

Fund adoption: A potential growth strategy

By Dan Sondhelm

Many boutique asset managers start mutual funds with the “Field of Dreams” mentality: If we offer them, investors will come. What they quickly discover is, without



a long-term track record, an extensive distribution network and a well-planned marketing strategy, efforts to get in front of clients and draw in AUM largely fall flat.

With flows to passively managed funds outpacing actively managed funds, and the fee stampede squeezing profit margins for all but the most popular fund families, asset managers that don’t have household names in their lineups may be looking for ways to exit the fund business. For many, executing fund adoption agreements with larger firms may offer the best way to focus on their core strength: managing investments for institutional or high-net-worth clients.

SHED THE PRODUCTS, KEEP THE EXPERTISE

What is a fund adoption? It’s a euphemism asset managers use when they sell their funds to a larger fund company and stick around to manage them as subadvisors. In many cases, this can be a win-win situation for both sides.

Adopters get to own funds that may be outside their area of expertise. The sudden influx of new AUM helps move them up the ranking of largest asset manager. The enhanced combination of depth and size gives them a better story to pitch to the gatekeepers and research teams. And since adopters generally have greater bench strength in their sales and marketing departments and a broader network of advisors and consultants to reach out to, they have a better chance of generating inflows for the newly added funds.

The adoptee sheds the costs and operational, regulatory and distribution headaches of managing mutual funds, freeing them to focus solely on generating alpha from the funds they’re subadvising.

Fund adoption can also serve as a viable

exit strategy for founders and partners who haven’t established succession plans.

GREATER SELLER-SIDE RISK

While fund adoption carries risks for both sides of a sale or merger, adoptees have more to lose if a deal goes south. Once the adoptee exchanges ownership and control of its funds for a subadvisory relationship, it’s essentially shedding its independence and autonomy. Adoptees have to play by the rules of their new parents. And since they’re sharing management fees, they depend on the goodwill of the adopter’s business development team to increase AUM to make up revenue shortfalls.

This can be a problem if the adopter’s network of investors and intermediaries are not interested in the newly acquired funds. Or if support for the adoptee’s new subadvisory role among senior executives doesn’t percolate down to the distribution personnel who are now tasked with the job of marketing and selling their former funds.

marketing resources to grow AUM in the funds you’re sub-advising? Are there opportunities beyond the funds such as annuities or institutional accounts to manage?

- Does your firm and the adopter share the same corporate values? Is there potential for clashes that could drive away your investment experts?
- Have they added AUM for an adopted manager before?
- Does the manager already have competing funds?
- How do you make sure the funds you’re selling are valued properly? What characteristics can raise or lower your valuation?
- How will you be paid?
- How much time will your managers need to devote to sales and marketing? Will they need to participate in sales pitches? Will conference appearances be required? Will they need to produce thought leadership?

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EVALUATING ADOPTIONS

You’ve worked hard to develop your funds and establish your reputation. That’s why, if you’re considering a fund adoption, it’s critical to conduct due diligence on any potential adopter. In addition to looking at the numbers, you need to get the answers to qualitative questions that could indicate whether the transaction is your lifeline to future profitability or points to a rocky road ahead. Consider the following questions:

- Is the adopter committed to growing assets in your funds, or are they buying them purely to gain AUM and to create the impression of being a more diversified?
- Does the company have the sales and

One manager had his \$60 million fund adopted by a large global asset management firm. Between the growth of the fund and other accounts he was given, he managed close to \$1 billion AUM. Sure, he had to do more marketing than he was used to. But as he said, “It was worth it. Half the fee of a billion is much better than the whole fee of \$60 million.” And managing \$1 billion made it easier for him to qualify for institutional accounts that came to him directly. [IMME](#)

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