Choosing an investment consultant

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The appointment of an investment consultant is a critical decision. The decision can have a profound impact on investment performance and alignment of an investment portfolio to the expectations of the ultimate beneficiaries. The right consultant will develop a thorough understanding of the organisation they are consulting to and then propose novel ideas that are fit for purpose and provoke discussion. Once appointed, the consultant should effectively become an extension of the organisation's team.

Investment consultants, also known as asset consultants, are appointed to advise on investment portfolios managed by a committee or Board for the benefit of individual beneficiaries, or for an institution like a university. As with other expert service providers, like legal, audit and tax, investment consultants are appointed either on a retainer or project basis to provide expert advice on a range of investment matters, or even for an objective outsider's holistic opinion or health check.

Effective consultants will contribute to the decision-making process, but not substitute responsibility. Decision-making is the Board or investment committee's role and responsibility. The investment consultant provides independent expertise, an informed framework and recommendations enabling the Board to take due care in executing its duties.

While investment consultants and financial advisers both provide investment advice, consultants are specialised in advising institutional investors. Institutional clients often require more sophisticated solutions, with consultants offering a broader knowledge base and more in-depth coverage that specifically caters to these complex needs.

There are also often triggers to change an investment consultant relationship. These include meaningful change in the investor's or consultant's business, service that is not meeting agreed standards, or where the outcome of advice is disappointing.

This paper outlines the key considerations and steps required in appointing a consultant with specific focus on the investment and servicing credentials of a consultant. There are other important operational factors to take into account including sufficient insurance cover, financial position, and administrative demands, but these are not considered in this paper.

Getting started

Appointing an investment consultant is a major decision which requires careful consideration before and during the process to achieve the best possible outcome. There are a number of steps that should ensure an organisation gains the best potential benefit from engaging a consultant.

Define the purpose and requirements

The first step taken should be defining specific needs to be met and the role the consultant will play in addressing those needs. It is important to include all relevant stakeholders in this process.

Being clear in defining and documenting the expected outcomes of the consultant's work will make it easier measure the success of the actual appointment.

The role of the investment consultant could include a combination of the following:

- Review or establish an investment policy or governance framework.
- Formulate and articulate the investment objective, to include defining the investment philosophy, return and risk objectives and investment horizon.
- Establish a strategic asset allocation to meet the investment objective over the long term.
- Establish a dynamic asset allocation framework and provide advice to enhance performance over the shorter term by taking opportunity of constantly changing markets.
- Provide research and recommendations on fund managers and products in specified asset classes.
- Continued monitoring of manager and product performance against appropriate benchmarks. This could lead to changes in manager selection or asset allocation.
- Advice on responsible investing challenges or objectives. For instance, assisting to develop a plan to meet specific climate goals adopted by the organisation, such as 'net zero', alignment with the Paris Agreement, or setting guidelines to participate in impact investing opportunities.
- Formulation of bespoke spending policy that caters to the organisation's specific requirements.

Identify key characteristics of the consultancy

Although all investment consultants offer similar services, there are significant differences across each consulting business. These differences will impact the quality of advice, the way advice is delivered, and ultimately the performance of the portfolio. There are a few important attributes we believe have a significant impact on investor outcomes.

Values, culture and beliefs

It is important to ensure the consultant's values and culture align to the expectations of a specialist service provider. Values reflecting integrity, honesty and collaboration are critical in guiding all aspects of the consultant's business. Consulting is a people business and one that requires teams of specialist staff working together to solve problems for their clients. Organisations that not just talk about, but can demonstrate teamwork, diversity and inclusion would be expected to achieve superior idea generation and outcomes for clients.

The investment consultant should have a culture of strong due diligence and risk management. They need to have a mindset and motivation of always keeping the client's best interests foremost.

Following values and culture is investment beliefs. It is important to understand the consultant's investment beliefs as these are crucial in ascertaining whether they have an investment philosophy from which to build a fitting solution for your portfolio. As a simple example, if the consultant's investment beliefs do not recognise climate change, they are unlikely to perform sufficient research in support of climate change as a key investment risk.

Conflict and ownership

An independent and unconflicted consultant is generally considered best for an objective, thorough and superior result. The consultant should be making recommendations with the investor's—and only the investor's—best interests in mind. Any means for the consultant to earn additional non-advice revenue from the recommendations they provide should be viewed cautiously. The consultant needs to demonstrate complete transparency in this regard by clearly disclosing all conflicts in place and detailing any associated benefit to the consultancy beyond a pure advice fee.

Some consultants will disclose potential conflicts and highlight how these are managed, but in Frontier's opinion, conflicts complicate the advisory relationship and require an added level of oversight, along with doubt. Ultimately the investor's relationship with the consultant should be such that what is best for the client is best for the consultant, and not the other way around.

