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The OCIO Dilemma: Buy, Sell, or Merge

Active management is feeling more love these days. With the surge in institutions seeking investment help, there is new-found affection for the experience, judgement, and human touch provided by outsourced CIO firms.

But with opportunity pounding on the door, why do so few OCIOs hunger for growth? Where's that entrepreneurial drive, that vision, passion, and focus on becoming the biggest and the best?

We have been tracking the industry for decades and have yet to see a single independent OCIO provider break through the one-hundred billion AUM level. Not one. Most will never reach twenty billion.

The OCIO business, as defined by Commonfund is...*the practice of delegating a significant portion of the investment office function to a third-party provider, typically an investment management or consulting firm.*

The industry, with \$2.38 trillion in assets as of our [latest report](#), is bifurcated, highly diverse, intensely competitive, and the largest six providers on our annual OCIO list - Aon, Blackrock, Goldman Sachs, Mercer, Russell and Willis Towers Watson - with their size and resources dominate the largest segment, corporate pensions.

In this segment, reality bites. There are only about three-hundred remaining internally managed corporate pensions over a billion AUM and those that outsource will chose one of the big six mentioned above or a major insurance company. Boutique OCIOs have no chance for the business.

Most new prospects dwell in the sub-\$1 billion realm - endowments, foundations, health systems, charities, and associations - and smaller sub-\$200 million customers including ultra-high-net-worth families and nonprofits.

The good news is that there are about fifteen hundred colleges and universities in the US, (about one-hundred-fifty endowments over \$1 billion and another one-hundred-fifty in the \$500 million to \$1 billion bracket) and several thousand foundations, health systems, charities, and associations.

The bad news is that most of the eighty-three firms on our list compete in this space along-side RIAs, brokers, and advisors. Hundreds and hundreds of rivals.

Most of these competitors would be better off buying, selling, or merging with other providers instead of grinding away with little gain.

Here's why.

OCIO units and stand-alone firms emerged primarily from four sources; banks, asset managers, consultants, and nonprofit institutions.

Most of the firms under fifty billion AUM (about 70 on [our latest OCIO list](#)) sprang from the nonprofit world and therein lies a problem.

Banks seeded OCIO units from legacy trust and private banking services, while asset managers including Vanguard, Blackrock and

Goldman Sachs grafted OCIO segments onto established distribution channels.

Consultants created internal discretionary asset management units to increase market share and boast revenue. But only Aon, Mercer, and Towers have achieved headline growth, primarily by aggressive merger and acquisition campaigns.

These three, like the banks and asset managers mentioned above, were industry heavyweights before they muscled their way into the OCIO space.

The fourth and largest group includes high-profile CIOs who jumped the fence from nonprofit institutional investment management to for-profit startups and existing OCIO business segments.

But the organizations these CIOs left were very different from the businesses they joined. Nonprofit CIOs have one customer, small staffs, and a buy side rhythm, the business comes to them.

It's all about the mission, not ambition.

Wall Street metrics like distribution, product innovation, customer acquisition, and AUM growth are heresy in the nonprofit world.

Few tent-pole CIOs have big-league management or P&L experience.

Most of these CIOs and founders acquired the majority of their clients in the early years of their venture, when their reputations were fresh. Once they hit their comfort level, growth stalled.

When asked why no independent OCIO provider has broken through the hundred-billion-dollar barrier they answer; the business can't scale, our service quality will deteriorate and, if we grow or merge we will lose our unique firm culture.

What most of these founders and partners really mean if they were brutally honest is, I make plenty of money now, life is comfortable, and building a business is really hard and risky, so why take a chance?

Despite this pervasive bias for the status quo, should the Aon WillisTowersWatson merger go through, the combined entity will manage by our tally four hundred and thirty billion in outsourced discretionary assets.

Tell us again that the business can't scale and still serve clients.

Commonfund opened its doors in 1971 thanks to a Ford Foundation grant and forty-nine years later manages twenty-three billion in OCIO assets.

Blackrock hung its shingle in 1988 and thirty-two years later manages seven and a half trillion AUM, including one-hundred eighty-eight billion in OCIO mandates.

Apples to oranges? Maybe. But their goals are similar, their customers overlap, and the challenges are the same...acquire and prudently manage client capital.

If the goal is to deliver superior performance, service and solutions and be there for clients twenty years from now, who's most likely to deliver and survive?

Blackrock seized every opportunity to acquire customers and capabilities -- buying State Street Research and Management, Merrill Lynch IM, Quellos, and BGI -- and their customers are the winners.

The OCIO story is a compelling proposition for many institutions and high-net-worth families, particularly now in these troubling times. And the market continues to expand.

But after fifty years of trial and error this case is closed. If you want to be a leader in the OCIO business, there are only three ways to break from the herd; buy, sell, or merge.

The Skorina Letter

Each issue explores how the world's most accomplished asset managers think and invest. Original content includes profiles and interviews with industry veterans and research on compensation and investment performance.

Our insights and commentary come from our clients - board members, CEOs, chief investment officers - and the global investment community within which we work as executive search professionals.

Institutional investors operate at the crossroads of capital, talent, and ideas, shepherding over seventy trillion dollars in global assets. It's a constantly evolving spectacle and The Skorina Letter gives readers a ringside seat.

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