PERFECT PARTNERS?

Kevin O'Connell outlines common misconceptions related to private equity investment in fiduciary businesses

The concerns felt by some around increasing investment by private equity (PE) in the fiduciary sector in recent years have led to a fairly negative perception overall. This is largely because intermediaries, and indeed clients, sometimes anticipate that fiduciary companies either owned or backed by PE houses suffer from two main issues:

- **a potential lack of continuity in relationships, and**
- **the short-term focus of PE houses, often leading to an increase in fees.**

I have encountered these concerns first-hand but my experience shows that PE investment in this sector can work extremely well if expectations are managed and roles clarified at the outset.

A number of factors have converged to encourage the fiduciary sector to become more open to the involvement of PE. First, client needs have become more complex, and consequently it is important to be able to offer a range of global solutions. However, it is difficult to offer these solutions without having a real presence in a multitude of onshore and offshore locations. For this reason, some businesses look to join forces with a larger group. Second, PE is one of the few reliable sources of funding in the current uncertain economic climate.

Meanwhile, there has been significant appetite on the part of PE investors to participate in what has traditionally been a strong-revenue sector. This appetite has been particularly keen in the UK Crown Dependencies. Given the above, PE involvement in the fiduciary sector is unlikely to be transitory and so it is worth talking a cold, hard look at the challenges (and opportunities) this brings and how these can be overcome.

THE CHALLENGES

We know that, if clients or intermediaries cannot rely on established relationships and are constantly speaking to new people, who are invariably unfamiliar with their structure, frustration will follow, which can ultimately result in the loss of clients, and embarrassment for the intermediary who originally referred them to that fiduciary business.

There can also be an expectation that, with PE ownership, there will be pressure to increase fees to maximise profitability in the short term, without considering the longer-term impact on clients.

COMBATING FEARS

It is human nature to be concerned about a potentially significant change in our environment, but change does not have to be for the worse.

In my view, a fiduciary business undergoing an ownership change needs to co-create a strategy with its new shareholder right at the beginning that has, at its core, recognition of the importance of investing in people, infrastructure and locations. Ultimately, it is about creating a dynamic culture where people want to stay, which will not only keep clients happy but will ensure that the business continues to grow. Of course, additional incentives such as share-ownership schemes that are open to all staff (and not just a group of directors) should also be seriously considered to decrease the risk of attrition.

On the thorny issue of fees, the key is finding a PE partner that recognises that the capital value of the fiduciary business will increase without being 'forced'. It would be naive (and immoral) for any business to believe that it can increase fees for no good reason and avoid recrimination. It is about identifying a PE backer that has taken the time to get under the skin of the business prior to investment and, more importantly, buys into the strategy proposed by management. This helps to set and align expectations around realistic future growth targets.

The other aspect is third-party bank borrowing, which the fiduciary business may seek – it is essential that any borrowings are maintained at sensible levels in order to avoid pressure to drive revenue through whatever means possible.

RELATIONSHIP MANAGEMENT

Client concerns also need to be managed. The importance of maintaining deep relationships cannot be underestimated and never more so than when there is a change in ownership. It is crucial that the fiduciary business meets clients regularly, carries out a comprehensive client-visitation programme and communication plan, and considers engaging a third party to check in with clients in order to gain an independent assessment as to how the business is delivering.

It is also worth highlighting to clients the advantages that PE backing brings. For example, funding can be:

- **applied to secure a presence in strategic locations, thereby providing a truly multi-jurisdictional offering with real substance in each location, and**
- **deployed to achieve a well-oiled and integrated operating platform.**

TO SUM UP

PE investment in a fiduciary business can act as a superb boost and allow it to deliver a strategy that meets the ever-increasing and changing needs of clients without compromising on service or fees. To achieve this, the collaboration must be with a PE investor that has taken the time to understand the business; there should be a cultural alignment between the business and the PE investor; and the level of investment in the business must be right. It is a case of 'forewarned is forearmed', rather than 'let the seller beware'.

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