The ownership of the consulting business is also an important factor as it provides an insight into its purpose. All successful businesses aim to make a profit to sustain the future operation of the business. Businesses, or parent companies, listed on a stock exchange will generally have a core purpose to maximise shareholder returns, which is generally short term in nature.

Businesses owned by private equity may have a slightly longer investment horizon for the owner, however, most private equity held businesses will eventually be sold and the purpose of private equity is generally to improve profitability and efficiency in search of the highest possible sale price. Privately owned consulting businesses, in general terms, would be expected to conduct their business with a longer-term mindset, which requires an enduring and satisfied client base.

People and incentives

Investment advice requires significant effort across a number of areas including capital markets analysis, asset class and asset manager research, responsible investment issues and technology. To achieve the best outcomes, consulting businesses are typically organised into teams with specialist expertise who work together to produce solutions and ideas for their clients. The ability to attract and retain talent is vital to achieve the best possible outcomes. Investors seeking to appoint a consultant should

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The quote

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understand the reputation of the consulting business as an employer and enquire about staff turnover. Try to develop a good understanding of the growth of the consulting business and how they are managing their resourcing in response.

Equally important is incentivisation and alignment. Ideally, the consulting business should have, at a minimum, market-based salaries and be able to compete for talent at all levels. Also important is a link between the short-term incentives of staff and client outcomes, to ensure an alignment of interest between the consultant and investor.

Match consultant capability to areas important to the organisation

Research the breadth of the resources and knowledge-base within the consultancy. A strong inhouse team covering a diverse range of relevant areas will provide a more balanced end solution and should be better equipped to provide the ongoing support needed. If there are requirements in a specific topic or area, it will be important to ascertain the consultant's experience and capability related to the specific topic where advice is sought.

Data and information have become an important input into the formulation of investment advice. Every credible investment consultant should have access to accurate and reliable information sources ranging from raw market data, economic data, data on investment managers, climate related data, journals and other financial publications. However, what sets apart the best consultants, will be how data is processed and embedded into the consultant's own proprietary models, systems and research to generate the best insights, ideas and solutions for the client. This is often an overlooked component in evaluating asset consulting proposals.

Ask for a list of subscriptions, systems and data-feeds they access and seek clarity into how that data is processed through to research, insights and ideas for clients. Ask about the consultant's annual expenditure on data and systems capability and their own dedicated internal resources.

Track record

It is important to find out if there are any independent measurement tools in the market to evaluate the consultant's track record. For example, investment consultants in Australia are measured by Peter Lee Associates in an annual survey of institutional investors which ranks consultants across a range of factors

The actual performance of a consultant's client's funds against industry benchmarks can be found in the public domain. In the case of superannuation funds this is readily available. Successful consulting organisations should be able to produce various performance metrics on request.

Advice on asset allocation is often considered the most significant element of achieving portfolio performance. Ask the investment consultant for a breakdown of their 'market calls' to review where their advice over particular sectors has either added to, or detracted from, the overall performance of their clients.

Investigate the number of clients gained and lost, including the reason for those losses and which consulting firms those investors moved from, and to, over the past few years. These movements usually follow extensive evaluation processes and provide an indication of recent market assessments and a sense of the general satisfaction of clients.

Request for proposal

A common approach to 'go to market' is to issue a request for proposal (RFP) to several consultants. The RFP should provide background information regarding the organisation's purpose and investment program, detail the scope of services required, ask a range of questions to help identify the best consultant for the role and provide information and a timeline for the tendering process. It is the main document for engaging with the market and a useful tool to help narrow the field to a shortlist of contenders for closer review.

A thorough RFP should include the following:

Enough information to accurately price the services

Consulting advice is a nuanced and often highly bespoke service that requires the consultant to have a solid understanding of the client's organisation, investment program and ways of working. RFPs should contain enough information to allow the consultant to accurately price the work. This should include current investment objectives, portfolio structure and manager line-up. If there are concerns about sharing this detail, ask the consultant to sign a non-disclosure agreement. Without the right information, the consultant may under, or over, estimate the assignment, which will ultimately be to your detriment.

Scope

The scope for the engagement should be defined in detail including a list of services, deliverables and timeframes. The better defined the scope is, the less risk of being presented with a generic solution. Agree internally on the required tasks and services upfront as this will provide the basis of the proposal and will be used by the consultant to frame their response and calculate the proposed fee. A well-defined list of services will also make it considerably easier to compare the pricing of different consultants as it will allow an 'apples with apples' comparison.

