

EUROPEAN ASSET MANAGEMENT STUDY 2020

Treading on thin ice?

Rethinking strategy in an uncertain world



Key results of our study

- 1** The single biggest issue facing the industry in 2020 is pressure on profitability.
- 2** Environmental, social and governance (ESG) factors are increasingly important. To follow ESG principles will not serve as a differentiator but will become a necessity.
- 3** Success factors include a broad distribution network, specific investment expertise and the ability to leverage economies of scale.
- 4** The industry outlook for the next 5 years is rather negative. Asset managers must focus on their core competencies to ensure profitable growth.
- 5** A business-as-usual mindset will only make matters worse. To be successful, a disruptive approach is called for.

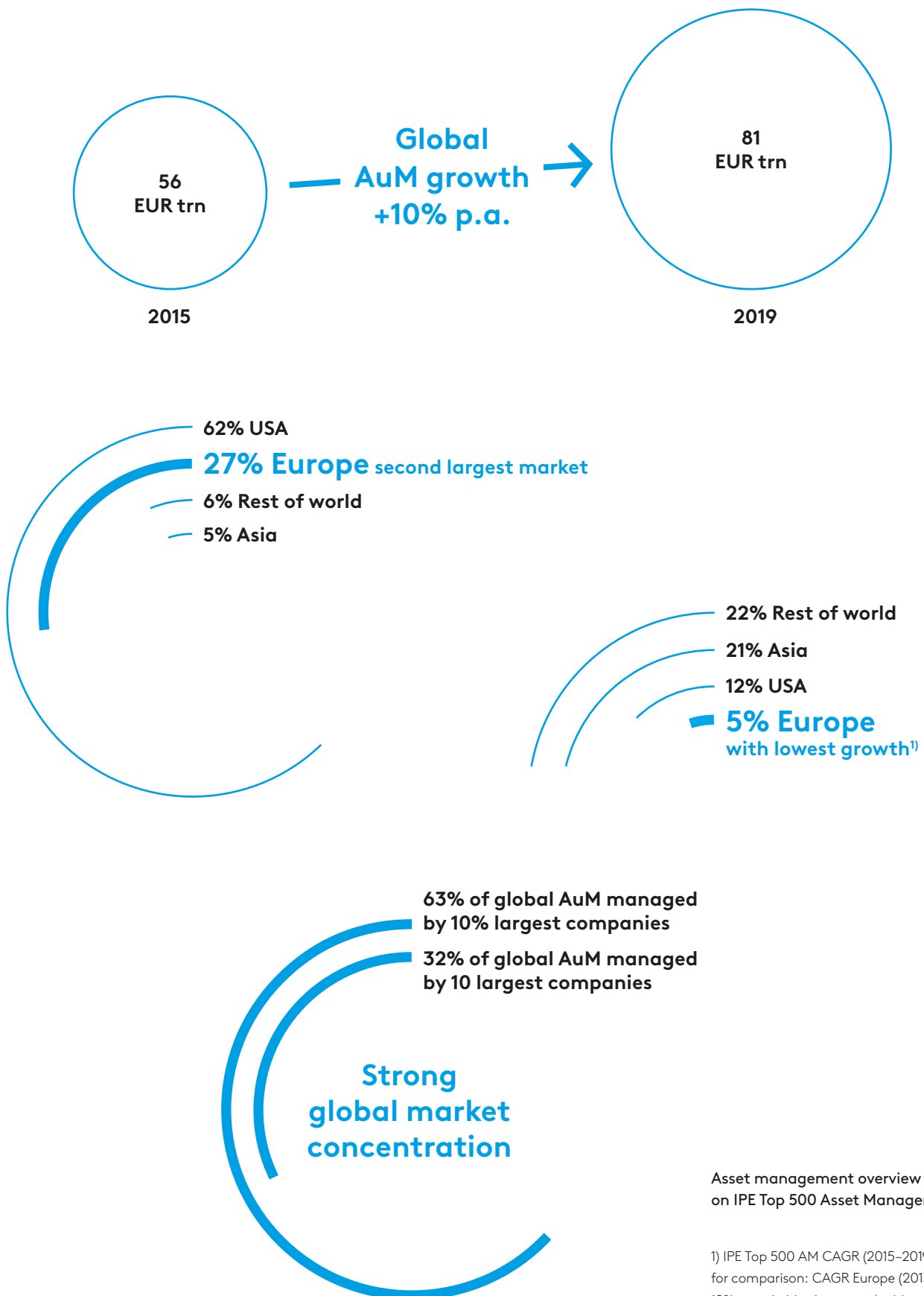
What's in it for you?

Since our last survey at the beginning of 2019, which analyzed the European asset management industry over the period of 2013–2017, **the fundamental environment for the global economy has altered at a speed hitherto unimaginable**. But even prior to the coronavirus crisis, there was a need for action by asset managers to ensure profitable, future-proof business. As we saw in our 2019 study, the industry had been lulled into a false sense of security – a comfort zone in which asset managers no longer continuously reviewed their competitiveness and adjusted their business accordingly.

