A place in the market for 'small shops'

What is a "boutique" fund manager? Four of the species explained themselves to a Securities Institute professional development seminar.

Driven at a "fast and furious" pace by people "passionate" about their work, the boutique funds sector has claimed a permanent place in Australia's investment markets. Speakers at a Securities Institute professional development seminar in August 2004 titled: "Property Boutiques and Private Equity on the Rise" were not afraid to use these adjectives.

The four speakers explained the development of their funds, their business philosophies and the investment policies that differentiate them from major investment institutions.

Boutique funds are often created by investment managers from large institutions. They will set up their own operations to exploit what they see as niches that may be too specialised to attract the attention of the majors. For some, their main clients are large superannuation funds which realise that small specialists can more effectively tailor investment products.

Bob Kelly, whose Eureka Funds Management was founded in January 2004, attributed the success of boutique funds to the recognition by big institutions that there could be better ways of doing things using people from outside the organisation.

Discussing the origin of the term "boutique fund", he referred to the French translation of "small shop". Small size was the defining characteristic of boutique funds. "It means that the senior management team can focus on clients' interests," he said. "The client wants to know who individually is working on their mandates.

"The disadvantages of big institutions are internal rivalries among staff, conflicts of interest and changing personnel. The hands-on approach of small firms is important. Independence is also seen by clients as very important, even though corporate ownership may bring significant benefits."

Kelly said Eureka had raised about $500 million in two non-overlapping funds, from wholesale clients in the large superannuation fund sector. The Eureka funds were closed-end with a limited life. The fact that assets were crystallised and returned to investors at the end of the term meant there could be no arguments about performance.

In the longer term, Eureka planned to have five or six funds operating simultaneously. "That would be sustainable," Kelly said. "At first, some doubters warned that the beaches were littered with the corpses of would-be boutique managers. However, some investors were prepared to support entrepreneurial players."

Kelly doubted that there would be a proliferation of boutique funds. Barriers to entry were high, with the need for a certain scale to attain profitability and a long lag before income could be relied on. However, it was not likely that existing boutiques would be absorbed by institutions in the next cycle – "customers prefer to deal with managers they know."

Kelly's last word: "In a small fund environment, the more entrepreneurial, the more successful."

Fergus Neilson, of Babcock and Brown Direct Investment Fund, emphasised the importance of opportunities to differentiate a boutique fund's products. "Superannuation funds own one-third of the ASX and half of the fixed-interest market, leaving a shrinking pool of investment opportunities for others," he said. "That represents a chance for boutique funds to look at direct investment in unlisted property, private equity and other non-traditional sectors that big funds are reluctant to enter."

Neilson stressed the independence of the Direct Investment Fund, although the Babcock and Brown name was important in establishing the new fund's credentials. He said there was an explicit, "carved in marble" set of rules about interaction to protect the interests of DIF's investors.

Philip Adams, of MFS Group, defined successful boutique funds as those with "peripheral vision" – the ability to see investment opportunities overlooked by others. The group focused on "mum-and-dad" customers – conservative investors in search of simple products – and offered a number of funds including property, structured finance, mortgages, hedge funds and income funds. MFS Had about $1.5 billion in assets, most tied in some way to property.

Adams said: "A critical part of growing a boutique business is having the right staff. We need young, vibrant, dedicated people able to take our message to clients. Success comes from recognising a different way of doing business in niche markets – not just providing 'vanilla' products."

Peter Hurley, of Valad Group, agreed that the strength of a boutique fund was "the people behind it". Able to move quickly and perform reliably, Valad has created a suite of investment funds to cater for all risk-reward appetites. A challenge in the future would be the increasing number of players in the sector. On the other hand, boutique funds were able to make investments that were "too hard" for institutions. J

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