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EXECUTIVE SUMMARY

- M&A activity is likely to pick up substantially and firms with a longer-term view should be ready to capitalise on the opportunities that arise
- Size will emerge as the most important critical success factor so long as there is decent investment performance and stability of fund managers
- Clients will become more selective, with their mandates reaching out to successful, stable and confident firms

M&A will shape the future of investment, globally

Asset managers may have weathered the financial crisis better than most retail and investment banks, but the changed financial and economic landscape is finally affecting the industry in a profound and irreversible way, says Ray Soudah

BY: RAY SOUDAH

The investment management industry survived the financial crisis in better shape than most banks. There are two main reasons for this. First is that unlike banks, investment companies hold the majority of their assets off balance sheet as they represent client, not proprietary assets. Thus the decline in capital values which occurred, affected revenues over time rather than immediate capital adequacy or solvency, as was the case at the banks that collapsed or struggled.

Secondly, despite the drop in revenues suffered by investment companies, such revenues bounced back during the first half of 2009, meaning that the rise in cost-income ratios of investment businesses rapidly recovered and the short-term losses in income were arrested as the central banks pumped free money into almost every economy around the world.

Furthermore, most investment companies were fortunate to have not been listed entities, escaping the pressures of being sold down in the panic or shorted as liquid proxies for market hedging. Some still like, and liked, being listed but such an interest is derived from founder-induced need for liquidity or exit strategies of key shareholders rather than financial or business need.

SURVIVAL

Thanks to the inflationary (longer-term) monetary policies of the world's leading central banks and the intellectualisation of printing and circulating massive sums of false money, more fancifully labeled as quantitative easing or asset purchasing, investment companies were rescued from short-term damage with the recovery in stock and bond markets but now have to face up to the longer-term need to reposition themselves for sustainable growth, even survival.

In this new world M&A activity will pick up substantially and firms with a longer-term view should be ready to capitalise on the opportunities that arise.

The most likely scenario will be that smaller firms will find it difficult to cope with the daily challenges of maintaining asset growth in net new money, maintaining adequate regulatory capital, coping with increasing compliance and risk controls for all sorts of regulators and authorities on a global basis, maintaining decent investment performance and motivating still highly paid fund managers and marketing and sales executives.

Size, predominately, will emerge as the most important critical success factor so long as there is decent investment performance and stability of fund managers at the investment firm or investment subsidiary of larger financial groups. Furthermore, being independent entities rather than subsidiaries of larger groups will increasingly demonstrate that the investment business does not belong within universal banks or insurance companies but rather at an arms-length subsidiary or standalone enterprise, avoiding conflicts of interest and interdependency of parent groups.

Being listed, which in itself is not a sin, will not always benefit these firms caring for their independence and caring for stability of their clients' assets. Volatility in stock prices has pressurised too many an investment manager to be a stark reminder of the risks of being listed with few benefits other than initial liquidity for some part of key shareholders' ownership.

Whether in the UK, Switzerland, the US or elsewhere, the key ratio to monitor will be the net new money growth, which should be at a level of 10% excluding market appreciation-depreciation and the cost income ratio, which should be below 75%. If these two indicators can be simultaneously maintained or bettered then the longer-term prospects are stable to bright.

If not, all options should be considered including merging, acquiring or selling out. Prices for investment firms are at present quite strong and will represent an opportunity to exit for those choosing that option but in time the supply of smaller firms exiting will increase as will the number of investment divisions of universal banks, especially UK and European groups which have little value added in holding on to investment subsidiaries or private client businesses which are sub-scale.

CLIENT DEMAND

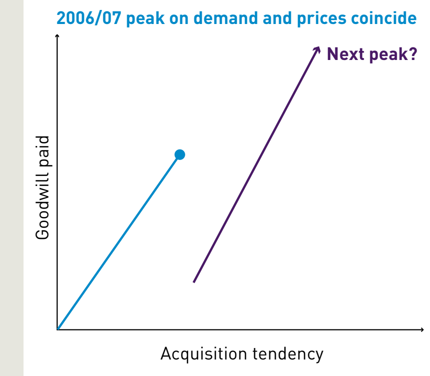
It is quite foreseeable that clients will also become more selective, with their mandates reaching out to successful firms which ooze stability and confidence. Many Scottish investment firms have such qualities and have grown in size and reputation in recent years while remaining or appearing quite independent. Ironically such firms have had successful global, US or European investment funds demonstrating that the investment industry professionals can invest globally and successfully without being resident in each economy simultaneously. Clearly the emerging market managers will also benefit from the same qualities needed for survival but it will be evident soon that some of these will face M&A choices as the bull run there stabilises; signs of this have already been seen.

In terms of decisive timing and execution of strategic options appropriate to each investment firm, consider your growth prospects, cost pressures, valuation and client satisfaction. The exact option will be clear then. I believe increased M&A activity will be seen in the UK, US and Switzerland.

"Size, predominately, will emerge as the most important critical success factor"

STATS

FIGURE 1: ACQUISITION TENDENCY GROWS WITH PRICES



Source: Data supplied by MilleniumAssociates

PROFILE – FACT BOX

Ray Soudah

Career highlights:
Ray Soudah is founder of MilleniumAssociates, an independent Swiss, UK and international M&A specialist for the investment management industry.