In this study we present data from our new survey of asset managers with a strong European footprint. We have updated our five-year analysis of the asset management industry from 2013–17 to 2015–19. In addition, **we offer you a simulation of what the future may hold** as the global economy begins its slow recovery from the pandemic, looking at the impact on profitability and growth for different types of players and asset management business models.

In many ways, COVID-19 has acted as a wake-up call for the European asset management industry. It has thrust a powerful spotlight onto the cost issues that already plagued the industry and it has sped up many of the trends observed in past studies. For years now, asset managers have been discussing these issues and challenges, but little has been done. Now, more than ever, they need to take action if they wish to avoid slipping from their comfort zone into a danger zone.

Asset management 2020: growing and concentrated



Asset management overview based on IPE Top 500 Asset Managers

¹⁾ IPE Top 500 AM CAGR (2015–2019) p.a.; for comparison: CAGR Europe (2013–17) = 12% p.a.; AuM = Assets under Management; CAGR (Compound Annual Growth Rate); Source: zeb.research

From comfort zone to danger zone?

Life before and during COVID-19

Asset management expanded globally at a rate of around ten percent a year in the period from 2015 to 2019, continuing a trend seen in 2013–17 (14 percent). Total assets under management were around EUR 81 trillion in 2019, considerably up on their level in 2017 and 2018. The degree of concentration in the global asset management industry is now even higher than in our 2019 study, with the ten largest companies accounting for around one third of the market and the ten percent largest players for almost two thirds. Europe continues to represent the second-largest market in the world, home to 27 percent of total assets under management, second to the United States, which represents 62 percent of the market. However, Europe also shows the lowest rate of growth, with a five percent CAGR in 2015–19, down still further on 2013–17 (12 percent).

Underlying global megatrends – the expanding middle class, the rising number of high net worth individuals (HNWIs), the ongoing shift from deposits to financial assets, increases in life expectancy, longer pension terms – look set to drive assets and flows long term, despite the current crisis. These trends are supported by other worldwide developments such as increasing urbanization, growth in non-residential and infrastructure investment, and recent economic stimulus and public investment programs, which have significant private financing requirements, providing investment opportunities for asset managers.



The biggest issue facing the industry remains the pressure on profitability. This has a number of causes, many of them already observed in our previous studies and likely to remain a factor for the foreseeable future. Fees are under pressure as a result of poor performance, increased transparency and the continued success of passive investments. Costs are still too high and are even rising in order to keep pace with regulation and digitalization, as well as burgeoning customer demands. Competition in the industry remains fierce as concentration continues, and broad access to distribution platforms is vital, plus the ability to carve out a distinctive profile on those

platforms. New players, especially Big Tech companies, are expected to enter the asset management arena, as they have done for banking. As we saw in previous studies, simply expanding in segments offering higher revenue margins is no guarantee of increased profitability, as having a larger share of segments such as retail or alternatives is often associated with higher operating costs.

To identify how the industry has changed over the last two years in terms of key performance indicators (KPIs) and success factors, and which levers managers should now be considering, zeb has

"Asset managers' fees are under pressure. But people are living longer – and they're keener than ever to make the most out of their money."

Arnd Heßeler,
Executive Manager, Luxembourg



carried out a new survey with the support of Morningstar. As in our previous study, we canvassed 44 asset management firms, differing in terms of their size and business model but all of them with a strong European footprint. Together, these firms manage assets of EUR 34 trillion, representing around one third of the total global asset management market.

Details of the sample are given at the end of this chapter. → p. 16/Fig. 1 & p. 17/Fig. 2

No change: the cost trap is still the key issue

Despite growth in assets under management of eight percent a year since 2015 in our sample, profit margins fell to just under ten basis points in 2019 driven by a declining revenue margin. → p. 18/Fig. 3

The cost income ratio (CIR) has remained remarkably stable since the beginning of our analyses, at around 67 percent, mainly benefitting from the growth of assets compensating for lower fee levels. Since 2015, the industry's absolute costs have been high; they were almost stable until 2017, then rose further still from 2018 as the market expanded. Nevertheless the cost margin declined – mainly due to the underlying AuM growth in the same period. If we assumed no growth in assets under management since 2015, however, the cost margin would have increased to 27 bp resulting in a profitability margin of only 3 bp. In essence, the industry is not addressing its absolute cost base. Cost growth exceeds revenue growth for most asset managers and, accordingly, profits are increasingly falling. → p. 19/Fig. 4

Success factors:
stay in the safe zone!

