Northill Capital

Helping start-ups gain a foothold while paving the way for established managers to change ownership

Jon Little, Partner

In the investment management industry we like to think of ourselves as an industry with a long tradition and history yet, in reality, the majority of asset management firms were established in the last 30 years.

In industry terms the period of 1980 to 2005 was, in retrospect a 'golden era' where talented fund managers liberated themselves from larger institutions. Armed often only with talent, self-belief and some contacts, small teams found it relatively easy to join an industry where there were few barriers to entry other than skill, common sense and some luck.

We now live in a very different world. For those trying to set up new asset managers the stakes have got much higher. Although there are jurisdictions which require a new asset management firm to have very little equity capital – most notably the US – in many places the requirements are becoming so stringent that even a relatively simple asset management company will require a significant investment of risk capital.

It is not just the formal capital requirements that have become a barrier to starting up new firms. In domiciles such as the UK the delays in getting authorisation combined with a near universal increase in the scale and complexity of set-up in terms of risk management plans, segregation of duties, licensing and operational complexity mean that the archetypal "two people and a terminal" set-up of ten years ago just isn't tenable. And all of this is before the firm begins looking for clients and actually managing money.

The market turmoil of 2008 combined with Madoff and some high-profile blowups have led nervous clients, shareholders and plan members to be reluctant to be early investors in new investment management businesses. Even where this capital can be sourced, potential clients' due diligence programmes can easily take six or even nine months from first meeting to funding – a lifetime when a new manager is living on its capital. This has led to a situation where the failure rate for new managers is probably higher than at any time in recent history.

The situation for established managers is somewhat different. There is a generation of very profitable firms that have been successfully established and continue to thrive but, in many cases, the founders of these firms are between fifty and sixty years old and beginning to contemplate the future. The last few years have seen their businesses grow in size, become more institutional and employ more people. If they're honest, the burden of managing a modern asset management business is very different to the job of boutique CEO in the past.

The CEO position nowadays is a lot less about managing money and a lot more about managing staff, regulators and clients. The principals of these firms may have mentored some great younger talent and put in place a management team around them but we frequently see firms where the gap between those who hold equity and those who will be the future of the business is significant and getting worse as the firm grows in size and value.

So what are the options for these firms and their controlling shareholders? Winding down or becoming a family office only really works for those who feel they haven't really built an institutional strength business – and besides, motivating people in an investment business with no clients isn't as easy as it seems. If the firm is a reasonable size, getting management to 'gear-up' to buy out a founder is not really an option these days – even if financing was available. Selling to a bank isn't likely to appeal to those remaining – even where, in a post Dodd Frank/Basle III world, the appetite still exists.

Finally, Private Equity (PE) offers a choice but in the culture of a privately owned asset management business the relatively short-term nature and structure of PE rarely makes it the first choice.

So, we are in an environment where new firms find it very hard to establish themselves and existing, mature private businesses face difficult choices as they contemplate succession. Northill Capital was set up to address both of these situations. We give start-ups and well established firms a more flexible, sensible option to achieve the right outcome for shareholders, staff and, most importantly, clients.

Northill was established in 2010 through a partnership between interests associated with The Bertarelli Family – one of Europe's wealthiest families – and an experienced management team led by Jon Little – former Vice Chairman of BNY Mellon Asset Management – one of the pioneers of multi-boutique asset management.

Northill has approximately $1bn of capital to deploy in the asset management business. There are other investors who say they do what we do, but we believe Northill has a unique approach.

We recognise that asset management is a business which values long-term stability so – unlike a PE firm which typically invests with a three or five year exit in mind – we invest for the very long term and derive our returns from the income generated by ownership rather than focusing on an exit.

Northill is also a specialist – we only invest in asset management and our partners and management have almost 150 years of industry experience between us; experience across all sectors, geographies and circumstances. In short, there isn't much that can happen in the life cycle of an asset manager that we haven't seen before. We are also careful who we work with. We like boutique businesses which focus on single asset classes or styles and we like to back teams with a strong investment ethos and a repeatable, scalable investment process – we don't back 'prop' traders, star managers, funds of funds or closet indexers.

For managers at early or start-up stage we bring equity and seed capital but we are categorically not 'seeders'. Seeders have a temporary relationship with the manager and are focused on getting money managed well for lower fees and, frequently, a 'top-line' revenue share. We believe that aside from bringing some AUM this approach is not beneficial to the future success of the target firm.

We aim to use our equity and seed capital and our expertise to work in close partnership with the new business to cut down the risks associated with starting up a new firm by helping with recruitment, organisational structure, project management, compliance, marketing and finance. Unlike a seeder we are an owner of the business alongside management – we only make money when they make money and vice versa – and we ensure that the capital is in place to ensure that the business can take the long view and the right decisions are made at an early stage.

Similarly, with more mature managers we offer more than just capital to begin the change in ownership transition. If the principal(s)of the firm want to retire immediately we are unlikely to be interested but if they want to move to that position in five or more years then Northill can play the role of 'anchor' shareholder to buy in to their business to help them move smoothly from majority to minority owner and to help structure and advise on ensuring that their existing management team make the transition from small shareholders to part owners of the business.

For both early-stage businesses and more transitional businesses we also put in place our unique equity recycling process. Whilst there is substantial evidence that privately owned asset managers outperform other types of firm, there are downsides to this model in that blockages can occur between the generations of management and equity owners find it hard to fully value or crystalise their stake in the firm. Our ownership model ensures that all shareholders have a known value for their equity annually and a clear mechanism for crystalising that value.

The asset management industry – conventional or alternative – has come of age. If things don't change the only new managers who can set up from scratch will be former prop traders or 'hot' star managers, because more low-profile but successful teams will not possess the capital to make it through the first few years. If that had been the case back in the 1980s or 1990s, many of today's most, successful firms would not exist.

Now in 2012 many of those same firms which remain private will need a new approach to ensure that they can continue to deliver on their founder's original aspirations – at Northill, we believe we have the answer for both.

This article was first published in *Hedge Fund Intelligence Global Review Autumn 2012*.