INVESTMENT CONSULTING FIRMS: A LONG JOURNEY TOWARD INCLUSION

By the National Association of Investment Companies

The Largest Network of Diverse-Owned Private Equity Firms and Hedge Funds
Investment consulting firms are often described as the bane of diverse investment managers in the process of raising capital. These gatekeepers for the institutional investors whose assets investment managers are looking to grow are known for gravitating towards larger, older (and whiter) firms, ignoring or unaware of smaller and often better-performing alternatives.

However, there are some positive changes in the works as some consultancies are implementing diversity practices and casting a wider net for asset managers to recommend to their institutional clients. This is something sorely needed given Knight Foundation’s estimate that only 1.3 percent of the $69 trillion asset management industry is managed by diverse- or women-owned firms, despite published reports documenting superior returns.

Wilshire Consulting, the Santa Monica, CA-based institutional investment advisory and outsourced-CIO business unit of Wilshire Associates, announced last year that it launched an initiative to promote diverse managers to its institutional clients and tied it to compensation for its senior consultants. The firm, as well as Marquette Associates, have both adopted policies requiring teams to include at least one diverse candidate in every traditional equity and fixed income manager search that meets client investment objectives, minimum investment and vehicle requirements.

Not long after, Colonial Consulting published an introspective white paper, “Differentiated Talent” in which the firm laid bare its shortcomings with regards to recommending diverse-owned investment management firms to its institutional clients. In the report, Colonial vowed to “secure capacity with a longstanding and thoroughly talented pool of diverse managers that will serve our clients over the long-term.”

Though it may yet be at an all-too measured pace, there are sure signs of progress that investment consulting firms are beginning to understand that expanding their clients’ rosters beyond the usual suspects can boost fund performance. “We’re seeing tactical examples of investment consulting firms trying to demonstrate that they are engaged, they’re interested, and they care,” says Robert Raben, Executive Director of the Diverse Asset Managers Initiative (DAMI), an effort to increase the absolute number of, and assets under management by, diverse-owned asset management firms. “It’s low, it’s tepid, it’s nowhere near what we need to make the kind of change that people deserve, but there’s no question that they’ve gotten the message that resting on a 1950s model is no longer appropriate.”

The industry still has a long way to go. On a 1-10 scale, Raben rates the current state of diversity efforts in finance as a 3. “I think we’re nowhere near where retail America is, compared with AT&T, Pepsi, Frito-Lay, Nike – those who actually interact with retail consumers and know that people of color are a big part of the market,” he says. “They are way ahead in terms of their stand, in terms of diversity, boards of directors, etc., so in that context, we’re a 3 but for an industry that for decades had no pressure to change from a white male band, we’re seeing a significant change.”

Andrew Junkin, President of Wilshire Consulting, says the firm “Always had a toe in the water when it comes to diversity in the manager space, but we wanted to be more intentional.” He admits that the industry has not historically done a good job at identifying talent, particularly at a time when more women and people of color are receiving the advanced degrees from the educational institutions the financial industry covets. “If the talent pool is not majority white men, why is the universe of managers we put forth majority white men? What it was about for us, was to make sure that we’re being as proactive as we can be when it comes to finding managers that can add value for our clients, and that’s what really pushed us to go from more of an ad hoc, client-driven approach to something that’s much more proactive.”
In addition to including at least one diverse-owned firm in every public securities manager search Wilshire conducts for advisory clients and tying senior consultant compensation to the quality and level of interaction with diverse-owned firms, the consultancy formed a diverse-owned management committee. This committee meets periodically to begin the vetting process and determine which managers to move forward to their research team to get fully scored and made part of the Wilshire pipeline. “We are working towards having that policy in effect for all managers, but still have some work to do,” says Junkin. Wilshire also hosts face-to-face meetings with diverse managers in each of their U.S. offices – Pittsburgh, Chicago, Denver, Santa Monica – to help these firms navigate the consultancy’s processes.