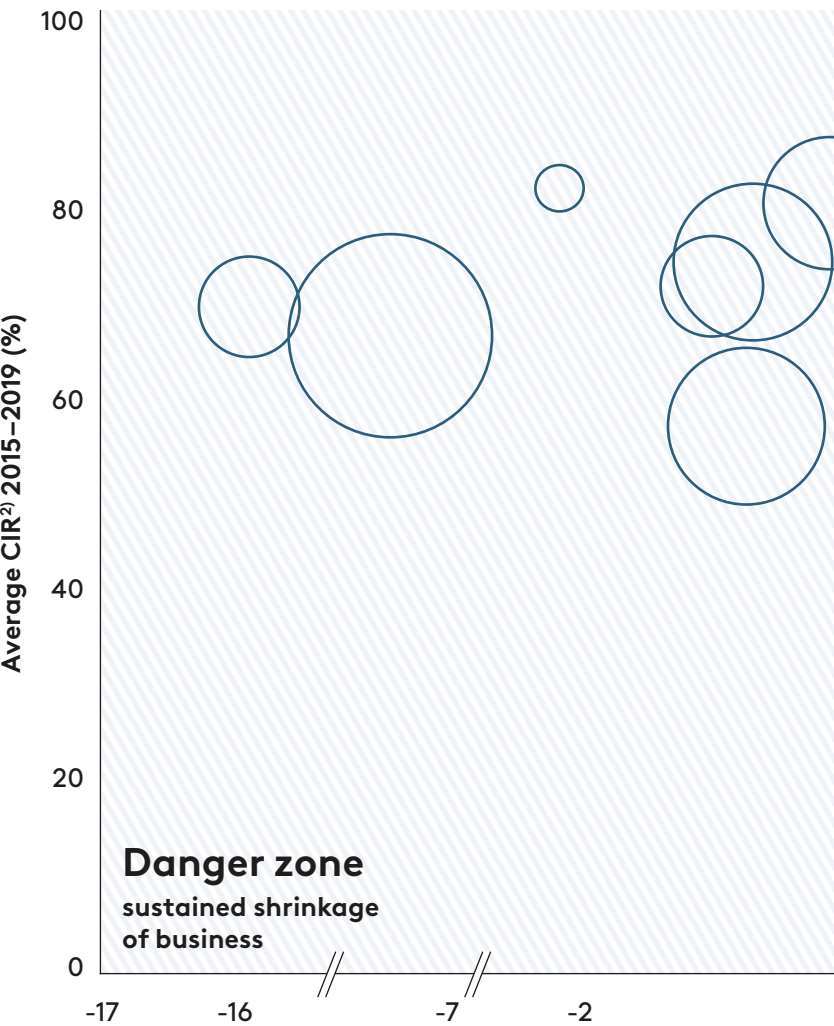
A few asset managers – but not many – were able to attract new business at the same time as increasing their profitability in the period from 2015 to 2019, as shown in the figure below. These successful players appear in the bottom right-hand quadrant of the profitability/growth matrix: the safe zone.

Successful players come in different shapes and sizes and pursue a variety of investment philosophies.

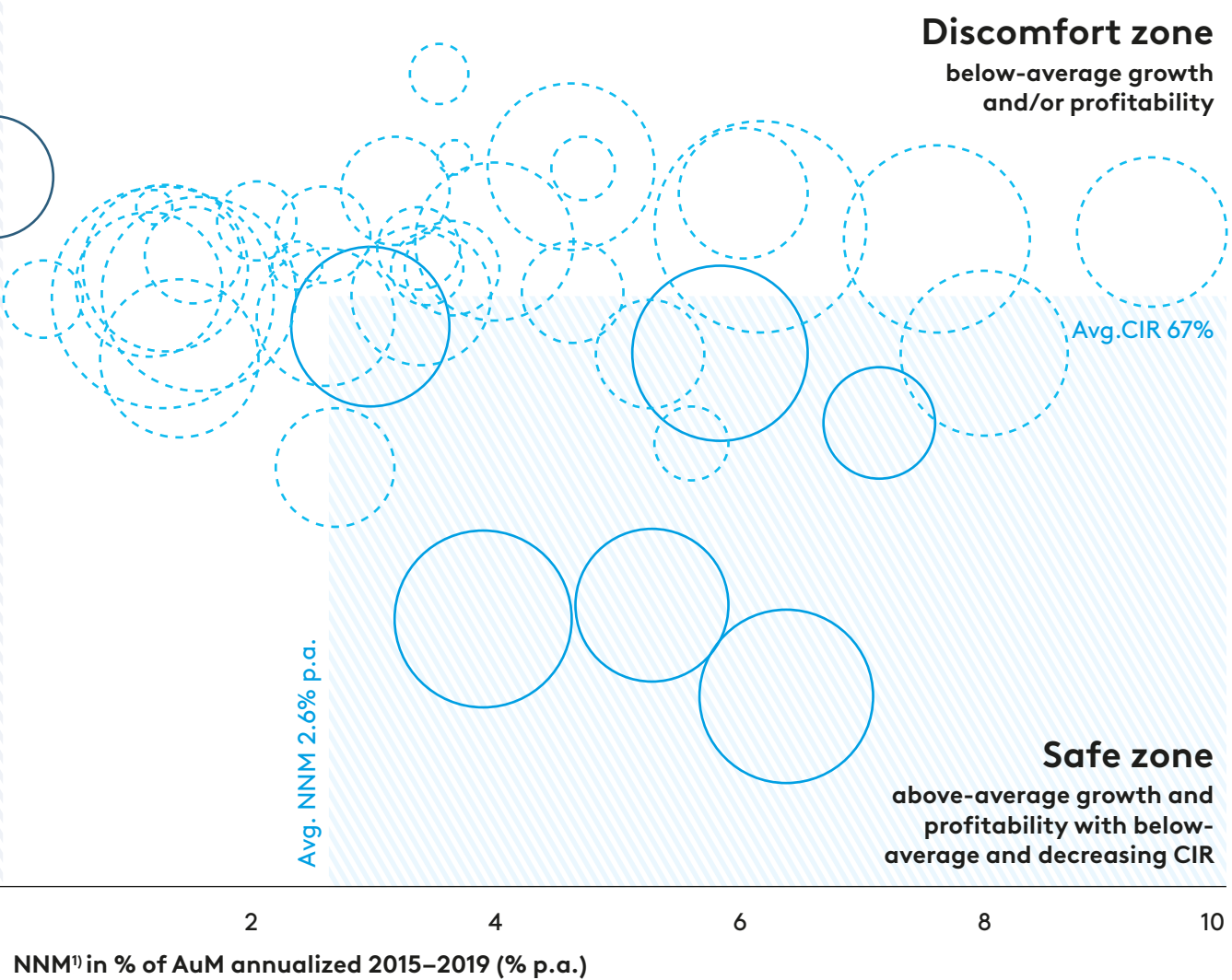
What they have in common is their broad distribution network (whether through captive channels, distribution agreements or partnerships), their investment expertise focused on specific asset classes / investment strategies, and their ability to leverage economies of scale and shared capabilities. For example, some global players have established distribution networks in strong growth markets in Asia, especially China and India, either directly or via partnerships and joint ventures. Other, local players have a strong local captive distribution network in either the insurance or banking sector and provide high-quality services at the point of sale (POS), including sector-specific IT interfaces enabling a highly automated advisory, sales and settlement process. Still others have been busy expanding their distribution channels and scaling via acquisitions.

