Battle for dominance in the M&A advisory business
Bulge-brackets vs. the boutiques

Deloitte Center *for* Financial Services

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Introduction

Wall Street, like Washington and football coaches, seems to have a special fondness for battle metaphors. Executives read "*The Art of War*," headlines speak of "corporate raiders," and the language of combat and victory pervades analysis of competitive trends.

Amid the noise and war whoops, it is possible that the true battles for industry dominance are being waged with little fanfare. Even when noted, closer attention may be required to understand their impact. One such battle is the ongoing contest between bulge-bracket investment banks and boutiques, played out on the fields of the mergers and acquisitions (M&A) advisory business.

Boutiques have been a major competitive force since at least the 1990s, and in recent years have further boosted both their share of the business and marketplace prominence — favored by specialist knowledge, a reputation for independence, and clients' reduced need for big banks' funding capacity. Some prominent gains have led commentators to proclaim a "rise of the boutiques."[1]

If boutiques are in fact making substantial advances into the established bulge-bracket territory, the potential damages to these large banks may be greater still. The advisory business, may not be as directly important to bulge-bracket bottom lines as it used to be, but the large banks may suffer if their boutique competitors make inroads there. Advisory revenue remains a significant, albeit reduced, contributor, as does the reputational effect of strong league table performance. Perhaps more importantly, the relationships that banks' advisory work builds can be leveraged to expand business in complementary product or service lines, such as equity or debt underwriting and treasury management services.

The evidence for the growth of boutiques in recent years is more than anecdotal. A number of indications in league table data suggest that boutiques have consolidated the gains made since 2008. Boutiques' share of industry fees, for example, has almost doubled since 2007.[2]

Still, a number of questions remain. How significant are boutiques' gains? How have different factors driven boutiques' achievements? Are these drivers sustainable, and how severe is the threat to bulge-brackets? This paper helps explain the evolution of the competitive landscape in M&A advisory and examines the drivers of change. It also helps to provide insights into the future of the competitive landscape in this bedrock investment banking business and offers recommendations for the consideration of both boutiques and bulge-bracket banks.

[1] Jennifer Cummings, "Recent M&A burst showcases rise of the boutiques," *Wall Street Journal*, September 8, 2010.

[2] Thomson Reuters M&A database.

The battlefield and its warriors

> “With a consistent client advisory team and less turnover managing those accounts, it does all pay off in the end because clients know you and trust you.[4]”
>
> **- Chris Ventresca, head of global M&A, JP Morgan**

M&A advisory is a relationship-driven business — one that thrives on trust and longstanding ties. These contacts also offer opportunities for banks to promote other service lines. With trading divisions taking large hits from 2008 to 2012, M&A advisory has been increasingly viewed as a business that brings both reputational benefits and more client business.[5]

Given the stakes, intense competition in M&A advisory exists among a wide variety of institutions. An analysis of league tables over the last decade shows competition among three distinct groups, with different business models and characteristics (see "Methodology and classification" for more details).[6]

Bulge-bracket banks

These are U.S. and foreign full-service investment banks with a large presence in the United States (considered in this paper to be assets greater than $500 billion). A strong balance sheet gives them large-scale lending capacity to fund acquisitions. In addition, they offer all types of investment banking services, including advisory, underwriting, trading, and research.

Boutiques

Known for their independent advisory model, boutiques are small investment banks, typically with assets of less than $50 billion. Specialization in specific services (such as restructuring) or industries is often their key competitive strength. Many focus on advisory business within certain geographies, primarily the United States; however, a growing subset of boutiques is expanding its global footprint.

Others

This group comprises two business models: 1) foreign full-service investment banks with a limited foothold in the United States (differentiating them from foreign banks that are part of the U.S. bulge bracket) and 2) traditional commercial banks that have yet to establish themselves as serious contenders in U.S. investment banking. Banks in this group are generally medium-to-large-size players (here, those with assets of more than $50 billion) and tend to offer a wider range of investment bank services than boutiques.

Methodology and classification

- The analysis in this report is based on data from Thomson M&A league tables for U.S. targets from 2003 to 2012.
- Drawing from the top 50 players in each year, 105 distinct institutions were classified into one of the three competitor profiles — bulge-bracket, boutiques, and others — based on the aforementioned characteristics.[3] The asset sizes used in classification lent rigor to subjective assessments of institutional types.
- The three groups were then analyzed on their performance in terms of deal value and number of deals. But since league tables credit banks with the full value of the deals in which they participate, the report combines deal value analysis with advisory fee data to rigorously assess competitive dynamics in the advisory space.

[3] The analysis excludes most nonbank players like private equity firms and professional services firms such as Deloitte. The 105 firms were part of the top 50 in at least one of the 10 years (2003-2012) under consideration.

[4] Soyoung Kim, “JP Morgan, top M&A bank in first quarter, buoyed by big deals,” Reuters, March 21, 2013.

[5] Dana Cimilluca, ”Goldman picks global M&A co-head,” *Wall Street Journal*, February 11, 2013.

[6] Thomson Reuters U.S. M&A advisory league table rankings from 2003 to 2012. Though the two main categories used here (bulge-bracket and boutiques) are standard, there is no common strict definition of their membership.

