Acquisition and consolidation in the fund administration industry: Is bigger always better?

Acquisition and consolidation activity continues apace in the fund administration industry. With financial institutions and private equity firms continuing to recognise the value in and potential for growth of administration businesses, the drive towards a market dominated by a handful of large, international players at times feels inevitable and the days of the independent, owner-managed business numbered. But is bigger always better from a client's perspective?

In this article we explore the positives and negatives of acquisition and consolidation in the administration industry from a client's point of view and discuss whether there is still space in the market for smaller, independent administrators to flourish.

Introduction

The past decade has seen a continued drive towards acquisition and consolidation in the fund administration industry. With sticky annuity revenues, scalable business models and attractive margins, large financial institutions and private equity firms have long recognised the value of administration businesses and their potential for growth. What was once a highly fragmented market now seems to be moving inexorably towards one dominated by a small number of large, international businesses, many of which are backed by financial institutions or private equity firms.

Whilst the scale of consolidation in the fund administration market is undeniable, we at Corvus Group do not think that it will inevitably lead to the demise of smaller, owner-managed independents. Simply put, bigger is not always better. Conversations we have had with a range of private equity and venture capital fund managers ("**PE/VC Managers**") reveal a strong desire among emerging, lower and mid-market managers for alternatives to the larger, more institutional players. Furthermore, on a human level, staff do not necessarily want to be comparatively small cogs in large corporate machines and the entrepreneurial drive among certain individuals to establish and run their own businesses remains undimmed, notwithstanding ever-increasing barriers to market entry. As a result, we believe that the current market is in fact fertile ground for the establishment and growth of a new crop of independent fund administration businesses.

In this article we explore the impact of acquisition and consolidation in the administration industry from the perspective of a client and consider why smaller, independent service providers may be the better fit for certain PE/VC Managers.

Advantages of acquisition and consolidation: A client's perspective.

The benefits of acquisition and consolidation from the perspective of an administration business, its shareholders, acquirors and targets are fairly obvious, but there can also be benefits from a client's perspective. For example:

1. Greater territorial reach

   Mergers and acquisitions can be used as a springboard to launch administration businesses into new jurisdictions in an expedited manner, cutting down lengthy lead-in times for regulatory approvals and the time and costs associated with new business establishments generally. For clients with funds and vehicles domiciled in a range of jurisdictions, or looking to establish in a new territory for the first time, having their incumbent administrator on hand to service all of their vehicles can ensure uniformity of service delivery across structures and jurisdictions, promote operational efficiencies, help to control fees and avoid the time-consuming process of conducting due diligence on, and the risks inherent in selecting, an alternative administrator.

2. A broader suite of services and systems

   Smaller administrators may lack the capability to provide larger and more complex clients with a truly holistic service. For clients investing in a highly diverse range of asset classes and/or looking to outsource as many functions as possible to a single service provider, the acquisition by their administrator of complimentary businesses (together with their associated technology systems) can be extremely beneficial. "One-stop-shop" service solutions should theoretically be able to leverage economies of scale to drive down aggregate costs and deliver operational efficiencies, resulting in better value for money for clients and a more streamlined service delivery. Furthermore, certain asset classes require asset-specific technology solutions (real estate being one such example). Smaller administrators may not have access to these more focussed systems and therefore be unable to produce the reports their clients require or produce them to the requisite standard.

3. Streamlining

   For administrators who have diversified into new business areas or territories without success or provide services no longer considered to be core, acquisition and consolidation can be an opportunity to create a more streamlined, healthy business. As disparate business units are merged or sold, old technology solutions are discontinued or modernised and processes are rationalised, administrators can provide more focussed and efficient services which better meet their clients' needs.

4. New management, knowledge and funding

   Acquisitions often result in new management teams taking the helm, incumbent management teams having their collective knowledge augmented by that of their acquiror(s), new specialists being added to the staff pool and/or additional capital being made available to fund corporate strategies. New leadership, a deeper pool of expertise and/or enhanced financial capabilities can result in better managed, more capable and more financially robust businesses which have the know-how and financial means to make the strategic moves needed to enhance the scope and/or quality of the services on offer.

Disadvantages of acquisition and consolidation: A client's perspective.

The success or otherwise of an acquisition depends on the metrics by which success is measured. Whilst revenue growth, an enhanced bottom line, an increase in jurisdictional scale, greater staff headcount and an expansion of available services and systems can all be viewed as signs of success, these will be largely irrelevant for clients with simpler structures, funds domiciled in a single jurisdiction and/or pursuing a single strategy.

Indeed, news that one's administrator has been acquired or completed an acquisition of its own can cause concern among clients for a number of reasons. The process of post-acquisition integration can be long and costly in terms of both money and human resource, the bringing together of different businesses (each with their own systems, processes and cultures) is rarely straightforward and smaller clients may feel sidelined if priority is given (consciously or otherwise) to those generating higher fees or with more complex needs.

Below we look at the impact of acquisition and consolidation at different levels of an administration business (i.e. senior management, operations, finance and support functions and client-facing teams) and explore the possible ramifications of each for clients.

1. Senior management

   An acquisition will often lead to significant changes to and by the senior management of a business (whether that be the acquiror or the acquiree).

   The departure of well-established senior team members (by choice or due to redundancy) can create instability among staff, augmenting existing management teams with new faces can create friction and changes to the composition of senior management teams will likely result in knock-on changes to corporate strategies, structures and cultures. Although many businesses can benefit from new ideas, a new identity and/or a new approach, not all of such changes will be welcomed by existing staff and there is, of course, no guarantee that such changes will be implemented successfully. Changes that, in a board paper, appear to be a pathway to greater success can in fact lead to a maze of implementation issues in which management and staff alike become increasingly lost. At the very least, senior managers will expend significant time and effort working through the myriad of internal issues that inevitably arise post acquisition, which can pull attention away from matters which more directly impact on the quality of client service.

