► **Greycourt White Paper**

White Paper No. 5 – *Working with Investment Consultants: Price Versus Value*

Background

Certain cost-conscious investors – especially smaller investors and charitable endowment funds – sometimes express concern about the level of fees charged by Greycourt and a few other premier firms. The purpose of this white paper is to explain why some firms charge more than others. We will describe the two kinds of investment consulting firms available to investors and suggest how investors might thoughtfully decide which type of firm is likely to best meet their investment needs.

Discussion

Why is investment consulting so expensive?

It isn't – it's just that investment consulting fees are highly transparent. Investment consulting firms – even premier firms like Greycourt – charge fees that are only a fraction of the fees charged by money managers, yet they add far more value. A US large capitalization core manager will, on average, charge 45 basis points (one-half of 1%) for a $50 million account. Yet roughly 70% of these managers have actually *subtracted* value from portfolios by under-performing an inexpensive index fund over the past decade. At best, a superb manager will add a modest increment over the index. Greycourt's ongoing fee for a $50 million portfolio will be about 19 basis points. Yet the areas we address – asset allocation and structuring the portfolio for the best risk-adjusted, after-tax returns – will dominate the portfolio's performance. The difference is that the manager's fee is typically buried in his returns, while Greycourt's fee is fully transparent to the client – as it should be.

Categories of investment consultants

Although they range across a fairly wide spectrum, investment consulting firms tend to be divided between those who compete with each other on price and those who compete with each other on the value they add to client portfolios. Neither is inherently preferable to the other – as discussed below, it all depends on the characteristics and needs of the investor.

The two types of firms are not difficult to distinguish, as they typically differ profoundly in several key areas, prominently including the fundamental value proposition they offer to prospective clients. A consulting firm that competes on price, for example, is saying to investors, "We will perform certain specific services for you and charge you as little as possible for them." A firm that competes on value-added is saying, "We will add enormous value to your portfolio and expect to be compensated accordingly."

As investors evaluate consulting firms the differences between price-focused firms and value-added firms will become obvious. Here are some differences you may wish to look for:

Personnel

Firms competing on price. Investors will find that these firms must hire mainly junior personnel whose compensation levels will be relatively modest. Typically, employees will consist of recent college graduates, as well as recently-minted MBAs and JDs, who will be supervised by a small group of more senior people. Very few, if any, employees will be principals or equity owners in their firms. Compensation will be based on seniority and client loads.

Firms competing on value-added. In contrast, these firms must hire very senior personnel, whose compensation levels will be significant. Most will have a minimum of fifteen to twenty years experience working with very large investors. In well-managed firms, these employees will be principals in the firm, owning significant equity stakes. Compensation will be based on revenue generated firm-wide, not merely on revenue generated by clients each professional advises.

Advice

Firms competing on price. Because they are using junior personnel, these firms must standardize the advice they give to clients and must carefully restrict that advice to asset allocation and manager selection. Junior personnel cannot be trusted to deliver custom advice to the client base given their lack of experience.

Firms competing on value-added. Because they are using very senior personnel, these firms must highly customize every aspect of their advice, from asset allocation to asset location to manager selection to tax-loss harvesting to associated advice about other issues faced by wealthy families and large institutions. Senior professionals will not tolerate being forced to use cookie-cutter approaches.

Attention to Client Needs

Firms competing on price. These firms must minimize the amount of time and attention they devote to clients, as these activities are very costly. They will typically be reactive, responding to client demands but not proactively offering advice or suggestions. Client loads per advisor will typically be very high.

Firms competing on value-added. These firms must be highly attentive to their clients, proactively contacting clients and anticipating their needs before demands are made. Client assignments per advisor will typically be very low.

Price

Firms competing on price. These firms will accept almost any fee arrangement demanded by the client and will then structure the delivery of their services in a manner that will insure a profitable engagement. These firms almost never decline an engagement.

Firms competing on value-added. These firms will typically quote a fee based on their estimate of the complexity of the engagement and the quality of service and attention that will be required. While fees are generally negotiable, the range of the negotiation will be fairly narrow. These firms frequently decline engagements.

Which types of consulting firms are best for which kinds of investors?
Ultimately, only the investor can answer this question. However, our experience suggests that some rules of thumb tend to apply in this area. For example:

- ♦ Smaller investors will tend to gravitate toward price-focused consulting firms, while larger investors will gravitate toward value-added firms. Because consulting fees decline rapidly as the client's asset base grows, the consulting fee as a percentage of the portfolio will be much less burdensome for large investors than for small investors. It is for this reason that Greycourt typically enforces a $10 million minimum account size: it is above this level that we begin to add value well above the size of our fee.
- ♦ Charitable endowments frequently wish to direct every possible dollar toward their charitable missions, and hence many will wish to work with price-focused firms. Other charitable organizations will prefer to maximize the risk-adjusted growth of their endowments, believing that this approach will maximize the availability of charitable dollars in the long run. These endowments will tend to work with value-added firms.
- ♦ Trustees of private trusts or endowment funds will frequently seek the fiduciary protection that working with an investment consulting firm brings.

When the trustees consider themselves fully capable of managing the funds committed to their stewardship, they will wish to pay as little as possible for fiduciary protection and will favor price-focused firms. On the other hand, trustees who lack the time or training to manage fiduciary portfolios will favor value-added firms.

- Investors who maintain fully integrated investment offices will rarely need to work with investment consultants on an ongoing basis. However, for occasional project-oriented work these investors will seek out price-focused firms for commodity-like work and value-added firms for more complex assignments.

As noted above, no firm will be right for every investor. Greycourt, for example, has deliberately positioned itself as a premier value-added firm. We work with ultra-wealthy families, with selected endowments focused on long-term growth of their charitable dollars, with fiduciaries seeking comprehensive advice (as opposed to mere fiduciary cover), and with smaller-but-serious investors. We will be happy to discuss whether Greycourt is the right firm for you. If not, we will be pleased to supply you with the names of several high-quality, price-focused firms.

GREYCOURT & CO., INC.
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(This paper was written by Gregory Curtis, Greycourt's Chairman.)