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Experts predict consolidation for boutique funds

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Boutique money managers are struggling to maintain their independent survival as investors shun small managers in favour of large, established brand names, according to industry experts. They claim difficult market conditions and increased costs are likely to accelerate consolidation among boutique managers.

Pars Purewal, head of UK asset management at adviser PricewaterhouseCoopers, said he believes M&A activity at this end of the industry is already on the rise. He said: “The market turmoil of the last week demonstrated how difficult it is for those who don’t offer a very broad range of services and don’t have the scale to continue to survive, unless they’re very niche and performance is very good.”

Christiaen van Lanschot, founder of boutique commodities hedge fund firm VOC Capital Management, said: “It’s a challenging environment at every level. We’re in active discussions with a strategic partner to allow us to grow assets under management more quickly.”

Large firms are winning a disproportionately large share of new mandates. According to Financial News’ annual review of Europe’s biggest hedge funds, the 20 largest hedge fund managers in Europe saw their combined assets rise by 26.4% to $259.6bn over the 12 months to the end of June, with four fifths of this growth coming from the top 10 managers alone.

As the fund management industry becomes increasingly concentrated in the hands of a few large firms, smaller managers are looking at mergers, sales and other strategic deals to help them reach critical mass.

For some, even good performance cannot ensure survival. Last week, Occam Asset Management, an emerging markets boutique founded in 2007, was bought by Liontrust, after assets fell from £240m in 2009 to £124m in July. Occam founder Jonathan Hughes-Morgan said that despite outperformance, a series of mandate withdrawals had stymied the firm’s growth. He added: “Any boutique with under $1bn under management would take an approach quite seriously.”

Jon Little, ex-head of BNY Mellon Asset Management and now chief executive of Northill Capital, said: “It is tougher if you are below a billion, but then it has been for quite some time.”

Institutional heavyweights

The bulk of the new money flowing into hedge funds is coming from institutional investors such as pension funds, whose heightened demands can make life more difficult for boutiques.

Philippe Bonnefoy, chairman of the asset allocation committee at Cedar Partners, a Geneva-based alternative asset manager, said: “It makes it much harder to run an investment management business on a small pool of assets if institutions want the robustness they’d expect from a $5bn manager. I think you may see more boutiques joining up to combine their infrastructures. It makes sense to share resources on the operations and marketing side."

Already this year, UBS has bought Luxembourg Financial Group a structured products boutique; fund of funds Northill bought a majority stake in Alpha Strategic, a listed hedge fund manager; and Swiss private bank Reyl & Cie bought a 50% stake in emerging markets specialist Samena Capital's hedge fund seeding business.

Market volatility is exacerbating investor reluctance to put money with smaller fund managers. Little said: "Large funds of funds, family offices and institutions are worried about what is going to happen in the market. Invest with a large manager and it goes wrong and it won't be your fault; it will be either the manager's or the market's fault. Whereas if they back a little boutique, it will be seen as the investor's fault if it blows up."

Kevin Pakenham, co-founder of advisory firm Pakenham Partners, said: "As liquidity dries up the profitability of small and some medium-sized firms is threatened. The bigger players are likely to benefit from a flight to conservatism and we are likely to see consolidation rather than fracturing in the current environment."

On top of weak markets and nervous investors, the cost of doing business is also increasing. Robert Mirsky, head of hedge funds in the UK at KPMG, said: "Because of the rising operational, legal, and regulatory cost, you do need to be of a certain size. For that reason, we are seeing very large managers looking to acquire smaller managers, and mid-sized and smaller managers looking to group together."

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