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***Editor's note:** Conventional wisdom holds that due diligence examines quantitative as well as qualitative characteristics of a manager, but the easiest information to get about a fund – performance numbers, statistics, pitchbooks, etc. – can also be the least likely to truly explain a manager's style, how he or she thinks, the firm's operational personality, etc. As pointed out by Bruce Frumerman of Frumerman & Nemeth in this contributed article, such "soft" information has become increasingly important in the minds of institutional investors, and alternative asset managers that don't pay attention to effectively communicating their soft as well as hard attributes may find themselves out of the running for an allocation.*

A Hard Look At Your 'Soft' Hedge Fund Marketing Information

by Bruce Frumerman, Frumerman & Nemeth Inc.

Earlier this year, researchers from the University of North Carolina and Tulane University published the study *Finding Fortune: How Do Institutional Investors Pick Asset Managers?* They had compiled information on the interactions between a large institutional investor and 1,093 long-short equity hedge funds it vetted over the course of eight years. Their objective was to examine the due diligence process and, in particular, determine the importance and value of manager scrutiny that goes beyond the numbers.

Here are five highlights of the study's findings that should be of most interest to hedge fund firm owners:

- By understanding and buying into how your firm invests, rather than focusing only on your numbers, an investor has the potential to achieve better returns. As the researchers reported, "A one standard deviation increase in our proxy for positive soft information doubles the probability of fund selection and reduces the due diligence time by 20%. Contrary to prior research, we find no evidence that relying on these subjective judgments is wasteful. Instead, in a matched sample, conditioned on the fund characteristics and past performance, the 12-month average peer-adjusted returns are 1.5% higher for the selected funds."
- "Hard information (by which the researchers mean data such as performance numbers, staff bios and organization charts) is fairly cheap to obtain but of relatively low quality versus expending resources (time, labor, and fees) to obtain additional 'soft information' that will better allow the allocator to identify the quality of the fund manager."
- At the initial meeting between the allocator and the manager or sales person of the fund under consideration, "most of the information collected and evaluated is 'soft' information that will characterize such things as the fund manager's style, idea generation process, risk management strategy [and] organizational structure." Soft information conveyed during the introductory meeting strongly influences the decision of whether to conduct further due diligence, and whether to invest.

- The “almost universal first piece of soft information about a fund comes in the form of the pitch-book,” they report. Here, they are referring to the pages where the hedge fund “discusses the fund’s investment process from idea generation, to portfolio construction, and trade execution.” “Risk management…is also discussed in this section. The general theme of this second section [of the pitch-book] is ‘differentiation’, i.e., what makes the fund’s process different and how does this translate into an investment edge.”
- Soft information “is typically summarized and aggregated in a qualitative way by the allocators’ investment staff through internal reporting systems and memos.” The researchers go on to note, “an internal database entry is created that includes notes and analysis of the fund by the allocator’s investment professional that conducted the interview… It is important to highlight that even at the first meeting, much of the information recorded by the allocator is inherently ‘soft’ in nature.”

FINalternatives asked Frumerman & Nemeth whether this study’s findings mirrors what our 29 year-old financial communications and sales marketing consulting firm has found in working with money management firms that serve, and market to, the institutional plan sponsor marketplace. The answer is yes. Ever since the early 1990s we have seen the ever-growing importance of, and focus on, ‘soft information’ factors in due diligence vetting that go beyond the numbers. Much of the work for which hedge funds and other money management firms come to Frumerman & Nemeth is, in fact, for helping portfolio managers craft this very content that sophisticated investors require.

What this study means for your hedge fund

This study again reflects what surveys of institutional and family office investors over the past few years have shown. Understanding and buying into investment process and strategy implementation are key factors in the investor decision making process. Further, they are the crucial focus of interest at the initial meeting investors grant the money management firms they are considering.

If a hedge fund does an inadequate job of communicating this “soft” information it will be out of the running to win an allocation.

The flipchart pitchbook remains the typical, and most often the *only*, marketing document handed over to investors that delivers, in print, any content about investment process and what differentiates the firm from competitors. This is actually a problem, both for the investor who is trying to decide whether the manager is worth dedicating more due diligence time to and for the hedge fund that wants to explain its investment process, differentiate the firm and out-market competitors with similar performance.

Note the use of the word “discusses” by the researchers when they made reference to hedge fund firm-provided content about investment process and risk management considerations. This is where I believe they unintentionally used the wrong semantics. Bullet points and diagrams in a pitchbook only enable a money management firm to deliver abbreviated, overview content, not any in-depth explanations about investment process. Delivery of any detail about this so-called soft information by a hedge fund actually takes place verbally at that initial sales meeting. ‘Discussion’ by the money management firm is literally verbal. That is a hedge fund marketing problem.

Importantly, as this study notes, the institutional investor contact person is, some time *after the fact*, writing up notes about that meeting that are meant, as the study points out, to summarize and aggregate "in a qualitative way" opinions about the veracity of how the manager thinks and his or her approach to investing.

The question this raises for the hedge fund firm owner is whether his or her message will fall the way reminiscent of the telephone game played at kindergarten birthday parties, where the first child's whispered sentences are passed around the circle and highly unlikely to come out the same when repeated out loud by the person at the end of the circle. *What is the likelihood the prospective fund investor will correctly remember, and be able to write up in accurate detail days later, information about a hedge fund's investment process and strategy implementation that was only conveyed verbally at the sales meeting?*

Since it is imprudent for the hedge fund firm owner to leave accurate recall to chance, a more buyer-focused approach — which is also in the best interest of the institutional investor — is called for when delivering such important due diligence related content.

The qualitative marketing edge

Hedge fund firm owners should take steps to create their so-called 'soft information' in detail, and be able to deliver it in print as well as verbally to institutional investors during the due diligence process. This requires having a fully developed storyline that educates and persuades people to understand and buy into how the fund invests. Further, the storyline needs to communicate in writing how risk management is employed in the research and analysis steps of the firm's investment process, in addition to how it is conducted at the portfolio monitoring stage.

Presentation of such content requires sentences and paragraphs, not bullet point phrases. Therefore, a flipchart pitchbook is the wrong marketing tool for this job. This content should be delivered to prospective institutional investors in brochure format. This "soft information" marketing document is separate from, and used in addition to, a data-based bullet point flip chart.

The delivery in print of this "soft information" about how a firm invests gives prospective allocators the very content they review and discuss at the investment committee level when seeking to identify and differentiate the quality of one fund manager over another.

Make it easier for institutional investors to receive, and be able to review, your hedge fund firm's full explanation about how it invests, and you will improve your potential to accelerate the due diligence process, win the investment committee vote and its next allocation.

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About the author

Bruce Frumerman is founder and CEO of Frumerman & Nemeth Inc., a financial communications and sales marketing consultancy that helps financial services firms create brand identities for their organizations and develop and implement effective new marketing strategies and programs. Founded in 1987 pre-crash, Frumerman & Nemeth's work has helped money management clients attract over $7 billion in new assets, yet they are not third-party marketers. Mr. Frumerman can be reached at info@frumerman.com, or by visiting www.frumerman.com.