The opposing forces

The M&A advisory industry has grown more competitive over the last decade. Although bulge-brackets continue to top league table rankings, boutiques have been gaining a higher share of advisory fees since 2008. In this battle for dominance, "other" institutions seem to be trailing bulge-brackets and boutiques in both rankings and fee share.

Bulge-brackets still powerful, but slightly weakened

An analysis of league tables for the past 10 years paints a clear picture of bulge-bracket banks' dominance: They have secured at least seven of the top 10 positions every year in the last decade, as their larger teams can support more deals than boutiques and others. In addition, bulge-brackets' strong asset base provides them lending and underwriting capabilities, and allows them to better manage high-value deals. A continued surge in the number of large transactions (greater than $1 billion) through 2007 directly benefited bulge-brackets' deal value and volume, thereby enabling them to maintain a strong lead over boutiques and others (Exhibits 1 and 2).

Bulge-brackets' overall dominance continues despite the downturn: In 2012, the average bulge-bracket bank advised on twice as many deals as the average boutique (Exhibit 2). They also advised on larger deals: The average 2012 bulge-bracket deal was six times the size of the average boutique's deal (Exhibit 1).

Exhibit 1. Average deal value of banks in the top 50 league table rankings ($ billions)

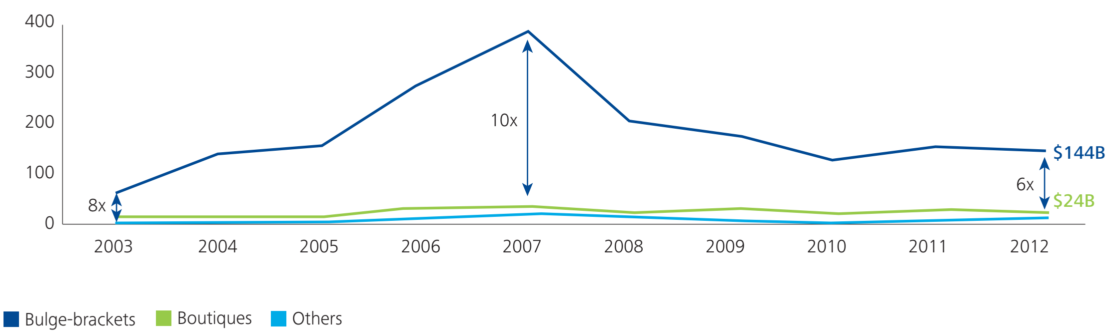
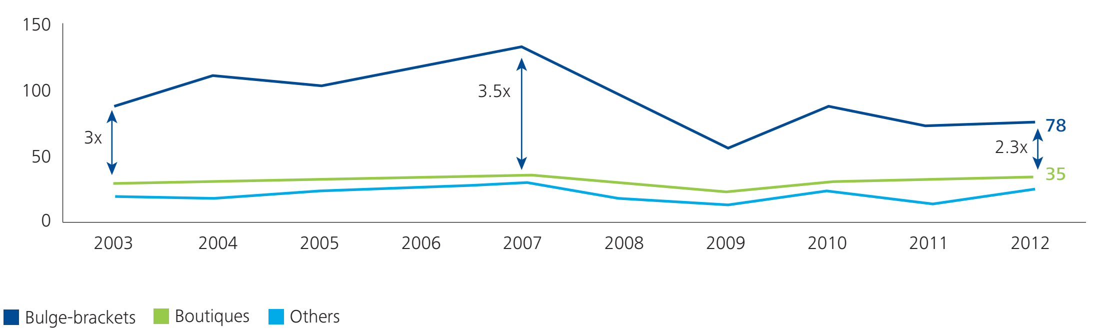


Exhibit 2. Average number of deals of banks in the top 50 league table rankings



Source: Thomson Reuters M&A database. See "Methodology and classification" on page 2 for more details. Calculations based on top 50 by deal value.