By contrast, companies with a less differentiated / focused business model and a corresponding lack of scalability – which is especially prevalent among mid-sized players – are located outside the safe zone. Interestingly, these companies are the same as in our previous study two years ago. Particularly striking is the fact that these companies, with only a few exceptions, saw their profit margins fall.

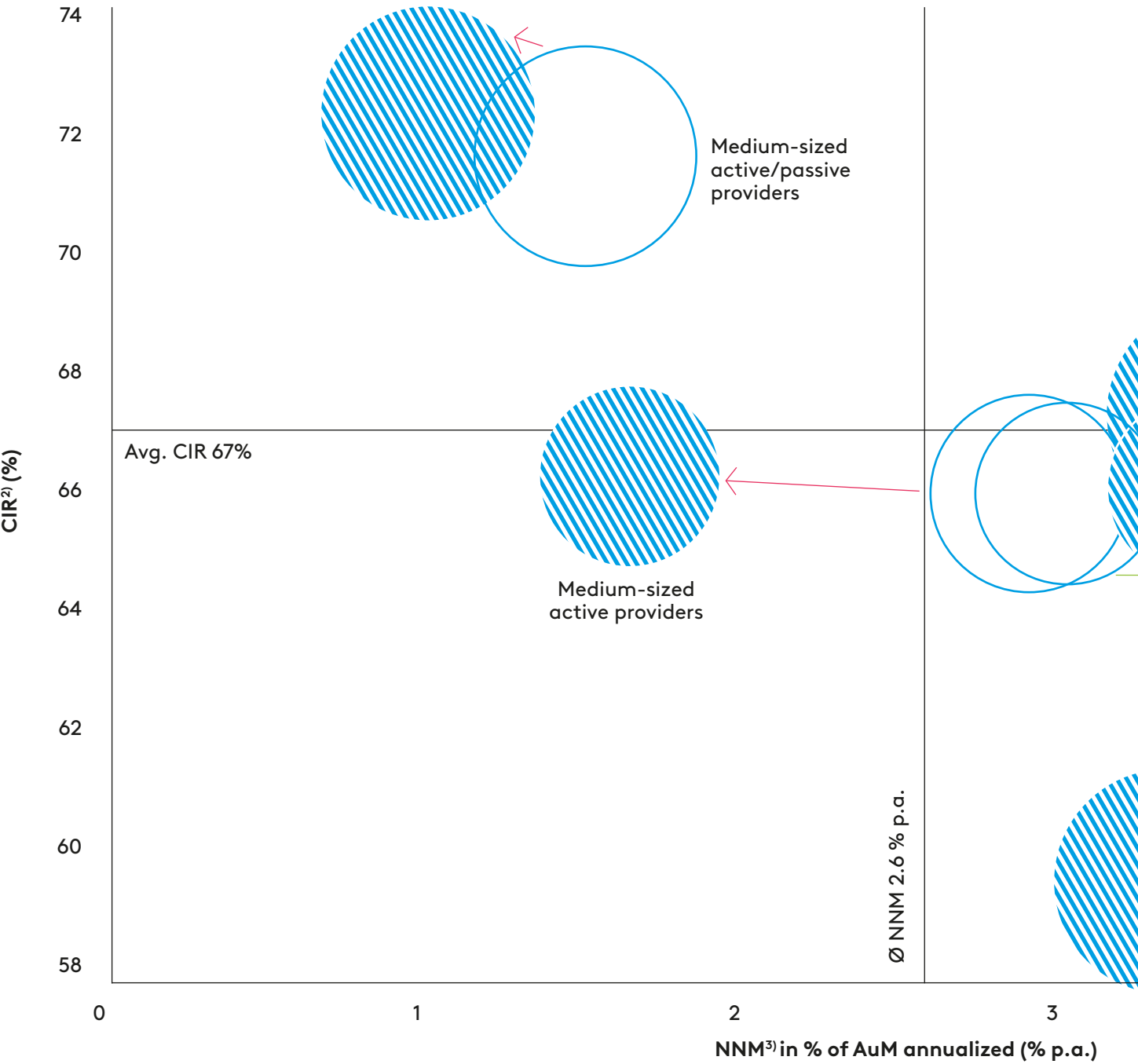
Profitability/growth matrix



at individual company level



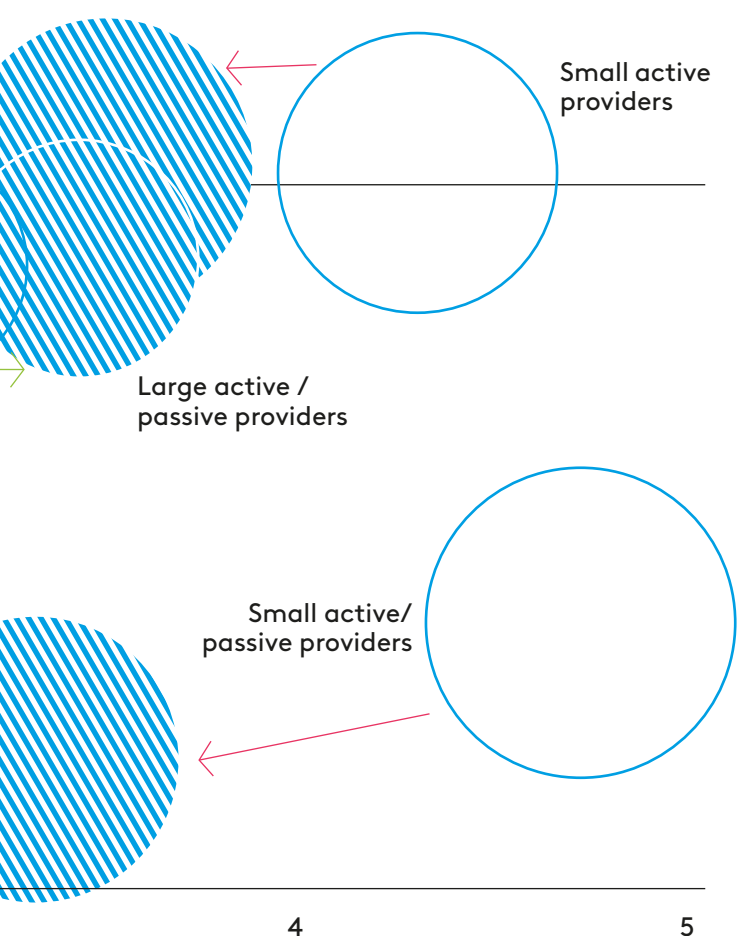
Profitability/growth matrix of various AM categories over time



Size matters: the winner takes it all

We are now in a position to compare the results of our new survey with the data for 2013–17. As shown in the figure on the left, we identify a negative trend for small and medium-sized asset managers and a further increasing market dominance of large providers.

Average profit margins fell for all categories of players apart from large providers (stable) and small active/passive providers (increased). Medium-sized providers saw the sharpest decline in net new money (NNM), which grew at a below-market rate. Mid-sized managers offering both active and passive strategies, which were already suffering from an above-average CIR, saw a decline in profitability, reflecting their less focused business models and limited scaling opportunities. Small providers experienced a decline in NNM, although this still grew at an above-market rate; at the same time, these players enjoyed greater profitability thanks to reductions in costs.



Only large providers grew at above-market rates while maintaining profitability at an almost constant level. This shows that the asset management industry is a “winner-takes-all” market and indicates a trend towards increased concentration in the future.

