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Decision Frameworks & Synergism in Investment Manager Selection

The methods that investment consultants and due diligence analysts, or gatekeepers, use to evaluate investment strategies and eventually award investment mandates to asset managers is of great interest. Traditionally, asset managers follow a well-documented evaluation framework, which most industry veterans call the 5Ps—Philosophy, Process, People, Performance, and Price; this is a simple organizational heuristic to direct research efforts (Arnott, 1992). However, apart from the Performance factor, academic research categorizes the multitude of subjective decisions made by gatekeepers as “soft factors” (Jenkinson et al., 2016; Jones & Martinez, 2017). The soft factor proxy for the complex decision-making process of gatekeepers plays a contributory role in establishing correlations between soft factors and investment recommendations (Jenkinson et al., 2016). Yet, it falls short of comprehensively capturing the intricacies of the complicated web of subjective judgments involved in assessing the talent of investment managers. While the general practitioner framework and research body are instructive, they provide very little guidance on the actual criteria used in everyday practice since the categorical descriptions lack information on the specific decisions employed. Logically, this should include the interplay of performance, non-performance, and behavioral factors. Previous studies have shown the existence of several categories that fit this description, but they have been less precise in the development and refinement of a complete taxonomy of factors. Instead, the literature focuses more on several isolated decision variables and their relationship to subsequent returns and investment flows rather than offering an in-depth, comprehensive understanding of the determinants of manager selection.

While consultant firms do codify their asset manager assessment processes, the reality is that a significant portion of the actual evaluation matrix is unknown due to self-imposed information barriers that prevent individuals from revealing the decision-making frameworks employed. This research seeks to investigate the opaque decision-making processes of these institutions by identifying the underlying investment mandate decision-making frameworks of professional buyers in the institutional and wealth management spaces. The purpose of selecting these segments is twofold: first, to cast a wider net on industry frameworks employed to capture a more generalizable industry-specific conceptual model more accurately, and second, to develop a greater understanding of the less studied wealth management segment through a segment-based comparative examination of decision -making approaches.

Academic research's lack of precision or depth in understanding the decision frameworks used by gatekeepers motivates the study's research approach. Grounded theory, a qualitative research approach, is well-suited for answering and demystifying the complexities of what constitutes "soft factors." According to Myers (2019) grounded theory's utility is manifested in "developing context-based, process-oriented descriptions and explanations of organizational phenomena," and it is particularly adept at developing theory from data (p. 127). This implies that in the absence of quantitative data, grounded theory is particularly useful for entering under-researched spaces and establishing new conceptualizations and theories that could serve to activate subsequent studies of quantitative or qualitative origin. Therefore, the qualitative design is expected to permit the emergence of new concepts, paradigms, and theories through semi-structured interviews and the analysis of contextual data obtained.

Over the course of this study, I observe the influences of the investment mandate, heuristics, and investment biases on recommendations. I also observe seven general factors or a priori factors, which categorize a multitude of sub-factors that comprise the general decision-making framework of gatekeepers. I find that a priori factors that are logically consistent and validated through evidence provide greater evaluative value to gatekeepers than a priori factors that lack these attributes. I also observe that this evaluative value increases synergistically as more factors share the attributes of consistency and validation, which also leads to a logical increase in the chances of recommendation. Furthermore, through a comparative analysis of the decision frameworks observed, I generate novel insights into the institutional and wealth gatekeeper segments analyzed.

The benefit of understanding these factor frameworks is multifold. First, gatekeepers can optimize their factor frameworks to provide greater value to clients. This could take the form of utilizing more efficacious factors in the manager selection process for improved performance outcomes or more effective communication regarding the value of services performed. Second, investors can gain insights into a highly influential industry segment and its capacity to direct assets; the sheer size of the assets that gatekeepers influence is estimated to be $26 trillion in assets under administration in both the institutional and wealth management industry segments (Pension & Investments, 2024; Cerulli, 2023). Third, gatekeepers can gain insights into a cohesive taxonomy of decision factors, which has yet to be thoroughly explored in academia.