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Building the World's Best Investment Management

When Investment Advisors Mergers

No business can outperform its business model -- Sam Kariuki, Kenya

It's never been easier to start a wealth management advisory business and never been harder to grow it. Very few investment advisors achieve national size and status without a product or technology edge.

Of the approximately three thousand RIAs and OCIOs in the US, only about eighty have managed to accumulate over five billion in AUM.

According to the Investment Adviser Industry's snapshot 2022, "most investment advisers (88.1%) are small businesses with 50 or fewer employees and one or two offices."

These small advisors, from $100 million to $5 billion AUM, grew at a compound rate of about 6% over the four-year period from 2017 to

2021. The largest advisors on the other hand, those over $100 billion AUM, grew more than twice as fast, 14.9% over the same four years."

Concentration creates another roadblock. As we noted in our last Outsourced Chief Investment Officer (OCIO) report, just eight providers out of the one hundred seven we listed – Aon, Blackrock, Goldman Sachs, Mercer, Russell, SEI, State Street, and Willis Towers Watson – manage well over half the OCIO assets, $2.073 trillion of the $3.74 trillion AUM.

So how do you build "the next great investment institution" as Jon Hirtle, executive chairman of Hirtle Callaghan describes the challenge? Why are there so few breakthrough OCIOs?

Barring a rare exception, there are only three ways most wealth and institutional money managers grow — buy, sell, or merge.

Those that finally opt for better-resourced allies are in good company. Echelon Partners 2022 RIA M&A Deal Report tracked 340 announced transactions in 2022 alone, the tenth straight year of record acquisitions.

The problem is, most mergers and acquisitions crash and burn. Roger L. Martin, former dean of the Rotman School of Management at University of Toronto, noted in a Harvard Business School article that 70% to 90% of all acquisitions are "abysmal failures."

Why? "Companies that focus on what they are going to get from an acquisition are less likely to succeed than those that focus on what they have to give it."

Professor Martin offers four suggestions to improve M&A outcomes.

- Be a smarter provider of growth capital.
- Provide better managerial oversight.
- Transfer valuable skills to the acquisition.
- Share valuable capabilities with the acquisition.

But if the dream is to build an enduring investment powerhouse, you had better pick the right partners.

Mr. Hirtle cautioned in a recent Financial Advisor interview that "a lot of acquirers are 'financial consolidators' who will be ready to sell again in three to five years after making an acquisition. Clients and staff do not want to deal with that kind of disruption a second time, so it is important to join with a stable firm who values you as a long term partner."

What do you guys really want?

Mr. Hirtle should know. In 2021, seven senior Abbot Downing client professionals joined Hirtle Callaghan. A year and a half later all seven are prospering with the company.

We asked John Fabie, former Abbot Downing senior director and current member of the Hirtle team in Minneapolis, why he thought their merger has worked so well.

"I think the most important factor was both team's careful search process," said Mr. Fabie. "When Wells Fargo announced the decision to retire the Abbot Downing brand, we debated a number of options; spinning out on our own, joining an aggregator, or a Wall Street wealth manager, but none seemed quite right."

“We are investors and relationship managers. We did not want to be smothered by bureaucracy or handed a paycheck and shown the door. In the end we chose a firm with like-minded values and similar goals. To be candid, it never was about the money, it was always about building a business together.”

Jim Morris, corporate development leader at Hirtle Callaghan mentioned one other element which helped the process, some timely third-party mediation.

“Here's an anecdote about the merger which helped the deal get done. One of those informal assists you don’t read about in the press releases.”

During one of our many discussions with the Abbot Downing team, a number of side issues had come up and the talks were dragging on. Debby Hirtle – a founding member of the company – had earlier walked into the room and was listening to the conversation.

During a lull she said “excuse me for breaking in, but could we put aside these details for a moment and answer a fundamental question, what is it you guys really want?" Well, that got our attention! We all relaxed, thought about it, and agreed that at heart we just wanted to build a great business. Not long after that we had a deal.”

Culture eats strategy for breakfast

There’s another critical ingredient to successful mergers of course, lauded by all the management experts, most notably by Mr. Peter F. Drucker, and that’s culture.

Culture according to McKinsey & Company is what an organization stands for and how work gets done.

Finding like-minded, ambitious, professional investment advisors with compatible cultures, whether RIAs or OCIOs, is hard work. But the teams from Abbot Downing and Hirtle Callaghan were willing to put in the time and effort and it worked.

Final thoughts

We understand the dilemma RIA and OCIO founders face.

Investment firms are notoriously hard to scale. Brilliant, original strategies lose their potency when they are widely replicated. Or, a strategy works in one season, in one kind of market, but not in another. To make matters worse, management expertise is often thin.

It is a classic business school lesson. In a free market, innovation follows a predictable pattern. Successful innovators lead to a flurry of copycat activity, followed by a shakeout and a consolidation. In the 1920's there were over 100 American automobile companies, now there are only the "Big Three," plus Tesla, and a hand-full of EV hopefuls.

OCIO is the most significant innovation in the investment management industry since indexing. But, once again an industry is in the midst of a consolidation and those who don't consolidate are likely to be left behind.

There is no clear "best aggregator." Most acquisitions have been made by finance people gathering AUM into roll-ups to be sold to one of the old model firms that OCIO was designed to disrupt!

OCIOs and RIAs are mostly small businesses, run by bright, competitive, individuals with little to no general management experience. While it is difficult to acknowledge one's limitations, it's even more difficult to recruit people with the skills to complement the founders' magic. And it’s expensive to bring in and integrate new partners, staff, systems, and technology.

OCIO services are a compelling proposition for serious investors, whether they are institutions or families. And the demand for full-service, discretionary asset-management shows no sign of slowing.

But building resilient client development and service capability, enhancing investment capabilities, adding financial muscle, and developing bench strength takes decades.

There’s no need to reinvent the wheel. Buy. Sell. Merge. It's how the big got big. Just make sure the cultural fits.