Google at $475???
Who Really Decides What’s in Your Endowment’s Portfolio

Warrington College of Business
The University of Florida
January 20, 2006
Google at $475

- Academic/student focus:
  - Why $475?
- Today’s focus:
  - How does it get into a portfolio?
Today’s Discussion Topics

- Who are the players?
- How do they interact?
- Who are the decision-makers?
  (and who holds the power)
- What works/what doesn’t work?
- How might life change in your working careers?
In the Beginning...

- Venture Capitalists
  - Goal: *Grand Slam Home Runs*
  - E.g., Sequoia Capital, Kleiner Perkins
  - Paid on percentage of profits (primarily)
  - Frequently ex-investment bankers
  - Mediocre track record in adding value
In the Beginning…

- Investment Bankers
  - *Goal: Get the Deal Done (at any price)*
  - E.g., Morgan Stanley, Credit Suisse First Boston
  - Paid on transaction value
  - Highest costs/value added ratio in the process
GOOG at $85—Who’s in the Picture Now?

- Sell-Side Analysts
  - Goal: Justify price to:
    - Get the Deal Done
    - Move inventory
  - E.g., Morgan Stanley, Credit Suisse First Boston, Citigroup, J.P. Morgan, etc.
  - Information source, NOT idea source for institutional portfolios
GOOG at $85—Who’s in the Picture Now?

- Sell-Side Analysts (continued)
  - Increasingly controversial due to inherent conflicts of interest
  - Paid implicitly based on transaction volumes
  - Penter’s Opinion: Role will change/diminish over next decade
GOOG at $85—Who’s in the Picture Now?

- Buy-Side Analysts
  - **Goal:** Determine Fair Value AND Get Idea into Portfolio
  - E.g., Fidelity, Capital Research/Guardian, AXA, BGI, Legg Mason
  - Paid in variety of ways, but frequently on performance vs. peers
GOOG at $85—Who’s in the Picture Now?

- Buy-Side Analysts (continued)
  - Relative importance in decision-making process varies significantly from firm to firm
  - Penter’s Opinion: Role will increase (at the margin) in the next decade
GOOG at $85—Who’s in the Picture Now?

- Institutional Brokers
  - Goal: Generate Trades
  - Same players as original underwriters, and then some
  - Virtually zero value in institutional marketplace

- Penter’s Opinion: Will have role virtually eliminated in next 10 years
GOOG at $85—Who’s in the Picture Now?

- Retail Brokers
  - Goal: Generate More Trades
  - Same players as original underwriters, and then some
  - Negative value to investors

- Penter’s Opinion: Role/fee relationship will change in part towards asset-based fee arrangement/financial advisor
GOOG at $100: Where are We Now?

- Venture Capitalists—Made their Money
- Underwriters—Made their Money
- Sell-side Analysts—Made Some Money
- Buy-side Analysts—Rendered Their Opinion
- Institutional Brokers—Made Some Money/Want More
- Retail Brokers—Dialing for Dollars
The Institutional Gatekeepers—Investment Consultants

- Primary Roles:
  - Drive Asset Allocation Decisions
  - Evaluate Investment Managers
  - Determine Investment Structure
  - Recommend Specific Strategies
  - Assist in Implementation Strategies
  - Monitor results
The Institutional Gatekeepers—Investment Consultants

- Key Players:
  - Actuarial/Benefit Consulting Firms
    - E.g., Mercer, Hewitt, Watson Wyatt, Aon
  - Multi-Service Investment Firms
    - E.g., Russell, Callan, Wilshire, Evaluation Associates
The Institutional Gatekeepers—Investment Consultants

- Key Players:
  - Independent Investment Consultants
    - E.g., Ennis Knupp, Asset Strategy, Rocaton
  - Financial Services and Brokerage Firms
    - E.g., Merrill Lynch, Smith Barney, Northern Trust
The Institutional Gatekeepers—Investment Consultants

- Goal: (Ideally) Provide Unbiased Views of Appropriate Client Actions
  - Pragmatically, also keep clients from messing up AND
  - Provide CYA protection if they do
The Institutional Gatekeepers—Investment Consultants

