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Size Advantage Dwindles as Small Managers Level Playing Field: Report

By Brooke Fox April 13, 2018

Small and mid-sized asset managers are better equipped now than ever before to fight for business against their larger counterparts. That's because new technology and a growing cohort of vendors have leveled the playing field between managers of different sizes when it comes to middle and back office infrastructure, according to a report by **Morgan Stanley Research** and **Oliver Wyman**.

"Large scale players have historically had a scale advantage in middle and back office… We now see these advantages eroding as smaller firms can 'buy instead of build' these scale advantages by outsourcing. The trend is only beginning but we see much more and broader outsourcing discussions happening at the moment," says **Christian Edelmann**, partner at **Oliver Wyman** and author on the report in an email.

Whether it's risk management, compliance, trade processing, valuation services, data management, taxes, reporting, fund administration, or investor portals, "literally everything in the back office but increasingly also in the middle office" can be outsourced, says Edelmann. Though the report notes that regulatory burdens will still favor the larger asset managers in terms of economies of scale.

Even hosting a server has become remarkably cheaper thanks to services like those offered by cloud computing companies, says **Steven Levitt**, founder of **Park Sutton Advisors**.

Firms should do a build versus rent analysis when deciding whether to outsource certain functions, says **Ed Higham**, managing director at **Silver Lane.**

"Today you can rent it, and yes there's a cost to that, but by outsourcing it to these bigger providers you are getting the purchasing power and the scale of those bigger providers, albeit you're renting a small slice of it, but in our opinion it definitely serves to level the playing field, at least relative to how things used to be," he says.

It's important to note that there are some downsides, however. "If you're a small firm, a lot of these outsource providers are probably not going to spend a lot of time customizing their services to what it is that you're seeking. If you're small, you take what you get off the shelf," says Higham.

Once a manager has decided to outsource, the services they need can come from a broad range of firms, "starting from the traditional custodians and securities servicing firms, to specialist fund admin providers, to investment banks and other specialists offering risk analytics," says Edelmann.

When evaluating various options, managers should carefully weigh the potential risks says **Thomas Holly**, asset and wealth management leader at **PwC**. Managers should consult their peers to find out what colleagues at other firms have found useful, as well as talk to a strategic consultant.

Regulatory requirements will still weigh heavier on small and mid-sized firms, as "rising regulatory overheads will preserve economies of scale for large players," according to the report. As these expenses go up, mid-sized firms will be squeezed the most, says Levitt.

One way to keep expenses down is to go through each line item to look for areas to cut costs. Levitt notes an example in which a firm had 25 Bloomberg terminals, but after a thorough cost analysis, found that they only needed about five.

It's important that everyone working at smaller firms start "thinking like owners" if they want to survive the next five to ten years of change in the industry, says Levitt.