


# Is small always beautiful?



The merger fever that gripped the investment industry during the late 1990s bull market created a sharp divide between large organisations and their smaller competitors. Investors came to see brand name firms with global reach as superior to less well-resourced niche firms with fewer products on offer. But this view is changing as large managers continue to suffer an exodus of their top talent to smaller houses, and as specialist mandates grow in popularity.

The successful asset management firms of the future will be those that are able to win the war for talent. If a business is well-run and has highly-skilled investment professionals in an environment that allows talent to flourish, it should be successful whether it is large or small. So, what should an investor look for?

### Does size matter?

The firm should be able to demonstrate a sustainable competitive advantage. In this, the quality of the personnel is by far the most important factor. It follows that the firm must have a business structure that can both attract and retain talent. The factors that help retain talent are more frequently found in niche firms, as a result of the strong cultural 'glue'. Bureaucracy is lacking, while there is clear accountability, with decisions being made by a small number of people. Perhaps most importantly, the leadership understands asset management.

The main disadvantage of niche firms is that management, while understanding the industry, may not understand how to run a business, with business issues distracting from the management of clients' portfolios.

### Is bigger better?

We are cautious about asset managers that are owned by larger parents – retail banks, investment banks, insurance companies – where asset management is not considered a core business area. Our concerns have grown as many portfolio managers have left the larger firms to start their own businesses. 'Big' clearly does not necessarily mean low risk and stability for investors.

On the other hand, a well-managed asset management

business that is part of a large organisation does have many advantages. Among these are synergies with other parts of the business, multiple distribution channels, and a diversified revenue stream, which helps if a particular style or product comes under pressure. In theory, a large parent can also provide significant marketing and administrative support.

In many cases, however, large firms have found it difficult to capitalise on these advantages, while many of the traditional arguments in favour of large firms may not stand up to close inspection. Asset management is not a capital intensive industry, so being able to dig into a parent's deep pockets, while beneficial, is not as crucial as is often believed.

In an environment where the war for talent is the defining success factor for asset management firms, we need to be selective about both large and small organisations. Over time, as a number of smaller managers inevitably fail, skilled professionals will recognise that there are benefits to being part of a larger firm. However, this will not prevent the larger organisations from losing some of their best people. It is important to assess the ability of these big firms to retain their people going forward and of their smaller competitors to manage their businesses properly.