end digital experience offered by Sidecar to test, monitor, manage and grow a high-caliber retail strategy. The Sidecar dashboard offers analytics and data, facilitating a detailed view into the progress and experience of each retail investor in the controlled environment of an employee co-investment program. Drawing on the data and analytics available, fund managers can fine-tune the quality of their retail offering while maintaining an eye on efficiency and cost.

Ultimately, the Sidecar strategy could trigger the seachange in retail investor participation that has long been anticipated by many in the industry. While the history of the fund management industry may epitomize the multiplier effects of starting out with immense wealth, the future of fund management, like many things, resides with technology, greater ease of information, and more popular access.

The net result is that investment managers and investors alike will benefit from a wider set of options. For retail investors, new investment products, along with new opportunities to generate personal wealth will be introduced by forward-thinking fund managers. For fund managers, expanded capital markets and the ability to serve a larger percentage of the population will allow them to continue to build a sustainable business.