MOTSWEDI
Economic Transformation Specialists

Should I worry about return on capital or return of capital?

There are roughly 140 fund managers in South Africa managing a pie of roughly R6 Trillion in long term savings and investments. Most of us are aware that the top 6 largest fund managers manage roughly 60% of that total however, less of us know that roughly 8% of this pie is managed by the 40 or so organically grown black fund managers. The challenge this presents to asset owners is how do you filter the good from the no-so-good.

This has been the challenge which most asset owners and their consultants have been sitting with for many years but even more so in the past 15 years. During this time a high number of new fund managers came to market and the behaviour of asset owners, generally acting on the advice of their consultants, took on one of two actions

1) Stick to the fund managers you know
2) Dip your toe with the start-up fund managers where you "know the guys" or "Like the guys"

Interestingly we have seen a slowdown in the number of new fund managers coming to market – mercifully I can hear consultants – but its testament to the high number of barriers to entry and challenges to attracting assets. Also, as the fund management industry knows, in a slow growth economy the reality is that for one fund manager to attract assets, another fund manager has to lose assets. Innovation and authenticity will be the drivers of the behaviour of asset owners into the future.

But my team can do that

During a recent conversation with a trustee, he said he had not heard about the fund managers I was talking about which were in my solution and would ask their consultant. In a subsequent engagement with said trustee, the message he got from their consultant implied that there was "too much risk" with the fund managers mentioned. This is of course relative to the large incumbent fund managers or familiar fund manager names which the consultant had already put forward. The reality is there is risk with all fund managers, what changes over time is the kind of risk associated with the manager based on where they are in their life cycle. For consultants the challenge is simply time, they do not have the time to spend researching the extra 40 black fund managers over and above the familiar names and are also not willing to risk their appointment on a manager which neither they nor the client have heard of before.

When trustees raise the theme of transformation of fund managers with their consultants and raise the kind of research that Motswedi are applying, the usual response is "but my team can do that". No doubt this is true, but again, the issue which comes to the fore is time. Are the consultants able to spend the required research time with these extra 40 or so fund managers. Not because we are dealing with black fund managers, but because we are dealing with medium sized businesses which may well need a specialised research approach based on where they are in their life cycle.

Caution

Consultants are right to advocate caution, but doing so as a reason for not spending the research time is not fair to the entrepreneurs which are running fund management businesses and is an impediment to economic growth.

In our observation the conversation is about and should continue to be about return on capital.