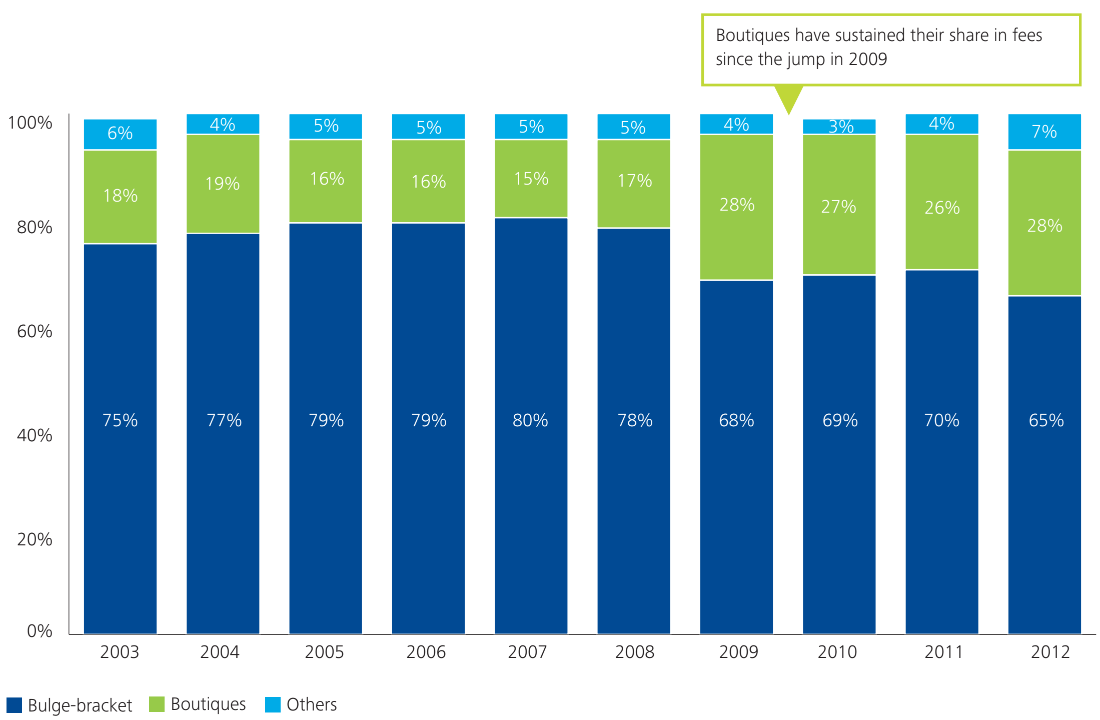
That said, bulge-brackets have faced formidable challenges since the 2008 financial turmoil. Their survival has entailed significant business restructuring, including cost-cutting programs, reductions in risk-weighted assets, and other divestitures. The advisory business of bulge-brackets has also taken substantial hits primarily due to a decline in the number of large deals. The 6x and 2.3x differentials over boutiques in average deal value and number of deals in 2012 were as high as 10x and 3.5x, respectively, in 2007.[7]

Boutiques gain prominence

In their competition with bulge-brackets, the financial turmoil of 2008 appears to have given boutiques a boost. The bankruptcies and bailouts that tarnished the reputation of bulge-bracket banks also drew attention to the potential conflicts between traditional investment banking services and trading. This likely encouraged some M&A clients to turn to independent advisors, even for some of their more complex and larger deals.[8] In addition, with corporate restructuring still a strategic priority, specialist boutiques continued to receive a healthy share of the restructuring business. Although a flat pattern in average figures for deal value and number of deals (Exhibits 1 and 2) makes boutiques' growth less evident due to a wide variation among boutiques, fee trends (based on dollar totals rather than averages) appear to depict a clearer picture.

The dollar fees earned by boutiques (in the top 25 advisors by fees) in 2009 fell by much less than the fees earned by bulge-brackets, indicating boutiques' resilience in a tough market.[9] In this context, the rise of the boutiques may be attributed in part to the weakening of the bulge-brackets. Of the top 25 advisors by fees in 2009, the share of boutiques as a percentage of total fees rose by 11 percentage points, while bulge-brackets saw a decline of 10 percentage points in their fees share (Exhibit 3).

Exhibit 3. Share of fees by type of institution



Source: Thomson Reuters M&A database. See "Methodology and classification" on page 2 for more details. Calculations based on top 25 by fees.

7 Thomson Reuters M&A database.

8 David Gelles, "Boutiques take growing slice of M&A work," *Financial Times*, October 2, 2012.

9 Thomson Reuters M&A database. Boutiques' fees fell only 7 percent year over year (YoY) in 2009, against a 51 percent and 42 percent YoY decline in bulge-brackets (in the top 25 advisors by fees) and overall industry fees.

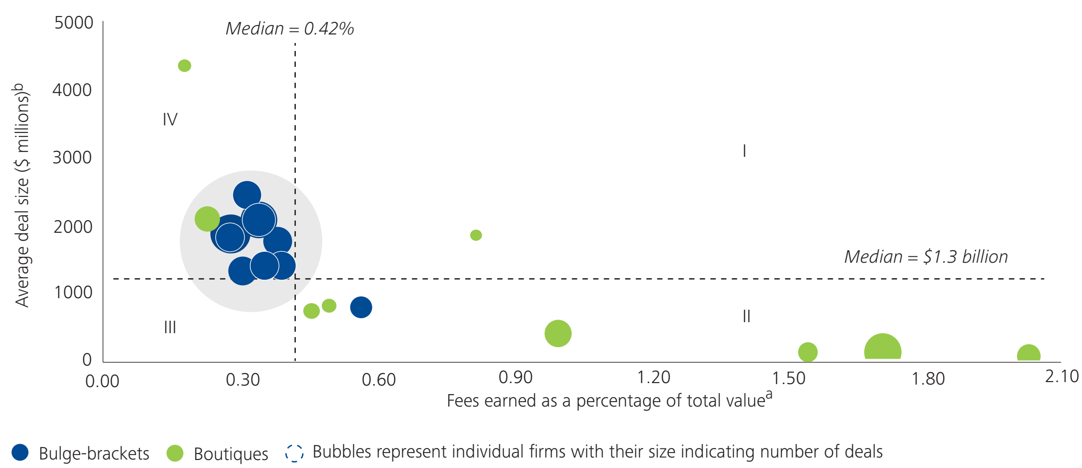
However, the gradually reviving M&A market and a larger number of deals have likely helped bulge-brackets regain some of their lost advisory revenue. Bulge-brackets (among the top 25 advisors by fees) earned $5.3 billion fees in 2012, up from $3 billion in 2009.[10]

The recent bulge-bracket dollar gains, however, do not appear to have translated into leaner times for boutiques. Exhibit 3 demonstrates that boutiques in the top 25 maintained their share in fees (approximately 27 percent) since the jump in 2009, indicating that they managed to grow their dollar fees at a rate matching their bulge-bracket opponents.[11] This strong performance brings to mind a simple question: How?