The main driver of asset growth in the five years prior to the coronavirus pandemic was market performance, accounting for almost 70 percent of growth. The remaining 30 percent was due to NNM, mainly invested in 2017 and 2019. In general, inflows are volatile and only really high when there is a strong year on the stock market.

→ p. 20/Fig. 5

Some 74 percent of the total NNM in our analysis period was acquired by just five large asset managers, while these players represent only 40 percent of the overall assets under management. All of these asset managers benefited – largely due to their significant passive product offering – an observation we already made in the period 2013–2017.

Passive investments continue their success story, attracting significant shares of NNM. Although passive investments only account for around ten percent of the assets under management in the Morningstar database, NNM was positive in Q1 2020 at +EUR 5 billion, while active funds suffered from outflows of EUR -127 billion.

→ p. 21/Fig. 6

○ 2017 ▨ 2019 → Positive trend → Negative trend
Circle size = profit margin¹⁾

NNM = net new money 1) last update: end of 2017 and end of 2019;
2) CIR = cost income ratio = operating cost / net income, Ø over 2013–2017 and 2015–2019; 3) NNM 2013–17 in % total AuM 2012 EoY or NNM 2015–19 in % total AuM 2014 EoY; Source: zeb.research; based on sample

One of the other key developments in the market, especially since 2018, is the rise of asset management in line with ESG (environmental, social and governance) factors. The increased emphasis on ESG factors is a reflection of the trend towards sustainability and social accountability.

