Does size really matter?

A look at how multi-managers view the pros and cons of large versus boutique fund managers when it comes to investment performance.

by Joao Frasco, Chief Investment Officer: STANLIB Multi-Manager.

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Chief Investment Officer: STANLIB Multi-Manager

The subject often comes up in investment circles: what's better, a large fund manager with its teams of people, resources and systems, or a boutique fund manager, small, nimble and streamlined?

An argument often used by boutique fund managers is their ability to access greater breadth of opportunities in the market. They can invest into large, medium and small-cap companies without taking a high percentage of the company that they are buying into while still having a meaningful position in their portfolio. If one of those companies happens to be a star performer, it's something that a boutique manager would have access to, and a larger manager wouldn't.

However, this assumes "all else is equal". In reality, all else is not equal. Large and boutique fund managers each have unique advantages and disadvantages.

Large managers may have access to more resources (people, systems, tools and processes) that could give them an advantage in the complex job of analysing companies' stocks. On the other hand, boutique fund managers are not under pressure to deliver set returns to shareholders so may be more likely to spend money on obtaining additional resources where they are needed.

Large managers may have better access to company management who would typically be more willing to spend an hour with a large fund manager (that could result in millions of rands of investment) rather than a small manager who may only invest one or two million.

A large manager may provide more stability in terms of the longevity of the investment team and processes as the organisation is established to outlast specific individuals. Meanwhile, boutique managers are reliant on key individuals. However, for factors within their control, boutique managers are more able to set incentive structures and a working environment that is conducive to staff retention, often leading to much lower staff turnover.

Trying to debate whether a large manager or boutique manager is "better" is a futile exercise. One is not comparing apples with apples, which is why STANLIB Multi-Manager ignores the size debate altogether and focuses on the real factors that need to be unearthed to determine the quality of the manager.

These include:

1. Philosophy – how does the manager think about the world, or about the capital markets in which they operate according to their particular mandate? What is their basis for investing in specific companies? Are they quantitative managers looking at certain risk ratios of companies or do they take a fundamental approach where they meet company management and understand the environment in which the business operates?
2. Process – how does a manager transfer their philosophy into organised thinking and execute their ideas around the analysis they have done?
3. People – the most important aspect. From analysts to the portfolio managers, how is each individual incentivised? Are they driven to perform in the short term or do they take a long-term view? Are they self-critical and self-aware? Does the team reach decisions together through debate or is there one person making the final authoritative decision?
4. Past performance – how does their past performance validate their philosophy and process? Does it bear out in terms of what they say their focus is?
5. Price – how do they charge for their skill as fund managers? And are they able to deliver performance better than a passive investment to justify their costs?
6. Physical environment – how is their office space structured? This includes everything from the system they employ, back office, middle office and front office functions, to the investment process and compliance checks. Is everything in place that should be in place, and does it operate seamlessly?

The above aspects form part of a detailed due diligence and it's one of the key reasons that investors choose multi-management as an investment approach. Knowing that one has an experienced multi-manager choosing underlying fund managers to deliver investment performance is a powerful proposition. Investors often feel significant peace of mind when dealing with a multi-manager that has a long history of appointing the best underlying managers to manage investors' capital, regardless of whether these are large or boutique firms.

The above factors apply universally to large and boutique fund managers and render the "size debate" about fund managers completely irrelevant. Outside the small advantages and disadvantages that size may bring, the strength of a fund manager's team, process and philosophy is what determines whether a manager is worth investing with.

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