Traditionally, large deals were perceived to be bulge-brackets' territory, given their financing abilities. And given the size of the deals, bulge-brackets could often charge lower proportional fees (often less than 1 percent of deal value) and still achieve high-dollar returns — also improving their league table positions into the bargain (Quadrant IV of exhibit 4). On the other hand, boutiques, given their smaller team size, have generally been associated with small- and medium-sized deals. Since small transactions also require a substantial amount of due diligence and other costs, especially in case of private companies where data availability could be a challenge, many boutiques tend to charge a higher proportional fee (between 1 percent — 2.5 percent of deal value) to adequately cover their expenses, though perhaps at reduced margins (quadrant II in exhibit 4).

But the 2008 financial turmoil has blurred business territories. According to Joseph Perella, co-founder of Perella Weinberg Partners, "Independent firms are complementary to big firms in every way."[12] This assessment seems more and more appropriate. The rising trend of soliciting independent advice of boutiques alongside bulge-brackets' on large and complex deals implies more slices of the same fee pie, indicating a threat to big banks' share of fees.[13] This threat comes predominantly from boutiques that have started demonstrating deal-activity attributes similar to bulge-brackets. These firms often charge competitive fees and are increasingly advising on large deals (greater than $1 billion) (as evident by green bubbles in quadrant IV of exhibit 4). With foreign bulge-brackets facing multiple regulatory and business pressures, including heightened capital requirements, more boutiques appear poised to rise up the rankings and compete toe-to-toe with bulge-brackets (shift from quadrant II to quadrant IV).

Exhibit 4. The competing territories of bulge-brackets and boutiques in top 25, 2012



a) Fees earned as a percentage of total deal value = total fees/ total deal value for the year
b) Average deal size ($ million) = total deal value/total number of deals

Source: Thomson Reuters M&A database. See "Methodology and classification" on page 2 for more details. Calculations based on top 25 by fees.

10 Thomson Reuters M&A database.

11 Ibid.

12 Christopher Alessi, "Investment banking boutiques are on the rise," *Institutional Investor*, May 24, 2011.

13 Ibid.

"Others" remain on the margins

In some respects, traditional commercial banks or small local subsidiaries of foreign banks — the "Others" in our classification — appear similar to boutiques, as they tend to work on fewer and smaller deals. But they generally differ in institutional characteristics and business models, and their share of the market has not changed much over time.

The reasons for this static performance may become apparent once the factors of M&A advisory success are considered: "Others" typically do not enjoy the advantages of boutiques and bulge-brackets. Regional or foreign banks may lack the specialized talent that attracts clients to boutiques. They may also suffer from relatively low-profile reputations in the investment banking space and a less distinct business model. Just as importantly, they may lack the scale across markets to compete toe-to-toe with bulge-brackets.

That said, while some foreign investment banks are scaling back, some U.S. banks without a historically large investment banking division are taking steps to build their businesses as part of a broader effort to improve fee income.

The narrowing lead

As the data shows, bulge-brackets' dominance weakened since the financial turmoil. For example, an average bulge-bracket advised on only 56 deals in 2009, falling 58 percent from a peak of 132 deals in 2007.[14] However, a more recent recovery in deal activity (number of deals) has helped bulge-brackets grow their dollar fees at a compound annual growth rate (CAGR) of 20 percent between 2009 and 2012. Though still not near their high, bulge-brackets' performance has improved: They advised on more deals and earned higher dollar fees in 2012, compared to 2009.

Boutiques, on the other hand, remained strong through the financial turmoil of 2008 and benefited directly from the weakening of bulge-brackets in 2009. Since then, their dollar fees earned have increased at a marginally higher CAGR of 22 percent compared to that of bulge-brackets, suggesting that their relative and absolute growth is likely more than an aberration. In fact, some boutiques have also been displaying deal-activity attributes similar to bulge-brackets, often competing aggressively in the latter's territory.

To sum up, while bulge-brackets stumbled during the financial turmoil, boutiques remained steady. And although both have been performing well enough in their respective capacities since 2009, boutiques' resilience has in part challenged bulge-brackets to attain the relative highs of 2007.

