

Foreign entry into the Australian funds management industry through investment advisory alliances

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Executive summary

The purpose of this project is to investigate (1) firm level determinants of alliances between Australian and international fund managers, (2) the performance impact of such strategic tie-ups on domestic funds and (3) their effects on the rest of the industry. The project uses a unique collection of information on international investment advisory firms who enter the Australian investment management industry through alliances with local fund managers in the period 1998-2005.

Background and aims of project

Foreign fund managers are entering the Australian market in larger numbers than ever, attracted by the pool of assets under management projected to grow to A\$1.32 trillion by 2015, according to AXISS predictions widely reported in the international financial press.¹ One predominant mode of entry is via joint ventures or alliances with local fund managers. Under the arrangements, local fund managers retain their licensing responsibilities with the regulatory authorities and continue to market the funds (often co-badged using the identities of the local and foreign entities), with the foreign manager as a sub-advisor to the fund. Although Australia is the fourth largest market for managed funds in the world, the subject has attracted very little interest from financial economists.

Very little is known about the types of local institutions that enter into alliances with foreign fund managers. Do any fund company characteristics systematically predict local strategic partners? What are the benefits that accrue to local fund managers who enter such JVs? Are there discernible performance improvements? Are there significant changes to fund flows? Do such managers increase their product universe as a result? How does the competition react in terms of performance and fund flows? Specifically, the aim of this project is to investigate three main issues raised by the entry of foreign fund managers into the Australian funds management industry through alliances and joint ventures (henceforth “alliances”) with local investment firms:

- The firm level determinants of alliances between Australian and international fund managers.
- The performance impact of domestic fund managers’ strategic tie-ups with foreign investment firms.
- The intra-industry competitive effects of foreign entry into the investment advisory industry.

¹ AXISS projections, widely reported in the international financial press, e.g. “Aussie funds pool to hit \$1.32 trillion,” *Euromoney*, February 2004 and “Further to go for pension pioneers: Australia’s compulsory occupational scheme,” *Financial Times*, 27 September 2004.

The project will utilize a unique hand-collected dataset of domestic-foreign manager strategic alliances in Australia. The main advantage of using alliances as opposed to direct forms of foreign entry such as establishing local subsidiaries is that alliances occur frequently, offering sufficient data for the investigation of the issues targeted by this project.

It is anticipated that the research will generate immense interest from the financial sector, including:

- Investors
- Investment companies already involved in or contemplating entering strategic alliances with overseas fund managers,
- Authorities responsible for competition policy and licensing in the funds management industry, and
- Industry analysts and academic researchers

Significance and innovation

The significance of this project is demonstrated through the size and scope of the industry being tapped into by foreign fund managers. The Australian investment management industry is currently valued at \$A955.3 billion in terms of assets under management (Australian Bureau of Statistics, December 2005). Given that the largest contributor to these funds as well as the main driver of the projected exponential growth in the sector is the accumulation of retirement savings through Australia's unique compulsory superannuation system, the need to understand the effects of foreign participation in this industry is of considerable significance to the Australian population.

The first major innovation of the project lies in the fact that the issues proposed for investigation have never been researched before. The management of investments in Australia inevitably involves foreign fund managers due to two main factors. First, the sheer size of the industry requires the introduction of additional expertise. Second, there is the need to diversify the talent pool responsible for managing the funds. Despite these imperatives, the participation of foreign managers in the domestic funds management industry remains largely under-researched.

The second innovation is that, to fine-tune the motivation of the hypotheses underpinning the research to reflect input from practitioners, the investigators propose to facilitate a focus group session involving industry participants. This step will provide practical background information for use in refining the project's focus.

The third major innovation of the project is the creation of a unique database of international alliances involving local investment managers. With this database, there is considerable potential for ongoing collaborative research involving the industry and Australian academics in this area beyond the current project.

Description of approach

Foreign entry in the funds management industry is examined through a series of separate but closely related research studies using a unique data set of domestic-foreign manager alliances. The first phase of the research involves a focus group session with industry involvement as well as the development of dataset. Data sources have been

identified and the procedures for constructing the sample carefully mapped out. The second phase of the project is devoted to data analysis using established financial research methods and writing up the research findings around the three research themes described above.

Project team

The project is led by two researchers with considerable experience in academic and applied research in the Australian investment management field. The researchers will be assisted by a well qualified programmer and research assistant.