Australian Funds Management Industry – Thriving on a Winning Culture

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The most recent ABS managed funds data reveals that the investment management industry is in a strong position and is rapidly becoming one of the world's mutual fund management exemplars. It is useful to explore some the factors that contributed to this outcome and to reveal some of the industry's plans for future growth.

The investment management industry holds more than $590 billion on behalf of more than nine million Australians. The June 2000 quarter data indicates that annual growth in these funds has been about 50 per cent over the course of the last three years. This strong growth has given Australia a prominent position on the world mutual funds league table. The US-based Investment Companies Institute March 2000 survey placed the Australian industry in seventh place on the funds under management ladder, This is one of the nation's stronger aggregate indicators.

> *[We] believe that Australia is home to the world's most sophisticated retail fund management market place outside the US…*
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> *Other nations' funds management industries dwarf Australia's in size. But size doesn't matter. Australia holds one of the most aggressive government-led retirement provision policies on the face of the earth – the SGC has generated more than A$200 billion savings in less than a decade.*
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> Cerulli and Associates (Boston) report 1999

Clearly underpinning this growth is a burgeoning superannuation industry which has just moved into the eight per cent Superannuation Guarantee zone. By 2002 it will commence its final ratchet of nine per cent. This increase of one percentage point will result in additional savings of about $15 billion annually being directed into superannuation. Also significant in superannuation is the trend towards greater levels of voluntary contributions. Some market analysts expect that the introduction of superannuation fund choice has the potential to drive additional savings as individuals take a greater interest in, and control over, their savings. As individuals rationalise their accounts and funds lose their low balance accounts (as a consequence of job turnover and casual work patterns), cost savings will come into play to increase effective rates of returns – fuelling funds growth further.

Also running strongly are contributions into non-superannuation managed investments. Here, Australian investors are seeking the diversification, pooling and management expertise that are part of the investment management process. Increasingly, "around the kitchen table" Australian families discuss prospects of their funds in cash management trusts, equity funds and listed property trusts. They have also taken advantage of the offshore funds, especially those which have delivered well above average returns over the last four to five years. It is quite difficult and risky for individuals to invest directly into offshore equity markets, hence the natural attraction of a managed fund. Changes to the capital gains tax regime, which provide fifty per cent tax relief on gains in these management investments, will no doubt continue the investor preference to invest in pooled vehicles.

A noteworthy achievement of the industry is that it has managed to achieve strong growth and earnings in the midst of unprecedented tax and regulatory reform. Accommodating the complex GST, PAYG and entity tax reforms has been a major challenge for most funds and life company managers. This success is even more creditable given that it has been achieved in the midst of moving the governance of funds over to the single entity structure under the Managed Investments Act.

The MIA reforms are important as they have placed funds managers themselves squarely in the corporate governance spotlight. The reforms have permeated the entire industry and now see all retail and most wholesale funds with Single responsibility Entity (SRE) boards. Under MIA regime SRE are required to have equal number of independent and executive directors, mandatory compliance committee, and to develop and lodge complex and comprehensive compliance plans.

Notwithstanding this internal focus, funds managers have continued in their quest to bolster corporate governance in Australia's listed companies. The IFSA corporate governance guidelines continue to be the benchmark for ensuring integrity and transparency on company boards. Recently, IFSA in conjunction with the Australian Shareholders Association and the Institute of Company Directors, released new guidelines on executive share and option schemes.

These guidelines are an important contribution to ensuring good corporate governance in Australian companies. They will assist company boards in designing share and option schemes, and will promote more informed shareholder voting on such schemes. Given the different circumstances of individual companies, it is not feasible to provide prescriptive details for particular schemes. However the guidelines set out key principles that should ensure that any such scheme designs are aligned with shareholders' interests.

Again, in furtherance of market integrity and transparency, IFSA worked closely with ASIC and the ASX to encourage all listed companies to develop procedures for the disclosure of price sensitive information. Accordingly, IFSA supports the general principles in ASIC policy regarding the monitoring and reviewing of the disclosure of material price sensitive information during analyst briefings. Non-public price sensitive information should not be disclosed during such briefings.

These developments in the industry have given funds managers a solid footing to drive even stronger growth in coming years. An IFSA 2000 survey of its members provides an invaluable insight into the strategic priorities and goals.

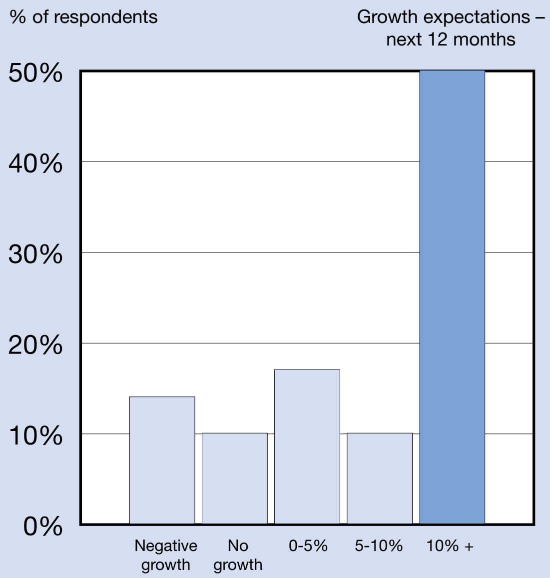
Overwhelmingly, industry expectations are that funds under management will grow between and 10 and 20 per cent during 2000/2001. This is reflected in profit expectations, shown in the graph below. To achieve that order of business development, IFSA members will boost revenue from existing customers, win business from competitors, find new customers both on and offshore and move to diversify. Importantly, to achieve growth, IFSA members will increase their employment numbers by three per cent over the same period, with some members needing six per cent plus increases in labour force

To meet the ever increasing need for technological empowerment, IFSA members rank highly their demand for IT human resources, however, product development and call centre staff requirement continue to be a priority.

The funds management industry has achieved its successes by accepting the enormous challenges of change. Under this type of pressure, individuals and managers in this industry tend to seek and eventually share competitive advantages. In quick time these advantages are competed away, hence the need to again innovate. Whether its new public policy, new legislation, new products from offshore, increased transparency and accountability requirements or even a new tax regime, the successful industry players have welcomed and squarely addressed the challenge by producing products and services that meet customer needs.

There is every reason to expect this "winning culture" to thrive.

Profit Expectations – what are expectations for profit growth over the next 12 months?



PricewaterhouseCoopers

Respondents posted profit growth of nearly 20% over 1998/99.

On the back of this performance, expectations remain very buoyant, with profit growth of 10%+ expected by 50% of respondents over the next 12 months.

However, 23% expect no growth or negative growth (over 10% of respondents expect negative profit growth) over the next 12 months, suggesting that competition remains fierce.

The survey suggests that controlling costs, particularly regulatory and compliance costs, is an important factor contributing to these negative expectations.