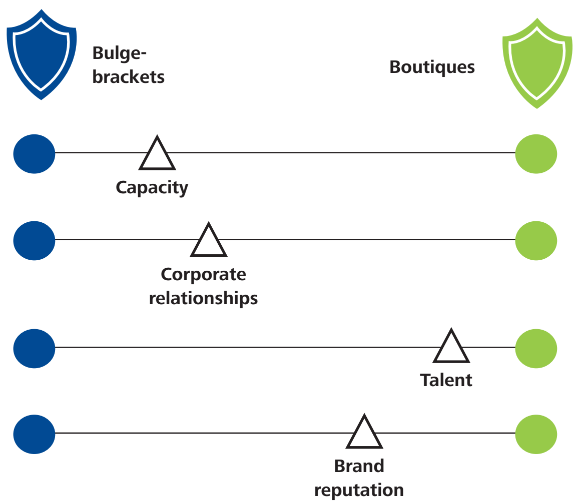
Having analyzed the competitive landscape, it becomes imperative to ask what factors have influenced the relative positions of bulge-brackets and boutiques, especially in the last four to five years. Where is the balance of factors now and how is it likely to shift? And which, if any, of the competing groups might the shift benefit?

[14] Thomson Reuters M&A database.

The balance of factors

Some advisory firms simply have top-of-mind association among potential clients. Understanding some of the key elements of success in M&A advisory is essential to assess the business' competitive dynamics. Speaking broadly, these factors are **capacity, corporate relationships, talent, and brand reputation.** Exhibit 5 shows how current dynamics in these factors tend to favor bulge-brackets over boutiques, and vice versa.

Exhibit 5. Key success factors and relative competitive advantage



* The sliding scale is a qualitative assessment of how much current trends in each factor currently favor an institutional type. The positioning of the triangle indicates the degree of advantage an institution has over a competitor with respect to a particular factor. The closer the triangle is to one end, the more trends in that factor favor that player. The positions are made based on subject matter specialists' assessments and analysis of a broad range of market sources.

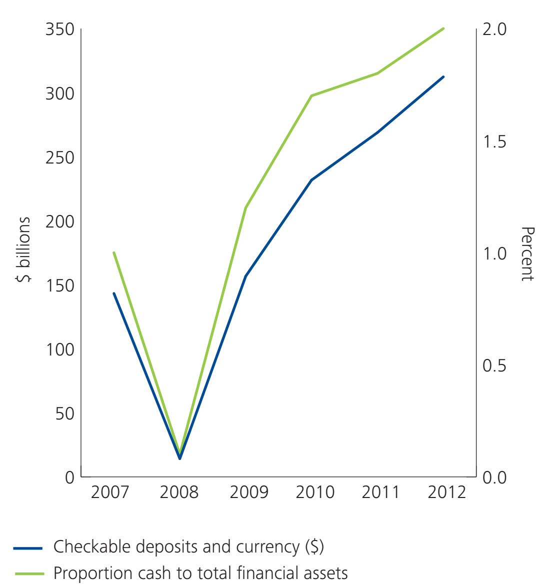
Source: Deloitte Center for Financial Services

1. Capacity: Bulge-brackets strong, but potentially challenged by diminished funding role

Global reach and large teams of M&A professionals give bulge-brackets capacity to advise on more engagements than boutiques. Moreover, funding, as a core element of M&A transactions, is one of the distinguishing services bulge-brackets can offer — especially in large deals. Their balance-sheet strength enables bulge-brackets to underwrite securities on a firm commitment basis or even directly finance the acquisition, sometimes making them indispensable to such large deals. According to Peter Weinberg, cofounder of Perella Weinberg Partners, "The boutiques should have a meaningful share of the M&A market, but not half, or even close. The big firms have a critical role to play, particularly on the financing side."[15]

However, the financial turmoil may have reduced the importance of funding to deal execution. Only 29 percent of the executives surveyed in the Americas region considered an investment bank's ability to provide financing as important while selecting an advisor, reflecting a decline in the relative benefits of large balance sheets for bulge-brackets.[16] One reason could be a significant decline in the number of large deals (170 deals valued at $1 billion or above in 2012, compared to 304 such deals in 2007), reducing the need for bulge-brackets' funding.[17] Another reason for this trend may be corporations' greater cash reserves (Exhibit 6), which in turn have the potential to reduce the role of debt financing in M&A. In addition, the stock-for-stock nature of some deals might not require funding at all, playing to boutiques' advantage.[18] Finally, when firms do require funding, low interest rates have

Exhibit 6. Cash holdings of U.S. nonfinancial corporations, 2007-2012



Source: Federal Reserve Flow of Funds

[15] Michael J. De La Merced, "In latest deals, big roles for boutique investment banks," *New York Times,* August 22, 2011.

[16] "2013 Outlook for investment banking services," *Freeman Consulting and Thomson Reuters*, 2013.

[17] Thomson Reuters M&A database.

[18] Michael J. De La Merced, "In ad merger, a boon for two smaller banks," *New York Times*, July 29, 2013.

made financing easier. The multiple-advisor trend also has an impact: Corporations can engage boutiques for their advice, and those boutiques can then help find another bank — not even necessarily a bulge-bracket — for deal financing.