ESG funds accounted for around 12 percent of NNM in 2016, but this had already grown to 50 percent by 2019.

In Q1 2020, as the impact of the COVID-19 crisis was felt, NNM invested in ESG funds was still positive (EUR +7 billion), even while other funds saw massive outflows (EUR -129 billion). According to Morningstar, the number of sustainable mutual funds and ETFs in Europe has grown to exceed 2,200 investment funds either committed to using ESG criteria in the selection of securities or aimed at delivering a direct positive ESG impact.

ShareAction is a non-profit organisation working to build a global investment sector which is responsible for its impacts on people and planet. We refer to their study of March 2020 called "Point of no Returns".

These figures represent the mutual fund market only. The demand of institutional investors for both ESG strategies and passive investments managed in segregated accounts or special funds is even more significant. Some experts forecast a total market share of 25% of passive investments by 2025 in Europe – slowly catching up with the conditions observed in the USA where passive may reach 50% of the total market in 5 years. Similarly, ESG investing can be considered mainstream in the institutional business and is estimated to account for more than 40% of all professionally managed assets around the world. In Europe, research from the Global Sustainable Investment Alliance estimates that ESG investments account for approx. USD 14 trillion corresponding to slightly less than half of total assets. → p. 21/Fig. 6

The most successful providers would appear to be those that have made ESG a core component of their strategy. Many players do so explicitly. For example, one company states that "sustainability is mission critical to us ..., both as an investor and as a company, and lies at the heart of our purpose and stakeholder relationships". Another states that it makes "inclusive capitalism" a guiding principle, investing to improve life, build a better society in the long term and create value. Indeed, a substantial number of companies aim to integrate ESG factors into 100 percent of their assets under management in the near future.

In many cases, however, it remains unclear what exactly these companies mean by ESG and what their level of ambition is in this regard: simply excluding investments not complying with their criteria, searching for best-in-class companies within each sector, or aiming to achieve a minimum level of impact through their investment decisions? Moreover, not all ESG claims are fully realized yet. In a critical review of ESG compliance of asset managers as organizations (and not just how they invest) conducted recently by **ShareAction**, no company achieved the best rating of AAA, which would indicate best practice in managing risks and opportunities as well as impact across all the areas of ESG considered. Two thirds of asset managers received a rating between C and E, indicating that most were still at the beginning of their journey towards ESG. → p. 21/Fig. 7

"Many asset managers claim to follow environmental, social and governance principles. But their claims are frequently more ambition than reality."

Wolfgang Schlaffer,
Partner, Munich



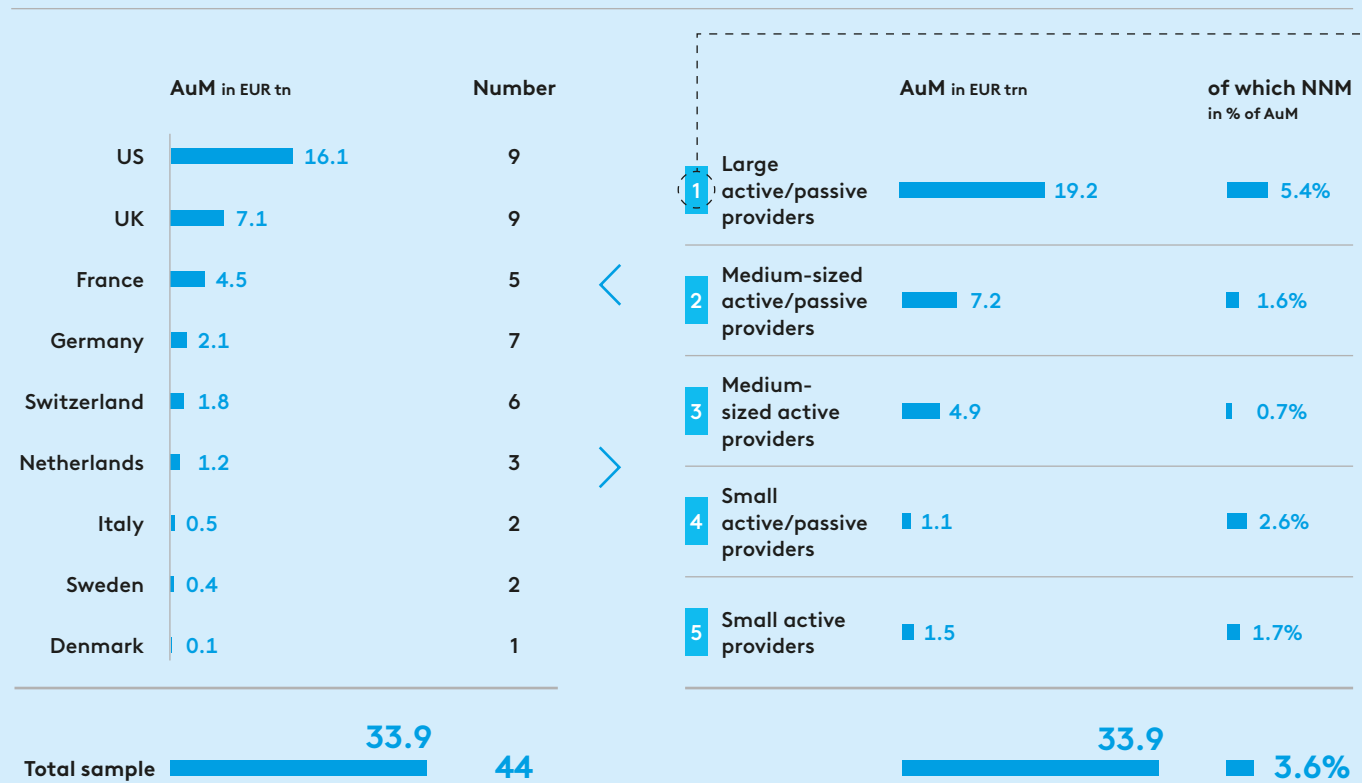
Of the 44 asset managers in our sample, 32 were also included in the review carried out by ShareAction. Of these 32, half were rated between C and E, and half A/B. Interestingly, we could not identify any clear correlation between a good rating by ShareAction and the position in our profitability/growth matrix, although the number of companies in question is too small to be statistically relevant. Nevertheless, just integrating ESG criteria is not enough to ensure success. → p. 22/ Fig. 8

