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MoneyVoices: What Funds Need to Do to Survive

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The very mature mutual fund industry is going to need to reinvent itself in the wake of the credit crisis. The onus will be on funds to gracefully change how they do business, and to do so in a manner that sits well with investors. No less than the financial well-being of most Americans is as stake. The key ways that “Mutual Funds 2.0” will come about are as follows:

Core Competency

Each firm managing other people’s money must have a unique and fully differentiated core competency and achieve better results than anyone else. There is simply no need for me-too products. Every investor is entitled to the best product available at the most reasonable price. A product line oriented around this idea will include a handful of top-selling products focused around a core competency that are a fit for the current investment climate. Fund companies should also include a number of products on the “back burner.” These strategies will be suited to the coming investment environment. And yes, no one knows what strategy that is. Remember, that is why product management is an art, not a science.

In this environment especially, new ideas centered on core competencies are needed on the product development side of the business. Core competencies can be specific investment styles, approaches to organizing portfolio management teams, firmwide pricing structures and flagship products that can be broadened into an entire product line.

Results

Every investment shop should take a clear look at its product lineup and cut, merge or deliberately and strategically deemphasize the bottom 20% of the product set. If it’s not a center of excellence, then it’s a diversion that a focused firm — and its worried clients — can ill afford.

Fair and Reasonable Prices

The fund and advice industries need to clearly delineate what consumers are paying for. They must explain at which points in the process advice, asset management and administration fees are paid. Fund companies must ensure that each component of the cost is reasonable. Total fees must be a number that allows investors to make money over time. If exchange-traded funds, essentially a single-share-class fund, are the better mousetrap, than fund companies must figure out how to approximate that product model on legacy products when possible.

Doing the Right Thing Is Right

As proved by the growing appeal of socially responsible mutual funds and all things green and sustainable, we see one other solid booster for these types of funds. Investors currently know what the industry has always known: While invested, people's hard-earned dollars are traveling around the world and taking all sorts of unexpected turns (auction rate preferreds, hedging strategies requiring counterparties, and so forth) in vehicles as Main Street as closed-end income funds and hedged mutual funds. We think this newfound knowledge is an excellent example of how the law of unintended consequences will drive flows to funds that take environmental, social and governance issues as seriously as they do their investment strategies.

Yes, we are living in interesting times. And fund companies can make the situation work in their favor by strictly focusing on products that embrace core competencies, revising pricing practices so investors know what they are paying for at all times and adopting a communications strategy that ensures greater transparency. If these principles are embraced, funds and investors can easily have confidence that their best days are ahead of them.