
Benchmarking Infrastructure Expenses in Alternative Asset Management

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Introduction

Convergence's introduction of infrastructure benchmarking data helps Asset Managers readily measure the performance of their infrastructure. Asset Managers use Convergence benchmarking data to identify specific opportunities to reduce Management Company and fund expenses.

The Objective of Benchmarking

Benchmarking provides a fact-based measure of performance relative to individual peers or peer groups. It positions an Asset Manager's infrastructure against peers who perform at best practice levels and opens your eyes to the "art of the possible." The regular use of benchmarking also provides an objective measure of how you are closing the gaps between your infrastructure and your target operating state.

A Historical Perspective

Asset Managers and investors already benchmark investment returns against Managers of similar strategies and size. This benchmarking enables Managers and investors to evaluate their returns versus the returns generated by other Managers in the same asset class.

When it comes to infrastructure costs, most Asset Managers and investors do a good job managing management company and fund expenses against their internal benchmarks which are typically their prior year end values. While these internal measures are useful, they do not provide the external perspective of what others in the industry, and peers in particular, are achieving with their infrastructures. The reliance on internal measurement without objective third-party benchmarks reflects the historic absence of credible peer and industry-wide data for Management Company and fund expenses. Ad hoc efforts to obtain standardized peer and industry-wide measures have typically resulted in data of uncertain quality, and therefore uncertain utility.

Convergence's Benchmarking Data

The infrastructure information in Convergence's Asset Manager database is obtained from a variety of sources including regulatory filings, websites and a host of other proprietary sources. We cover over 10,000 managers of all sizes and strategies. Our data includes total and functional headcount and is enriched with

over 50 types of activity/volume data to measure productivity at a granular level. We have productivity statistics for substantially all of the tasks typically performed by middle and back office personnel. Our data may be provided in an infinite number of ways enabling our clients to compare their headcount, functions and volumes to customized peer groups that they create, or to standard Convergence industry composites.

Convergence Research Findings

While it is widely known and accepted that Managers shape their investment processes to differentiate their returns and define their brand, less is known about differences that may exist in their infrastructures. One would expect to see similarities between the infrastructure headcount at managers of similar strategies, sizes and volumes. After all, the trade life cycle for the same asset class should not vary materially between similar Managers. Until now, there was little empirical data to support or refute this view. Yet, Convergence's proprietary database and research has identified dramatic differences in the headcounts of Managers of similar size, strategy and volume. What drives these differences is worthy of study because what you might learn can save both Management Companies and funds enormous amounts of money.

How widely should the cost of these activities differ across managers in the same strategy and size band? Table 1 illustrates the material headcount differences between three managers, each with \$6.7bn of regulatory assets under management (RAUM)¹. While the number of investment professionals (IP)² is consistent, the number of non-investment professionals (NIP)³ varies widely. Trading volume for these three similar sized managers is also comparable so typical volume measures such as unique investments, use of leverage, trade tickets, corporate actions, accounts and clients cannot explain these differences.

Understanding what drives infrastructure cost differences can lead to material improvements in your efficiency that lower Management Company and fund expenses.

Table 1: Multi-Strategy Managers

Manager	FTE	IP	NIP	FTE/BN	IP/BN	NIP/BN	NIP/IP
Manager 1	195	47	148	29.1	7.0	22.1	3.1
Manager 2	152	41	111	22.7	6.1	16.6	2.7
Manager 3	111	48	63	17.0	7.4	9.7	1.3

Understanding the Differences

Convergence benchmarking begins its analysis with the type of headcount data illustrated above, as headcount is typically the single largest driver of expense. Further, we know that no one organization operates exactly the same way, regardless of process consistency. Thus, every organization is going to have a different cost profile that in part reflects its culture and investment process. The question is how different should these cost profiles be and what impact do these difference have on fund returns and Management Company profits? This is where additional layers of Convergence data will begin to clarify where

¹ RAUM refers to Regulatory Assets under Management defined by the SEC

² IP refers to Investment Professionals as defined by the SEC

³ NIP refers to Non-Investment Professionals defined by Convergence

opportunities may exist to improve process efficiency and to quantify exactly the cost of the Manager's "culture."

The Cost of Being Different

Assuming a fully loaded cost⁴ of \$200,000 per non-investment professional (NIP), Manager 1 spends \$7.4mm more than Manager 2 and \$17mm more than Manager 3. Does Manager 1 know what drives the relative incremental cost and does it provide him the breadth, depth and quality of service expected? Can Manager 1 rationalize these incremental costs by pinning it to culture, investment or business processes? Do your investors see the benefit of this spending? Convergence can help you answer these complex questions.

Conclusion

Managers and investors can now supplement the traditional benchmarking they do on performance returns with Convergence's proprietary infrastructure benchmarking data. Our analysis helps you identify opportunities for sustainable process improvement programs that will lower fund and Management Company costs and reduce operating risk.

⁴ Fully loaded costs refers to the base, benefits, bonus and overhead (rent and other related overheads) earned and allocated to non-investment professionals.