

SENIOR CONSULTANT

The Voice of the Investment Management Consultant



eFrontiers Puts Möbius, Manager Search and RFP Process On-Line for Free

Like the siren song of Greek mythology, the alluring call of the internet has become faster, better and cheaper, yet its promise has always been access. The internet is the vehicle that will take the thesis of investment management consulting into the financial services mainstream. It has been 40 years since modern portfolio theory was formulated, and it still has not been embraced by the financial services mainstream.

Most investors do not understand it is not possible to add value in a commission brokerage account through a series of disjointed, unrelated transactions with no accountability for performance. Half of all institutional accounts do not have a statement of investment policy, and not so coincidentally, half of all institutional accounts have not engaged the professional investment and administrative counsel of an investment management consultant. Ninety-nine percent of all investors have not had an asset study that establishes how all their assets look as a portfolio, delineating its risks, returns, tax efficiency, liquidity and cost structure relative to goals and objectives. Most investors are not even aware the investment discipline of investment management consulting

exists or that there is a process through which high level professional investment and administrative counsel is provided.

The key to this thesis of adding value being embraced by the financial services mainstream is to

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provide free access to its process, technology and methodology via the internet. Only with access will Nobel Prize-winning investment theory that drives investment management consulting begin to come alive for all financial advisors and all investors. eFrontiers.com

is literally beginning to move the financial services marketplace toward advice by providing free access to the Möbius separate account database and a powerful investment manager search and selection process which includes a template to create customized on-line requests for proposals that streamline the RFP process for investors, managers and consultants.

With eFrontiers' manager search and selection process and the RFP process on-line for institutional investors, managers and consultants, we are at the very beginning of what will become the Renaissance of investment management consulting,

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Schwab Doubles Merrill's Growth Rate, Battle Between Asset Gathering and Transactions Has Clear Winner

Over the last 15 years, Charles Schwab has grown from an obscure discount brokerage firm where client accounts averaged \$15,000 to a full-service powerhouse that is challenging the supremacy of the nation's top brokerage – Merrill Lynch & Company. During that time, Schwab's assets have grown from 8% to 43% of Merrill's, and those assets are growing at twice the rate of Merrill's. Not taking into consideration Merrill's overseas expansion, comparing U.S.-based assets to U.S.-based assets, Merrill's average annual growth in assets would drop from 17.5% to 15.5% relative

to Schwab's 39%. In the strategically important area of growth in on-line access, the momentum is in Schwab's advantage with their on-line asset growth rate averaging 97% over the past 3.5 years from an asset base of now over \$100 billion. Much can be and should read into the specific numbers which are unfolding, which even shows Schwab beating Merrill in the growth of its proprietary asset management business, 33% Schwab to 22% Merrill.

Yet, no one is talking about the most fundamental reason for Schwab's success because it may be considered heresy within the commission brokerage

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also signing up to participate. President and co-founder, Steven Cohen, said, "By providing direct process access to investors and consultants conducting searches, eFrontiers expands distribution for all investment managers in a cost-effective manner."

The most subtle but most important contribution to eFrontiers is that it also marks the beginning of a shift from product management to process management. It recognizes financial products do not add value; it is the process or what you do with the products that add value. eFrontiers is process management rather than product distribution and trade execution.

As eFrontiers expands its suite of services, it is not inconceivable that it would eventually offer the full comprehensive range of services that would include asset study, investment policy, strategic asset allocation, performance reporting and tactical asset allocation to complement its on-line management search and selection services. No major

financial services firm in the U.S. is currently offering this level of service which would address and manage the investment values of risk, return, tax efficiency, liquidity and cost structure necessary in order for investors to achieve their long-term goals and objectives. Thus eFrontiers may well become the purveyor of a comprehensive investment process technology tied to a virtual real-time balance sheet and income statement which includes all the client's assets and liabilities that has been so difficult for the product-focused commission brokerage mainstream to phantom. By definition, the consulting industry cannot rely on the financial services mainstream to create fully integrated, comprehensive investment process technology because that would mean they would have to accept it, embrace it and understand it before they create it, which is not likely, given their commission brokerage focus, culture, structure and technology. Thus, eFrontiers may