Capacity, especially in funding, is expected to continue to be a bulge-brackets strength. But recent trends appear to make it less so. Interest rates seem likely to remain low through 2014.[19] Moreover, corporate cash holdings appear to have stabilized at high levels, presaging a potential flood of cash deals once buyers have sufficient confidence — deals in which boutiques may be more competitive than otherwise. That said, in the longer term, rising interest rates will likely accompany diminished cash reserves, tilting the scale back toward bulge-brackets. Balance-sheet strength could become more important again as the economy improves and the appetite for bigger, global deals comes back.

2. Corporate relationships: Where bulge-bracket banks shine

Bulge-bracket banks' broad portfolio of products and services allows them to leverage preexisting corporate relationships to cross-sell advisory services. Similarly, corporate clients are also likely to prefer working with an important and trusted business partner.

Although boutiques may leverage the corporate relationships of their key bankers, the smaller scope of their service offerings often means that they have limited opportunities to gain complementary business from existing customers.

The balance of favor in corporate relationships is not expected to shift away from bulge-bracket banks, which will likely continue to benefit from multiple corporate relationships. But as some boutiques grow, they may broaden the breadth of their services and professional reach. Other boutiques may develop highly specialized reputations that mean they could partake most business within their niche.

3. Talent: Boutiques' recent advantage

Large teams of experienced talent may give bulge-brackets a firm hold on many large and complex deals. However, the notion that bulge-brackets might be putting their junior and less experienced staff to work on small- to medium-sized deals might push some clients toward boutiques. In addition, many bulge-brackets are experiencing a critical talent retention challenge.

The last six to seven years have been marked by a talent drain from many bulge-brackets.[20] Apart from moving from one bulge-bracket to another, professionals at many levels have joined existing boutiques, set up their own shops, or shifted to a different industry altogether. From the talent migrating to smaller advisory shops, boutiques have not only gained deal-making skills and specialized industry knowledge, but also bankers' business relationships and contacts. Many bulge-brackets are worried about losing the fight for talent — both junior and senior — to boutiques, as they now essentially "compete for the same talent," in the words of Mark Eichorn, cohead of investment banking at Morgan Stanley.[21]

Four main factors are likely to have contributed to talent migration from bulge-brackets to boutiques:

- **Layoff pressure at bulge-brackets:** Some M&A professionals at bulge-brackets have faced reduced job security since the financial turmoil, as their banks struggled to justify high staff levels amid declining revenues.[22] In this situation, a shift to a boutique may have become more attractive to many talented advisors.

- **Compensation considerations:** Regulatory pressures and shareholder opposition have forced bulge-brackets to impose restrictions on executive pay, including clawback provisions and compensation deferrals.[23] On the other hand, boutiques — operating below the regulatory radar — are luring talent from bulge-brackets by offering attractive compensation packages, evident in their higher compensation ratios.[24] In addition to cash, the use of share-based compensation may offer a greater incentive at boutiques (whether public or partnerships) because of the tighter

[19] Recent FOMC statements (June 19 and July 30, 2013) indicate rates will remain between 0 and .25 percent until the unemployment rate drops to 6.5 percent, which, according to economic projections from the June 18-19 meeting, is likely to occur in 2014.

[20] Lauren Tara LaCapra, "Wall Street executives fret about talent drain," *Reuters,* January 27, 2013.

[21] Aaron Lucchetti, "Morgan Stanley exec says boutiques may be hurting recruiting," *Wall Street Journal*, May 30, 2013.

[22] Christopher Alessi, "Investment banking boutiques are on the rise," *Institutional Investor,* May 24, 2011.

[23] Donald Delves, "Clawback requirement removes board discretion," *Forbes*, July 14, 2011.

[24] David Benoit, "Comp ratios at I-banks: How Goldman stacks up to boutiques," *Wall Street Journal*, March 27, 2012.

connection between individual performance and firm profitability. In contrast, advisors' performance at bulge brackets may be offset by poor results in other business lines, potentially diminishing bulge-brackets attraction for top talent.

- **Prestige:** M&A advisory often accounts for a smaller share of revenues than trading does at the bulge-brackets. M&A bankers may not feel like a core part of a bulge-bracket, especially when boutiques may offer them a more partnership-oriented culture, implying greater significance, independence, and power to pursue client relationships.[25] According to a bulge-bracket banker who eventually shifted to a boutique in 2007, "At a big bank a lot of time you become a salesman of securities and other financial products. I really missed spending time with clients."[26]

- **Low barriers to entry:** Advisory may be less capital-intensive than other lines of businesses, such as trading, which typically requires heavy investment in technology, or lending, which demands a large balance sheet. For some rainmakers at bulge-brackets, it is generally not so difficult to start their own advisory boutique by leveraging prior client relationships to win advisory work, potentially earning more, as well as increasing control over their own careers.

In both the near and medium term, talent drain is likely to be an issue without an easy solution, given continued regulatory scrutiny, the complexities of talent management, and shareholder or organizational constraints on compensation. Given these hurdles, boutiques are expected to maintain this advantage over bulge-brackets.

4. Brand reputation: The power of the independent advisory model

The likelihood of large investment banks being chosen in advisory roles for future engagements depends at least in part on their past market share and league table rankings.[27] A history of top rankings and a rich experience in the field have often helped bulge-bracket banks win advisory business. However, the past financial turmoil tainted the reputation of some bulge-brackets — many of which have been accused of putting their interests before that of clients.