Ask the consultant to specify individuals on the team

A reasonable expectation is that the people involved during the assessment process will also be on the team to do the job. Individuals expected to work on the assignment should be listed with a synopsis of their backgrounds and expertise. There is a risk the people listed in the proposal, and who are involved in pitches for the services, are not the people ultimately allocated to the work. Corroborate their availability by requesting the workloads of the proposed individuals. Naturally if the consultant is proposing a high-profile individual who is working on several other clients, and a less senior resource who is working on one or two other clients, it might be expected the less senior resource will ultimately perform the bulk of the work.

Specific questions
Ask enough questions to understand the many facets of the consulting business as discussed throughout this paper. The consultant's answer to these questions should help to develop a reasonable picture of the consultant's strengths, weaknesses and what it will be like working with them, all of which will be helpful in determining a short list or awarding the work. Ask for specific samples of work such as manager ratings or other pieces of research or examples of how the consultant has worked with similar clients to solve similar challenges. Avoid asking questions that will not help in the final evaluation as this just creates extra work for the consultant in responding, and in turn for those reading through the proposals.

Format and timeline
To make the task of comparing responses easier, specify the format for responses, at least in terms of the way and order in which questions should be answered. Emphasise brevity and specify limits around the length of responses to avoid having to read through large amounts of marketing and material. Alternatively, avoiding including word limits might provide a sense of the natural style of the consultant and how their actual reports and papers are constructed – concise and clear, or unnecessarily complex and lengthy.

The interview

Following the review of tendered proposals, arrive at a short-list of candidates for an interview, or pitch. Interviewing consultants is a critical step as it allows a better appreciation of what they might be like to work with and can potentially provide a deeper insight into the culture of the consulting organisation.

Interview each of the individuals who are intended to work on the proposed assignment rather than high-profile individuals that may only be brought in for the tender process. As noted earlier, it is not uncommon for consulting firms to engage through the tender phase using their most senior and highest profile consultants to then have these individuals reassigned to other clients or drastically reduce their involvement once the tender has been awarded. Make sure the people who will do the work are prominent in any interview or presentation to understand how they will perform.

The following points should be assessed during the interview process:

Does the person listen?
It is important the consultant listens and shows they appreciate the intricacies and dynamics of your organisation.

They should ask about the investment objectives, financial needs, restrictions—regulatory and other, operational workings and tax status. A good consultant will want to discuss these details and be thinking about how to deliver advice that is specific to the organisation's requirements. The consultant should be curious about the business and seek to gain an understanding of its history.

Fit and alignment
Building a long-term relationship with a person or team of people that can be trusted is crucial. Through the interview seek to gain a sense of whether there are shared values and ethics. Try to imagine what the working relationship might be like as a successful relationship requires respect, comfort and a high level of trust between all parties.

Confidence
Seek to assess the confidence of the individuals participating in the interview process. Confidence is gained through experience and knowledge and having had previous clients where great results were achieved. A confident consultant will provide recommendations positively and be open to feedback, rather than be overly insistent or dogmatic on their ideas. The converse is overconfidence, which should be avoided. Few investors want to be forced to adopt an approach – most would rather work in partnership with their consultant. Humility in approach is a very valuable attribute. In investments, where the knowledge base is wide, a consultant needs to recognise when to refer to other specialists on matters outside their area of expertise.

Collaborative
Gain a sense of whether the consultants in the proposed team work well together and that the consultant will work well with your organisation's team. Measuring collaboration is challenging and subjective. The key aspects to look for are communication style, listening skills, team structure and the degree to which the consultant is willing to tailor its client engagement and working style to best suit the team's requirements.

Collaboration is critical when it comes to the client-consultant relationship. At a minimum, collaborating via regular meetings will minimise the risk of the consultant's recommendations missing the mark or not taking into consideration an important attribute of your business strategy, for example. It is important to tease out the consultant's preferred working approach and their willingness to engage in regular meetings particularly for new relationships.

The quote

The investment consultant should have a culture of strong due diligence and risk management. They need to have a mindset and motivation of always keeping the client's best interests foremost.

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The attributes in investment consulting that will ensure the highest contribution to results are quality of staff; range of relevant services provided; depth of resources and diligent research; independence or lack of conflict; aligned values and strong character.

Communicating clearly and emphatically

Does the consultant have conviction around their view and can they communicate that clearly? Are they prepared to discuss differences in opinions and be resolute? It is important that a consultant provides their best, objective opinion, backed up with experience and research. Being frank and honest can sometimes be challenging for any adviser but staying the course and communicating this to stakeholders is key.