be the institution that capitalizes on the trend toward high level advice by filling the investment advice and investment technology vacuum. Whether it is eFrontiers, The Investment Source Company (see front page story of *Senior Consultant*, March 2000) or some unknown technology firm that ultimately fills the investment advice vacuum, the investment management consultant has an important strategic ally in eFrontiers in advancing the thesis of investment management consulting and in addressing and managing the investment values most important to each investor in terms they understand. eFrontiers makes the investor more aware of high level advice and by providing free access to process on-line, eFrontiers provides a vehicle that greatly accelerates the acceptance and emergence of investment management consulting by the financial services mainstream as the financial product and service delivery platform of the 21st century. ■

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financial services mainstream. Commission brokerage, or the execution of a series of disjointed, unrelated transactions, where no one is accountable for performance and it is not possible to add value, is an increasingly ineffective asset-gathering strategy. In commission brokerage, the primary focus is on trade execution which triggers immediate commission gratification without accountability for performance and little or no client relationship. The stockbroker is just one of three or four brokers with whom their clients have a relationship, and the broker is only as good as their last trade. Merrill understands that in Schwab's independent advisors advising all of their clients' assets that each year it is building on a solid asset base of recurring fee revenues, while each year Merrill brokers have to start all over again with a clean ledger and no earnings. Merrill's asset base is only as secure as its broker's recommendations. In times of volatility, where Schwab advisors are making it clear you can't add value through commission brokerage without an investment process that is designed to do so,

Merrill's assets are increasingly in play. Schwab advisors have a much smaller number of clients, but in managing all of their client's assets, have a deeper client relationship and provide a higher level of advice and service.

Understanding the dynamics of the marketplace, Merrill Lynch has been brilliant in developing and promoting a new internet-

driven advice business model that will incorporate all the client's assets and liabilities in a virtual real-time balance sheet and income statement. In fact, Merrill Lynch's financial services portal will likely be a model for the industry. Merrill's challenge is not the brilliance of its strategy, their challenge is in the tactics of their execution. They have a brilliant advice strategy, but their tactics are commission brokerage. Their brokers, their branch managers, their product managers, their technology, their organizational structure are so steeped in commission brokerage and the immediate gratification of commissions that they are being out-executed by Schwab's independent advisors. It might take Merrill years, even a decade, to effectively transition the firm toward advice which is more than enough time for Schwab to overtake it in assets. Thus, Merrill's challenge is to radically change its culture, structure and technology so it is the epitome of the new advice business paradigm. What makes Merrill a commission brokerage powerhouse is not what will make it successful in the new internet-driven advice business environment. It must become leaner, more entrepreneurial and more client-focused.

In essence, Merrill, the largest and the most successful commission brokerage firm in the world, must reinvent itself. This is no small task. Schwab's principle business advantage is that it doesn't have to move a massive bureaucracy in order to move the

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marketplace. Schwab is highly entrepreneurial, fast and adaptable, and has a low cost structure and relatively little bureaucracy. In contrast, Merrill's bureaucracy defines it. Despite the brilliance of its advice strategy, Merrill is still entrenched in commission brokerage tactics in its branches, its organization structure and in its technology.

So how does Merrill transform itself overnight into the global leader and the new paradigm of the emerging advice business? There are precedents for old-line industrial companies making such a radical transition like General Electric and the U.S. automobile industry, but the better model for today's internet-driven advice business model is found in the explosively growing and rapidly changing U.S. technology industry. The internet revolution is lowering barriers to entry, arming customers with information and speed, and destroying ignorance. The lack of corporate focus and commitment as well as process delays that used to protect status quo and mediocrity is being exposed in every industry by the internet. Everything is transparent to the client; there is only room for the highest level of advice, and your people are the only competitive edge you have. In the stark, cold reality of the internet world, there is continual, thorough, unvarnished evaluation of results, and there are no excuses. To a bureaucracy, this unvarnished evaluation seems almost inhuman – because there is only room for "A" players. Yet, to consumers and to firms like Merrill who suddenly find a vested interest in providing outstanding service and value, this unvarnished continual evaluation is honest and considerate. In fact, with Merrill's vast resources it could easily become the paradigm of the new advice business model. Yet, the difference in "saying and doing" boils down to execution at the top. Ted Waitt's challenges at Gateway a couple of years ago provide us insight into what will likely happen at Merrill.