Boutiques, on the other hand, by the nature of their limited operations, are often free from conflict of interest between advisory services, lending, and trading. In addition, clients' desire for industry specialization may play to boutiques' advantage. Sixty-nine percent of the executives surveyed in the Americas region considered an investment bank's industry knowledge critical while selecting an M&A advisor.[28] Since many boutiques specialize in a particular industry, this client priority could work in their favor.

The independent advisory operating model is expected to favor boutiques as long as bulge-brackets continue to face criticism for their role in the past financial turmoil and potential conflicts of interest. Yet eventually, this advantage may shift toward the mean as bulge-brackets regain their lost reputation.

[25] Julie MacIntosh, "Back to the old school," *Financial Times*, July 15, 2009.

[26] Christopher Alessi, "Investment banking boutiques are on the rise," *Institutional Investor,* May 24, 2011.

[27] François Derrien and Olivier Dessaint, "The effects of investment bank rankings: Evidence from M&A league tables," January 2013.

[28] "2013 Outlook for investment banking services," *Freeman Consulting and Thomson Reuters*, 2013.

Macroeconomic fundamentals: Friend or foe?

In addition to the four factors identified above for competitive success, economic fundamentals — such as GDP growth and confidence in the economy — also influence the competitive balance by affecting deal activity. Keeping other factors constant, a robust M&A market may benefit bulge-brackets, as larger deals become more common. Yet a strong deal market could also provide growth opportunities for boutiques.

In contrast, a weak deal market akin to that of the last few years may harm bulge-brackets deal volumes more than boutiques deal volumes. Bulge-brackets may suffer without a consistent flow of large deals to sustain their advisory revenue. In contrast, boutiques may still be in higher demand for their industry knowledge and independent services among the segment of clients who value these attributes. However, even if their volumes are not as affected by a weak recovery, analysts expect reduced deal numbers to be especially bad for boutiques from a profit perspective, as it threatens the sustainability of businesses that depend largely on advisory fees for revenue.[29] Therefore, continued weakness, especially in small- and mid-cap deals, could mean bottom-line pressure for nondiversified boutiques even as they perform well in league tables.

The success factors and economic fundamentals together help determine the degree to which a player enjoys a net competitive advantage over the other. The direction of both will likely drive the future of competition between bulge-brackets and boutiques.

[29] Brett Philbin, "Deal-making drought is bad news for M&A boutiques," *Wall Street Journal*, July 2, 2013.

The next stage of the battle

Near-term possibilities: Boutiques expected to continue their growth momentum

Strong M&A volume in the latter half of 2012, record cash balances, cheap debt, and rising stock markets — along with some predictions of strong economic performance — helped boost the market's optimism about a resurgence in deal making in 2013. Yet, despite having at least some of the essentials for M&A activity in place, the first half of 2013 (1H13) did not meet the high expectations. In 1H13, deal activity was flat YoY in dollar terms, and the number of deals was down by 2 percent compared to 1H12.[30] Moreover, the industry earned just $4.2 billion in advisory fees in 1H13, a 21 percent YoY decrease from $5.3 billion in 1H12.[31] The Federal Reserve's comments, suggesting cutting back on bond purchases later this year or in early 2014, have increased market volatility and reduced corporations' confidence in valuations — some are wary of overpaying for acquisitions or selling too cheap. With this market uncertainty expected to linger through the rest of the year, M&A volume is likely to remain near its current level.

While some analysts expected boutiques to underperform in this sluggish deal environment, the small advisory firms maintained their share at 32 percent of the top 25 players' fees in 1H13 compared to 31 percent in 1H12.[32] In part, they are benefiting from several European bulge-bracket banks' continuing reduction of their U.S. presence due to competitive and regulatory pressures. Going forward, boutiques' business model may continue to entice both clients and dealmakers from bulge-brackets — at least in the near term.

Although top bulge-brackets will likely maintain their overall dominance by virtue of their size, the situation may demand their making improvements to counter boutiques' current momentum in key success factors.

Medium-term possibilities: Bulge-brackets leverage scale and financial muscle to reinforce dominance

Deal activity is expected to return to form over the next four to five years, driven by reduced market uncertainty, high CEO confidence, and limited organic growth opportunities. In addition, funding will potentially regain importance, as excess cash reserves are exhausted and corporations more actively seek out M&A targets.

If bulge-brackets efforts to improve brand reputation and retain talent are reasonably effective, strong deal activity may draw clients to their scale and funding capabilities. In order to maintain their new strength against a resurgent bulge-bracket, boutiques may have to go beyond simply maintaining their momentum in talent and brand reputation in the medium term.

[30] Thomson Reuters M&A database.

[31] Ibid.

[32] Ibid.

[33] Jed Horowitz, "Analysis: Big M&A banks move down-market in hunt for fees," *Reuters*, May 25, 2012.

Strategies and tactics

As the balance of favor in near- and medium-term outlooks appears to indicate, bulge-brackets' focus areas probably deserve more immediate attention, whereas boutiques' are longer-term strategic considerations.

