

**E P Davis and B Steil, Institutional Investors,
MIT Press, Cambridge, MA, and London, England, 2001, pp524**

A review by David Blake, Professor of Financial Economics and Director of the Pensions Institute at Birkbeck College, University of London

Institutional investors have a much bigger influence over our lives than most of us realise. This follows from the rapid institutionalisation of our savings in recent times. Not so long ago most of us just kept our savings in banks, building societies or the post office. But from the beginning of the 1970s this began to change. More and more people joined pension schemes and started buying their homes with endowment-linked mortgages and began, as a result of generous tax breaks, to transfer their savings to collective investment vehicles such as unit trusts and investment trusts. As a consequence we have seen the rapid growth in pension funds, life assurance companies and mutual funds over the last three decades.

However very little is known about these vast and powerful organisations, so 'Institutional Investors' by Phil Davis and Benn Steil fills a much needed gap in our knowledge and understanding. The book concentrates on the investment and asset management side of institutional investors' activities and the influence of these activities on the financial markets and the wider economy, rather than on the products and services they offer to retail customers.

The first part of the book examines the development and investment performance of institutional investors, especially in the Anglo-Saxon countries, such as the UK and US, where their development has been most marked. The key factors identified by the authors in promoting growth are: ease of diversification, improved corporate control, deregulation, ability to take advantage of technological developments and enhanced competition. Investment performance depends on the asset allocation and stock selection skills of the fund manager as well as the nature of the liabilities that eventually need to be paid (eg future pension benefits linked to earnings). The authors present the findings from academic studies that show that active fund management is a negative value added industry: the average fund manager would have been better off by investing passively in an index fund.

The second part of the book looks at the industrial organisation of the fund management industry. The authors show that there is a striking difference between the Anglo-Saxon and non-Anglo-Saxon systems. The fees are higher in the latter and the emphasis on performance is lower. In the former, the market is more contestable and this helps to keep fees low and performance more transparent. There are also differences between the US and UK: specialist mandates are more common in the former, while balanced management predominates in the latter.

The third section of the book investigates the influence of institutional investors on the financial system and the economy as a whole. The authors examine their impact on capital market size, microstructure, innovation and the creation of efficient markets. They examine whether the collective behaviour of institutional investors heightens or lowers stock market volatility and find conflicting evidence. They also

examine how competition from institutional investors has affected the traditional banking sector: the loss of traditional business has encouraged greater balance sheet risk and this has led to banking crises.

The final part of the book looks at institutional trading and the rapidly changing trading environment that institutional investors face, in particular, the automation of trading that has occurred over the last decade. The authors examine the pricing of trading services, changing competitive strategies, trading system architecture, cross-border access, exchange alliances and mergers, exchange governance and the cost of institutional trading.

As I state on the back cover of this book: 'The book is excellent and very comprehensive. It makes a much needed contribution to the literature'. My only concern in the rapidly changing world of institutional investors is how the authors will manage to keep their book up to date!

Professor David Blake
Professor of Financial Economics and
Director of Pensions Institute,
Birkbeck College, University of London
August 2001