- Typically, paid directly by clients
  - Historically, many conflicts of interest
  - Paid on flat fee, asset-based fee, or time/materials
    - Typically lowest cost/biggest impact of primary players involved in process
      - Very difficult to measure value added/lost in process
The Ultimate Decision Makers—Trustees

- **Goal:** Determine Appropriate Strategy/Managers to Meet Long-Term Investment Objective

- **Backgrounds:**
  - **Internal Staff**
    - May be investment professionals
  - **Internal Administrators**
    - Frequently NOT investment professionals
  - **Outside Board Members**
    - Generally NOT investment professionals
The Ultimate Decision Makers—Trustees

- Financial Rewards
  - Internal Staff
    - May be performance based
  - Internal Administrators/Outside Board Members
    - Zero to modest payments
GOOG at $475—How it Really Got in Your Endowment’s Portfolio

- Larry Page and Sergey Brin—Got an idea
  - Received enormous paper equity and cash
- Kleiner and Perkins gave them the start-up capital
  - Get 20% of the profits
- Morgan Stanley and CSFB brought it public
  - Get 5% to 7% of value
- Underwriting sell-side analysts promote idea
- Fidelity, et al buy-side analysts evaluate idea/recommend to portfolio manager
GOOG at $475—How it Really Got in Your Endowment’s Portfolio

- Portfolio manager/firm decides to purchase stock
  - Paid 50-100 basis points on assets
- Investment consultant: a) determines need for large cap growth manager b) evaluates merits of investment manager c) recommends potential managers to endowment clients
  - Paid 1-3 basis points on assets
GOOG at $475—How it Really Got in Your Endowment’s Portfolio

- Endowment fund trustees select manager
- Investment manager purchases stock for portfolio
  - Brokers get paid on transactions (5 to 50 basis points)
Who are the Players?

Investment Bankers

- Backgrounds
  - Ivy-League B-School Graduates
  - Attorneys/CPAs
  - Former corporate strategists
  - Former commercial bankers
Who are the Players?

Investment Bankers

- **Pay Levels**
  - Entry Level: $75,000 to $200,000
  - Senior Level: $1,000,000 (and multiples thereof)

- **Future Prospects**
  - Generally similar to current market
  - Cyclical business
Who are the Players?

Sell-Side Analysts

- Backgrounds
  - B-School Graduates
  - CFAs/CPAs
  - Former commercial bankers
Who are the Players?

Sell-Side Analysts

- Pay Levels
  - Entry Level: $50,000 to $150,000
  - Senior Level: $250,000 to $1,000,000 (and multiples thereof)

- Future Prospects
  - Likely declining
  - Dependent on supporting role to investment banking and transaction volumes
Who are the Players?

Buy-Side Analysts

➤ Backgrounds
  - B-School Graduates
  - CFAs/CPAs
  - Modest prior experience
Who are the Players?

Buy-Side Analysts

- Pay Levels
  - Entry Level: $75,000 to $200,000
  - Senior Level: $250,000 to $1,000,000

- Future Prospects
  - Likely growth
  - Career analysts and route to portfolio management role
Who are the Players?

Portfolio Managers

- Backgrounds
  - B-School Graduates
  - CFAs/CPAs
  - Material prior relevant experience
Who are the Players?

Portfolio Managers

- Pay Levels
  - Entry Level: $150,000 to $250,000
  - Senior Level: $500,000 to $1,000,000 (and equity)

- Future Prospects
  - Likely modest growth
  - Source of assets/structure may change
Who are the Players?

Investment Consultants

- Backgrounds
  - B-School Graduates
  - CFAs
  - Modest prior experience
Who are the Players?

Investment Consultants

- Pay Levels
  - Entry Level: $50,000 to $100,000
  - Senior Level: $250,000 to $1,000,000

- Future Prospects
  - Likely modest growth
  - Multiple career paths in related roles
Final Thoughts

- Value-added/cost ratio not terribly efficient in institutional investment marketplace
- Costs are becoming increasingly important
- Conflicts of interest are inherent in the process
  - Understand each player’s motivation
- Overall investment industry prospects are solid
  - Somewhat cyclical
  - Moderately changing roles
Final Thoughts

- Doing the “right thing” is rewarded
  - For clients, for associates, for yourself