Experience with similar investors

Consulting firms are increasingly taking on a more diverse client base. The best consultants will generally have established client segments in their firm to ensure a sound appreciation of the different types of clients they work with. Enquire about the individual consultant's work history, the types of clients they have worked with and how they have helped clients meet specific challenges. Try to test the individual's understanding by asking specific industry related questions, raise pertinent news topics, or seek to understand how their advice to your organisation will differ relative to a similarly sized investor in a different industry.

Evaluating fees

The goal with agreeing fees should be a reasonable and sustainable cost structure for the services required. Seeking the lowest fee may not provide the best value. If the budget is limited, consider whether all services being priced are critical, or can be met internally or through other providers. To evaluate value, think of what the advice is worth to the business and how the fees compare with other professional services like legal, tax and audit.

The true value of the advice ought to be considerably more than the quoted fee. The quoted fee is typically, though not always, an easily identified and measurable one-off or annual figure. However, the value of the advice is more subjective as it is spread out over numerous years and can involve opportunity costs. In valuing the advice, it is important to consider the potential gains alongside the cost savings of avoiding expensive pitfalls, both qualitatively and quantitatively.

When fees are evaluated, it is important to make a 'like with like' comparison. Depending on the services required, there could be hidden fees or costs not necessarily transparent in the proposal. As previously explained, consultants often also sell products where they earn fees. If their advice recommends buying those products, additional fees may be embedded in the product. This needs to be factored into the total fee assessment. Be alert to low fee outliers as this could either be a sign of the consultant wishing to recoup costs via other, potentially hidden fees or the consultant may not be pricing for the complete list of services. An outlier on the high side may indicate some confusion on the type of services being built into the offering. Be prepared to check with the consultant to ensure accurate pricing for the organisation's needs.

An investment consultant with strong scale can also help negotiate better fees from fund managers. In terms of total cost to the investor, this ability to reduce investment fees should also be factored into the total net fee calculation.

Investors should seek to have a complete understanding of fees and consultants should be completely transparent on how the quoted fees are calculated.

Other considerations

Using a tender consultant

As discussed throughout this paper, appointing an investment consultant is an important activity which requires considerable thought and input to make the best decision. Not every investor will necessarily have the resourcing to be able to commit the time required to maximise the chance of a successful decision. For these investors the best option may be to employ the services of a tender consultant to support it in managing the search process. A tender consultant will be well placed to engage all the relevant market players and ensure the briefing and process is the same for all potential providers. An independent consultant can help a business make a clear comparison and an objective and informed decision.

Referees

Reference checks are a critical part of the selection process as they provide an investor's perspective of what it is like working with the consultant.

Ask consultants for at least two references and preferably from clients who the consultant has completed similar work for. Accept that the referees provided would be expected to be positive in their feedback so ask questions to understand style and approach and to test any areas of uncertainty and concern that may arise. Reach out to your networks to enquire about the reputation of the consultant and speak to current and former clients that have worked with them. Increased insight can be gained in understanding why clients have terminated services. This is good to ask the consultant, but even better if it can be verified independently.

Developing a long-term relationship with the consultant

Consultants' advice and services will be enhanced as they develop a better understanding of the business through a strong relationship over time. The true test of an investment consultant is the value-add through the market cycle, navigating the pitfalls, market challenges and periods of economic turbulence. A consultant with insight in the business will become a reliable partner through time.

Be realistic in setting a time frame over which to assess the value delivered by an investment consultant. While one should expect to see immediate results in terms of process and service delivery, any required portfolio restructuring and subsequent investment performance can take longer to materialise. Retainer contracts typically run for a minimum of three years which allows sufficient time for an assessment of the performance and value being added by the consultant.

A consultancy with an in-depth skillset can assist with other projects and services in the future. The dynamic market environment will present new demands from stakeholders and considerations by the Board or investment committee, which will need to be addressed. Where there is an existing relationship with a trusted consultant that possesses the necessary expertise and understanding of the organisation and portfolio, it should be more efficient, cost effective and insightful to work with this existing partner on future tasks.

The final word

A good investment consultant will help optimise decision-making and governance structures and help achieve additional long-term investment performance. The added performance will generally outstrip the fees to be paid by a considerable margin.

There are a range of consultants with different areas of expertise and approaches, but a robust process of assessment will clearly show how each differs, and which will add the most value to the specific solution required. As portfolios grow, appointing an investment consultant provides an opportunity to gain institutional grade advice.

The attributes in investment consulting that will ensure the highest contribution to results are quality of staff; range of relevant services provided; depth of resources and diligent research; independence or lack of conflict; aligned values and strong character.

A consultant brings extra skills to the business, a valuable external perspective and objectivity and assurance. The right investment consultant is arguably one of the most important relationships for any investor to have and upon which a long-term partnership can be built based on shared values, respect and trust. **FS**