Focus areas for bulge-brackets: Addressing challenges in talent and reputation

Many bulge-brackets have adjusted to the challenging large-deal environment by expanding their mid-market efforts, in part emulating the boutiques with which they compete.[33] While this strategy will potentially expand their market and fee share (as the mid-market is the second-most active deal territory),[34] other changes and improvements may also be required.

Two main focus areas are attracting/retaining talent and maintaining the sanctity of the advisory business model. As bulge-bracket banks move to reinforce these weak points, they may wish to consider the following priorities:

- **Talent:** Some talent challenges for bulge-brackets may diminish with a more robust deal-making environment that can better support compensation growth. But firms should act on some of the root causes of their lost momentum in talent. In some instances, they may wish to consider emulating boutiques by reworking current practices to better incentivize entrepreneurial attitudes and improve retention. Because banks often have limited room to move on financial incentives, non-financial and intangible rewards have gained importance. Increasing the diversity of assignments, providing a clear career path to senior positions within the group or the firm, and other career-enhancing steps might help improve bulge-brackets' attraction for their key assets.

  Another priority might be improving retention and deepening the "pool" of midlevel talent, in part by applying the tactics mentioned above. This could directly improve future senior-level talent and mitigate the impact of senior departures. Deepening the mid-level bench typically requires renewed investment in recruiting lower-level talent and creating long-term career growth opportunities for experienced bankers; efforts to provide the career growth opportunities of a smaller firm within a big one may support these initiatives.
- **Brand reputation:** The appropriate strategy to address reputational challenges may vary depending on the specific situation of each bank, but certain principles are likely to be common across institutions. Bulge-brackets should not cede the "independent" label to boutiques; they should strengthen public efforts to reduce the appearance of conflict between advisory and other businesses. But as clients gain increased confidence in the integrity of their advisors, bulge-brackets should also showcase their capacity to offer complementary services. Achieving the tricky balance between pitching independence and complementary services may be challenging but essential to improving bulge-brackets' competitive position.

Focus areas for boutiques: Building scale and scope over the medium run — without threatening the independent brand

Some boutiques have already taken many steps to safeguard advantages in the talent area, particularly in terms of retention. (For example, emphasizing deferred compensation arrangements such as restricted stock units.)

But these tactics might not be enough to determine their long-run success. Keeping this in mind, boutiques may wish to focus on these areas:

- **Scale:** For a select group, building scale will likely be a strategic priority; without it, efforts to compete toe-to-toe with bulge-brackets may meet with limited success. While boutiques generally cannot match the capacity of bulge-brackets, increasing team size and geographic reach can set them up to compete for a larger number of bigger deals. Consolidation will likely be an important driver enabling boutiques to build scale.
- **Diversification:** The cyclical nature of the M&A business can make sustaining a firm through peaks and troughs difficult. Diversification is one potential remedy for earnings volatility at boutiques.[35] Although pure advisory specialists are expected to continue to exist, some boutiques are positioning themselves between a simple advisory model and the diversified bulge-bracket archetype. Boutiques often have a range of options, from basic diversification within advisory across industries and services such as restructuring to expansion into less volatile or complementary business lines — including private equity and alternative financing arrangements.[36] But whichever strategy boutiques pursue, they may have to be careful not to jeopardize the independent, specialized identity that is one of their key competitive strengths.
- **Ties with funding providers:** Given expectations of a growing need for funding, boutiques that strategically engage with firms having lending capabilities will likely stand a better chance of advising on large deals that require financing.

[34] Thomson Reuters M&A database. An average of nearly 27 percent of the deals above $5 million between 2009 and 2012 were in the mid-market range ($100 million-$500 million), second only to small-sized deals ($10 million-$50 million) that garnered an average of 35 percent of deal activity during the stated period.

[35] Julie MacIntosh, "Back to the old school," *Financial Times*, July 15, 2009.

[36] Ibid.

Conclusion: The fortunes of war

Bulge-brackets and boutiques often battle for M&A business on numerous fields: industries, markets, and different types of deals. For the past four to five years, the currents of battle seem to have flowed in favor of boutiques, and they may continue to do so in the near future.

But if bulge-brackets find and deploy new strategies against their competitors, they may be able to regain some of the lost ground. Expanding advisory in the small- and mid-cap market may be a worthwhile strategy, but the situation likely demands more. Two areas stand out: managing the talent base and improving negative perceptions regarding potential conflicts of interest among their various businesses. These strategies may require new weapons, whether in the form of innovative retention policies, creative brand-positioning strategies, or other developing tactics.

Even a partially successful counteroffensive by bulge-brackets will likely require boutiques to marshal their strongest reserves to consolidate their gains as the deal environment may turn in a favorable direction for bulge-brackets in the medium term.

The stakes are high: M&A business often matters to bulge-brackets for revenue contributions, and perhaps even more for relationship building and prestige. For the less diversified boutiques, consistently strong performance may be a matter of life and death. Excess capacity in the industry will likely lead to consolidation, and boutiques with limited global networks and more narrowly focused experience may be at a disadvantage.

The often subtle battle between bulge-brackets and boutiques could intensify as different players seek and expand their respective advantages in the future. To win the day, each institution should make sure it has a clear strategy for the next stage of the campaign.

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