For Colonial, following a bit of soul-searching detailed in “Differentiated Talent,” the firm came up with a procedure for tracking and recording the number of diverse managers that went through their process, from meetings to sourcing and vetting to recommendations to clients and finally those who were hired. They also took steps to ensure no manager was slipping through the cracks due to size or lack of a long-term track record. “I explored our database, and we added additional fields to ensure we're counting everything, capturing everything. I created a watchlist to ensure everything was fair, which entailed reading various post manager meeting notes to see if positive attributes and concerns were consistent for all managers in order to manage implicit bias,” recalls Angela Matheny, Head of Diverse Manager Equity, Colonial Consulting.

Additionally, some of Colonial's clients wanted to be educated on the value of including diverse managers in their portfolios when consultants made routine recommendations. Matheny says diversity and greater outcomes ultimately tie into many of the missions and values of Colonial's clients and consultants have been able to add investment manager diversity to Investment Policy Statements, creating sustainability.

“If I'm going to do my job effectively in getting diverse managers a seat at the table and then across the finish line, I really had to avoid looking at our efforts from a social justice lens but rather from a performance standpoint. This truly means focusing on sourcing exceptionally talented, high-performing, top-quality managers who happen to be diverse,” Matheny says. “We are not simply checking a box and want to make it clear that manager diversity is about differentiated talent and building better portfolios. And at the end of the day, that should be at the top of everyone's list.”

The end result: In 2013, Colonial had approximately $375 million allocated to diverse managers, and has roughly $2.2 billion allocated today. Of the firm’s 145 clients, 109 have exposure to diverse managers. “Adding diverse managers to our approved list and then not receiving capital is a complete waste of time and a disservice to managers who have the opportunity to scale. No one gets on the list unless they are going to get some money,” says Michael Miller, Chief Investment Officer, Colonial Consulting.

While there are signs of progress, Junkin says there is still a long way to go, admitting that results from the firm’s initiative to promote diverse managers yielded lackluster results initially. “It becomes incumbent upon us as a firm to make sure that we are engaging with as many diverse-owned firms as possible to try to make sure that we've got the kind of robust pipeline that we need to have firms fully evaluated, ready to include in searches.”

Once a well-designed system of inclusion is put in place, identifying and conducting due diligence on an emerging manager investment requires little extra effort than what would be done with any other vetting process. But to see more encompassing changes, the institutions that retain these consultancies would need to gain a better understanding of the returns being generated at many of today's diverse-owned investment management firms. “I think there needs to be some continued education of clients,” says Raben. “Then clients need to speak up – the endowments, the universities, the pension funds, high net worth individuals. They need to stop pretending that quiet conversations with their firm about an interest in diversity are sufficient when they're not.”
There also needs to be more trustees willing to champion diversity’s cause within boardrooms in addition to an overall greater awareness of the talent and strategies many diverse firms are employing to deliver superior returns. Buy-in from the institutional investors must be legitimate to spur consultants to look beyond the bulge bracket firms. “I think we’ve got to improve the demand/push side, which to me is the consultant, and the demand/pull side, which is clients,” says Wilshire’s Junkin. “I think it’s got to be both. I don’t think it can be one or the other.”

Though there may be some movement within these consultancies, the fight for inclusion will be a long, hard one. Raben, who actively lobbies in Washington, DC to require the industry to measure, track and report on diversity progress, says one of DAMI’s sub-strategies is working to change the culture of investment consulting firms from what has been described as, ‘it’s not our fiduciary duty to promote people of color,’ to one in which the investment consultants embrace that it is in their fiduciary interests to bring top diverse asset managers to their clients because of their extraordinary talent and strong performance. “We have no shortage of talented Hispanic, Black, Asian, Female asset managers who have set up multiple funds,” he says.

In an industry that purports to be driven by performance, it is time to stop ignoring the data in all of the research focused on this space. An elegantly constructed portfolio that includes diverse asset managers drives greater alpha. Period.