We believe that in the upcoming post-pandemic period, ESG compliance will become a hygiene factor for asset managers rather than a differentiation factor.

Related facts and figures

Figure 1: Overview of study's AM sample | [← p. 9](#)

Sample includes 44 largest asset managers with a strong European footprint, managing assets of € 34 trn in total – five categories defined in terms of size and investment philosophy

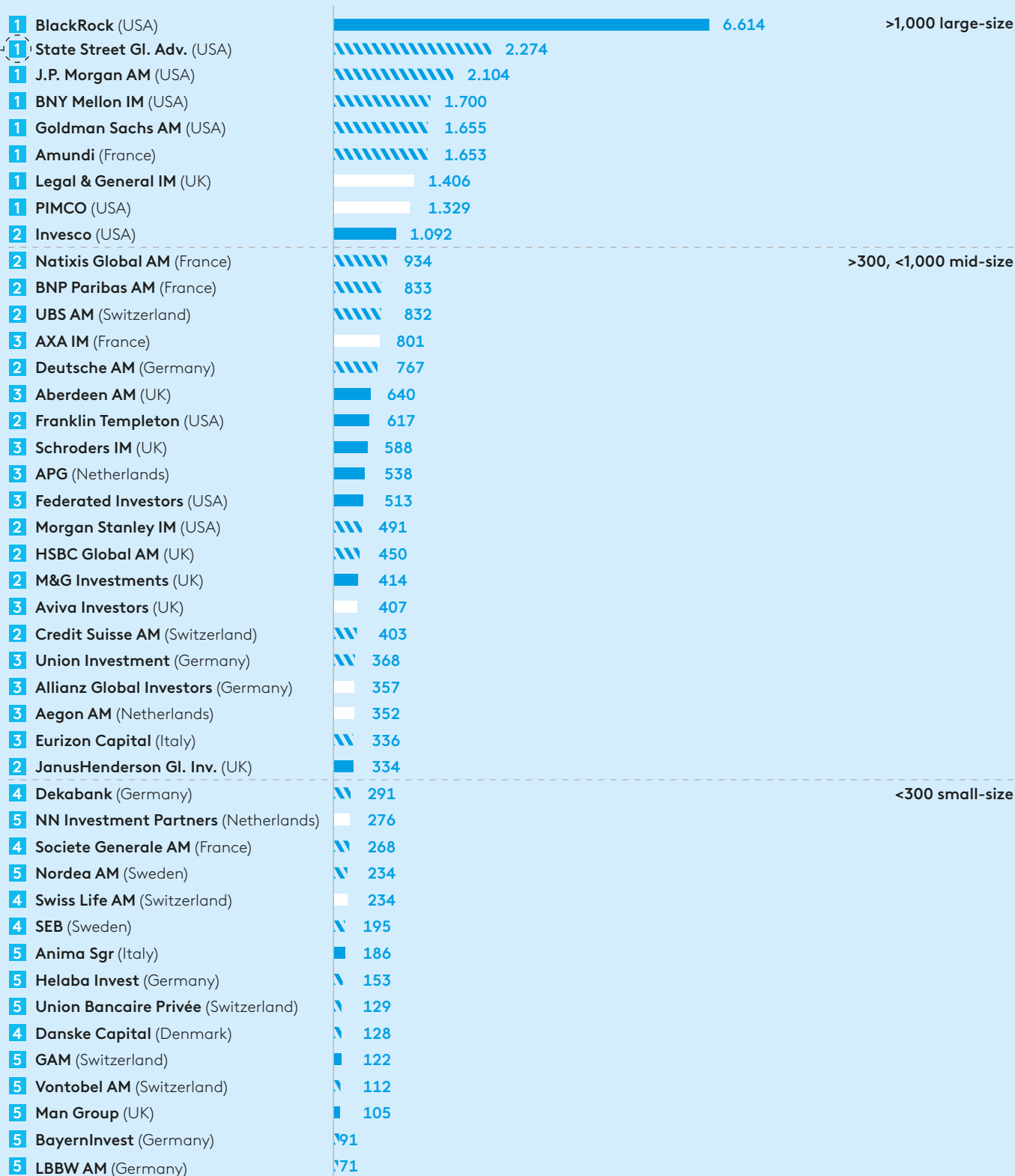


Source: zeb.research; as of 12/31/2019; definition of size classes of companies – small AuM: < € 300 billion AuM; medium: € 300 billion to € 1 trillion AuM; large: > € 1 trillion AuM (average AuM within analysis period)