Several years ago, Gateway was sucking air. It had a disastrous quarter, its stock tanked, the COO left, and Ted Waitt was in one of those crises that determine whether an entrepreneur is the real thing. He looked around, faced reality and decided the company he had started in a barn needed fundamental shaking up, now that sales were running \$6 billion a year. Merrill has a

brilliant commission brokerage management team and structure that is increasingly inconsistent with a new emerging business environment that will be driven by high level advice. Waitt brought in consultants to evaluate Gateway's top 100 employees with lots and lots of questions about a person's life since high school, plus highly detailed evaluations from a wide range of co-workers. Waitt found ". . . all the stuff I knew but didn't want to find. Top executives with a traumatic business problem almost always know it is there. They just don't want to face it until they absolutely have to."

This is when Waitt became a different kind of CEO. He concluded he would have to blow up his top management team, a team he had hired himself, its members sparkling with credentials from great companies. He admitted that if he wanted to attract the world's best executives, he couldn't afford to keep his headquarters in North Sioux City,

TODAY, MERRILL KNOWS THAT HIGH LEVEL ADVICE REQUIRES A DIFFERENT VISION, A DIFFERENT SKILL SET, A DIFFERENT TYPE OF SUPPORT THAN COMMISSION BROKERAGE

South Dakota. He realized in deciding to fill most of Gateway's top positions with new people almost simultaneously, he was betting the company. But he also realized if he didn't, he was betting the company as well. Merrill is in a similar situation by not aligning its culture, structure and technology with its advice business strategy. It is, in effect, betting the company. Though Merrill's vision is built around advice, it is still executing like a commission brokerage firm that it is. Meanwhile, every function and every aspect of Schwab is committed to high level advice as they grow 2.5 times as fast as Merrill.

Waitt started with hiring new managers for ten of the firms' top 14 jobs and many more at the lower levels, moving his corporate headquarters to talent-friendly San Diego, all the while growing the company by 20%. Jeff Weitzen, Gateway's CEO formerly with AT&T, went through a 5-hour interview with consultant Brad Smart of Smart & Associates and Ted Waitt. They got a staggering detailed picture of his work, his educational history and personal traits, and

conducted deep reference checks. They asked about college study habits, his biggest mistakes of the past 10 years and how his administrative assistant would describe him. Waitt became committed and passionate about only hiring "A" players and coaching "B" and "C" players to become "A" players, or moving them into other jobs where they could be "A" players or moving them out. Waitt knows in today's highly competitive, high tech, internet-driven business environment, your people are the only competitive advantage you've got.

In today's business environment, it is no longer good enough for Merrill to just say it is in the high level advice business, it must be reflected in the actions (culture, structure and technology) of every employee of the firm, from its product (process) managers to its branch managers, from its CEO to its brokers, from the highest to the lowest level team member. They must be passionate about their work in adding value and in helping their clients.

It is now clear that Waitt won his bet. Eighteen to 24 months after the major new hires came on board, all are still on their jobs, an amazing result since half of all new hires don't work out in the U.S., and Gateway is doing better than terrific. But most importantly, the corporate reengineering movement started

by Jack Welch at General Electric 30 years ago has gone to a new level that is setting the client service bar very high in building a client-centric business. Waitt is committed to the highly demanding, detailed, time-consuming, relentlessly honest processes for recruiting new employees and evaluating current ones whom he adopted when he bet the company. He only hires "A" players, and the process never stops. This is the optimal business environment in which to excel, and everyone takes pride in achieving at high levels. This is also your competitor's worst nightmare.

