DESIGNING A BEST-PRACTICE INVESTMENT FUND

CASE STUDY

SITUATION

The CEO in a large corporate with over 125 subsidiary entities was concerned about the possibility of earning sub-optimal investment returns as a result of cash being distributed between, and effectively locked in, poorly controlled subsidiary entities.

The CEO suspected there was a problem but did not know the scale of the problem nor how to solve it.

The CEO was not only concerned about loss of returns through sub-optimal investment, they were also concerned about loss of capital through inappropriate investments in speculative investment products.

INTERVENTION

Marengo Capital performed both time-series and cross-sectional analyses of unrestricted cash balances and reserves, and restricted cash-backed reserves, within the overall subsidiary entity structure.

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The analyses were made much more complex by data not being readily available owing to the complexity of the corporate structure, the use of different financial systems and under-resourced financial teams across the subsidiary entities. To provide a timely and reasonable estimate to the client so the problem could be quantified, actioned and managed, we interviewed key internal stakeholders to establish a representative sample of subsidiary entities which were most likely to have large cash balances and reserves.

Having obtained representative data and performed time-series and cross-sectional analyses, we found over $2 billion in cash and cash-backed reserves distributed between subsidiary entities. These cash balances were invested in very high credit quality, short-term cash products which were rolled immediately prior to maturity. Therefore, returns were at the lowest end of the opportunity set.

Our analyses showed that accumulation of distributed cash balances and cash-backed reserves into a single Fund would produce material economic benefits, including:

- Efficient and effective centralised investment governance by investment experts, ensuring compliance with all investment delegations, policies, mandates, and approved products;
- Lower financial risk from diversification within and across asset classes;
- Higher financial returns by investing in allocatively efficient portfolios; and
- Access to lower wholesale fees from accumulated economies of scale.

Marengo Capital designed a best-practice investment fund structure for the client, providing for a staged implementation to extract immediate benefits and to increase the level of sophistication over time as stakeholders gain more confidence in Fund operations, to ensure benefits are maximised and enduring.

RESOLUTION

The CEO is happy with the Fund concept. Marengo Capital is assisting the CEO to implement the centralised investment fund, including by participating in intensive and extensive stakeholder communication with subsidiary entities, noting that their participation in the Fund is voluntary.

In addition to designing what the client wants - a wholesale investment fund - we also designed what the client needs (but were unaware of):

- A liquidity management system to allow cash and cash-backed reserves to be invested for much longer periods and thus at different risk profiles, providing the fund with access to much higher returns on the efficient frontier; and
- A system for securitising physical infrastructure by centralising subsidiary entity distributed physical infrastructure into a portfolio to attract direct investment capital from large fund managers and superannuation funds.