Even absent changes to senior management teams, new owners bring new expectations. Senior managers of businesses acquired by private equity funds may find their primary focus shifted towards growth, with a greater emphasis being placed on growing headline performance metrics such as revenues, bottom line, margins, AUA, client numbers and jurisdictional reach at the expense of other measures of success, such as client service standards and staff/client satisfaction. Businesses which are subsumed into larger financial institutions may find themselves competing with other (potentially larger, more lucrative and/or core) business units for capital, leading to a reduction in the scale and scope of corporate strategies and the capex available to improve services and systems.

2. Operations, finance and support functions

The integration of systems, the migration of client data, the creation of new reporting lines, the introduction of new business processes, the establishment of new entities or business units and the hiring and exit of staff can all place a heavy burden on an administrator's operations, finance and support functions (e.g. HR, IT, legal and compliance). Although not client facing, for many administrators, their operations, finance and support functions are vital to delivering client services. Examples include maintaining the smooth running of systems, creating, maintaining and monitoring processes and workflows, monitoring and managing staff performance and progression, assisting with client on-boarding, negotiating contracts with clients and dealing with the third-party service providers on whom the administration business relies. Dealing with the challenges of an integration can become a major distraction for these teams, in turn leading to less time, focus and budget being allocated to the outputs which underpin and enhance day-to-day client service delivery.

3. Client-facing teams

The establishment of new reporting lines and the introduction of new systems and processes can all create instability in the outputs of client-facing teams as staff grapple with new systems and ways of working. Also, as businesses become more institutional and hierarchical in nature and corporate cultures and business priorities change, the satisfaction of front-line staff can fall. Some may feel as though their career trajectories have been curtailed or complicated and others may simply feel as though their faces no longer fit. Such factors can lead to increased staff turnover and inherent instability in client-facing teams, which can be hugely detrimental for clients who have grown to trust in and rely on the individuals dealing with their work on a daily basis. An increase in staff turnover can also lead to a dilution in overall service quality if staff departures result in those who remain being promoted beyond their capabilities or being left without the valuable knowledge and skills of more experienced former colleagues.

For emerging, small and mid-market PE/VC Managers, having one's fund administrator acquired by a larger business can lead to a significant change in one's perceived relative value as a client. Clients who may have been considered marquee names prior to an acquisition may find their significance substantially reduced in the context of an enlarged business post-acquisition. Whilst client size should have no bearing on the quality of the services delivered, clients may in practice experience a diminution of service quality as the needs of larger firms with more complex and time-consuming outputs are consciously or sub-consciously prioritised. By way of example, a more complex client is likely to consume much of the time and attention of more experienced staff members. This can result in those staff members dedicating less time and attention to less complex clients, whilst also detracting from the time that they have available to oversee the work of their more junior colleagues who are often allocated to smaller, ostensibly simpler, clients.

The benefits of owner-managed independents.

A large institutional administrator is not a natural fit for every PE/VC Manager. Many clients will not be in a position to benefit from increases in the size, complexity and/or jurisdictional reach of their administrator and the potential downsides flowing from acquisition and consolidation activity can be numerous from a client's perspective, as outlined in this article.

For many emerging, smaller and mid-market PE/VC Managers, Corvus Group believes the owner-managed independent offers a more suitable fit. These businesses retain a level of flexibility, agility and pragmatism that larger businesses often struggle to match, enabling them to respond to client needs more quickly than their more institutional counterparts.

We firmly believe that clients and colleagues enjoy working with people they like and with people like themselves. The owner-managed independent is more likely to create and seek to maintain a strong corporate culture, hiring and retaining like-minded people who reflect that culture whilst simultaneously promoting a sense of unity through a shared identity and common values. This sense of belonging aids team stability, which in turn drives service consistency and the maintenance of service quality. Smaller administration businesses are also more likely to give extra consideration to a client's needs and business ethos when assigning new hires to client-teams or when assigning new clients to existing teams, ensuring a closer alignment in terms of personality and capability. Coupled with service standards focussed on quality rather than quantity, modern systems and operations free from the inherent complications of legacy and integration and an approach to business offering greater scope for more bespoke workflows and outputs, we believe that the owner-managed independent can offer clients a more tailored service experience.

With the shareholders of an owner-managed business also directing its management, the interests of owner and manager are truly aligned. As a result, senior management teams can set growth trajectories and corporate strategies free from the influence of third-party investors, the majority of whom will possess little to no experience of running an administration business and whose objectives are focussed on growth and value extraction over a prescribed timeframe. Owner-managers are also likely to have a more holistic barometer of success, with customer and staff satisfaction and the maintenance of service standards and corporate culture valued just as highly as more traditional performance metrics focussed on size, scale and pure financial performance.

Conclusions

Despite regular announcements of consolidation and acquisition activity in the administration space, we at Corvus Group firmly believe that there remains space in the market for owner-managed, independent administration businesses. Bigger is not always better for clients and we believe that owner-managed independents like Corvus Group are well positioned to partner with emerging, small and mid-market PE/VC Managers looking for a more boutique alternative to the larger, more institutional players.

If you would like to speak with us regarding our services or any of the topics raised in this article, please do not hesitate to contact us (contact details provided overpage).

The Corvus Group is an independent provider of administrative and advisory support services to the closed ended funds and asset management industries.

Andrew Brizell

T: 07713 749094

E: ab@corvusgroup.com

James McCarthy

T: 07713 640152

E: jm@corvusgroup.com

Dave Bridger

T: 07841 403981

E: db@corvusgroup.com