Today, Merrill knows that high level advice requires a different vision, a different skill set, a different type of support than commission brokerage. In the good old days of analog, the brokers would fight it out in the marketplace, and the best brokers would win. In today's digital age, the best brokers will lose every time if they don't have the best financial product and service support platform geared to the highest level of professional investment and administrative

counsel. Merrill, without question, is the most powerful commission brokerage franchise in the world, but that is not what will drive the financial services industry well into the 21st century. Schwab has set its sights on owning the high-end of the advice marketplace where all the assets are. It is aggressively changing every aspect of its

internet-based platform to facilitate the delivery of high level advice. It has acquired U.S. Trust which is an important brand for high level advice, which will provide access to the processes and methodology of high level advice and which has a relatively small but highly entrepreneurial staff who is fast, adaptable and totally committed to the

vision of high level advice. Merrill might want to consider how committed its people are to the delivery of high level advice. An "A" player in the commission brokerage model does not translate into an "A" player in the high level advice business model, and it is going to take "A" players to win the asset game. ■

Cortez And Pastore Join Goldman Sachs to Create and Execute the Firm's Consulting Strategy

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investment strategy, but unlike the Northern Trust Service model, at Goldman each team is headed by an investment banker. This is because Goldman uses their advisory services as their primary methodology for relationship management. The investment bankers and analysts are in and out very quickly, but Goldman's banking clients use its advisory services at least weekly and often several times a day. This inundation of investment-related questions requires the investment banker to have an advisory services team. This facilitates continual contact with investment banking clients almost daily and positions Goldman to win secondary banking and underwriting opportunities after the initial public offering.

Although advisory services is an important part of Goldman's business, just one investment banking offering could generate far more revenue than all the revenues generated by Goldman's entire advisory services enterprise. Last year, Goldman hired 100 investment bankers to head up relationship management teams which affirms their approach to advisory services is very much a subset to their investment banking business.

Bob Pitti who has built advisory services businesses to support investment banking at First Boston, Montgomery Securities and Thomas Weizel Partners, observed, "These businesses thrive in a partnership business structure where everyone is interested in growing the firm's overall revenues because as owners and partners, everyone is rewarded accordingly. In a corporate environment, this level of service may not be possible because the individual banker is

compensated only on the deals they generate, thus spending time building long-term relationships is far less important than doing deals. At Goldman, they view advisory services and its associated relationship management as protecting its investment banking franchise."

As you might expect, Goldman's process for providing high level advice at the highest end of the high net worth market is

ALTHOUGH ADVISORY SERVICES IS AN IMPORTANT PART OF GOLDMAN'S BUSINESS, JUST ONE INVESTMENT BANKING OFFERING COULD GENERATE FAR MORE REVENUE THAN ALL THE REVENUES GENERATED BY GOLDMAN'S ENTIRE ADVISORY SERVICES ENTERPRISE

totally customized. Each client and their circumstances are unique. Though investment banking was the catalyst for creating the relationship, the Advisory Services Group has extraordinary experience in trust, income and estate taxation, investments and investment strategy, and has successfully worked with the principals of large firms which have gone public. This very impressive client list in concert with the impressive capabilities of advisory services makes Goldman Sachs a very formidable competitor. The six services that comprise the investment process (asset study, investment policy, asset allocation, portfolio construction/manager search and selection, performance monitor, tactical asset allocation), are all incorporated in the services Goldman

provides but may not necessarily manifest themselves as formidable stand-alone services. Extraordinary emphasis is placed on defining the client and their unique needs and circumstances (asset study/investment policy) and in creating an investment strategy (strategic asset management) and constructing a custom investment portfolio for each client. Stan Coglemen heads a 12-person asset allocation group with five Ph.D.s which create custom investment strategies for clients. The more complex the client's financial circumstances, the better for this group. Cogleman's group has created manager of manager limited partnerships around specific investment management styles similar to Frank Russell's approach and has an impressive array of public and private investment vehicles (trusts, foundations), tools and methodology necessary to literally handle the most intricate and complex investment strategies.

With the firm having extraordinary sophistication in using third party managers, Cortez and Pastore have a wonderful platform to take Goldman's services outside the firm for use with third party investment management consultants who have high net worth clients with substantial assets. The promise of Goldman Sach's becoming more attuned to the trend toward high level advice, both inside and outside the firm, is an exciting prospect. The Goldman Sach's name commands great attention in the marketplace which may well translate into their becoming an important supporter of the investment management consulting industry, particularly if Rick Cortez and Peter Pastore can influence the firm's direction. ■