Figure 2: Overview of study's AM sample | ← p. 9

Global AuM of AMs in the study with a volume of > EUR 100 billion to EUR 6.6 trillion – top 10 AMs by size dominated by global players with headquarters in the USA

Global AuM at the end of 2019, in EUR bn



■ Independent AMs ■ Bank captives ■ Insurance captives

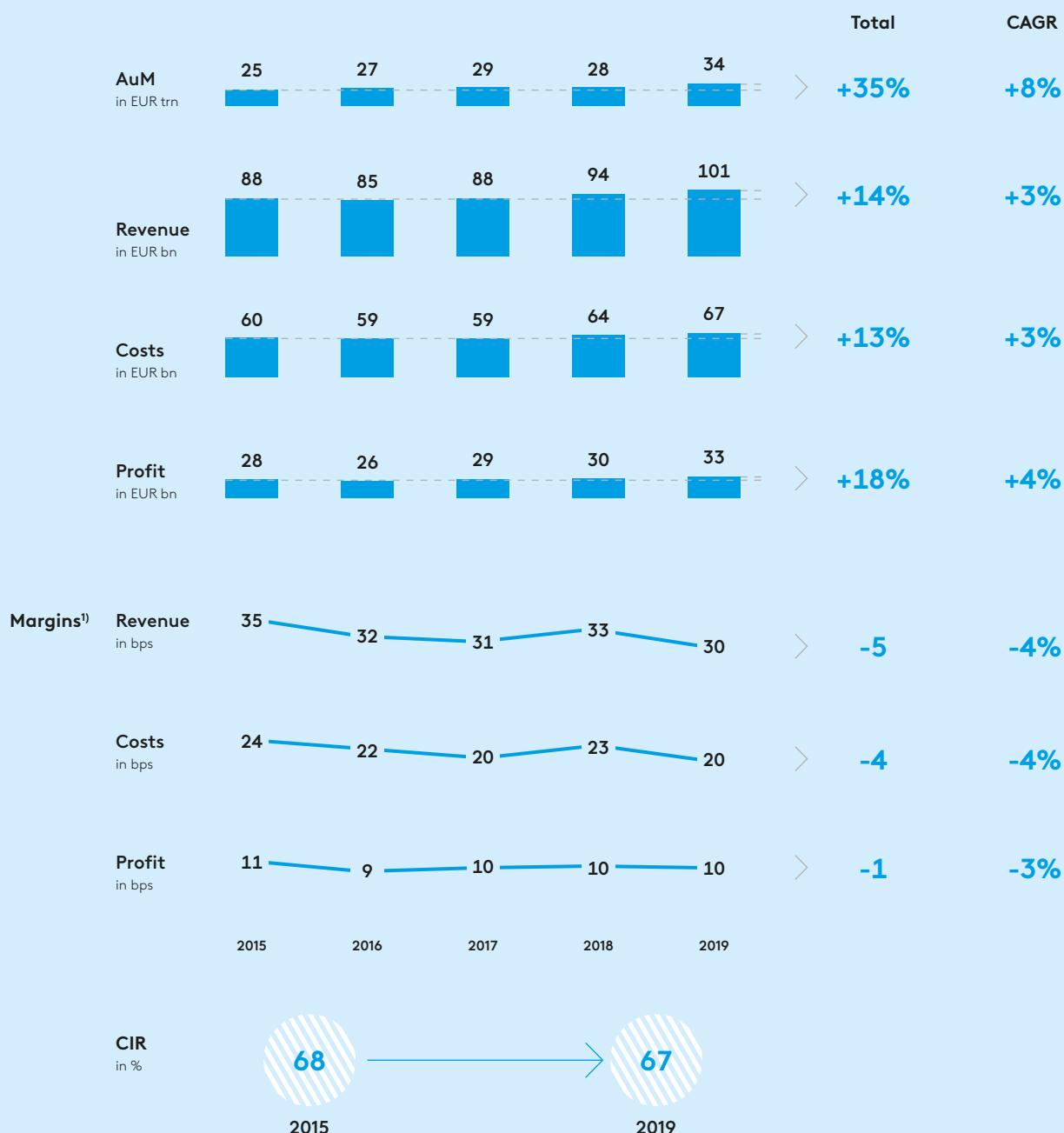
○ Explanation: State Street Gl. Adv. belongs to ■ Large active/passive providers and is a ■ Bank captive

Source: zeb.research, companies' annual reports

Figure 3: Business results of the asset managers covered by the study

← p. 9

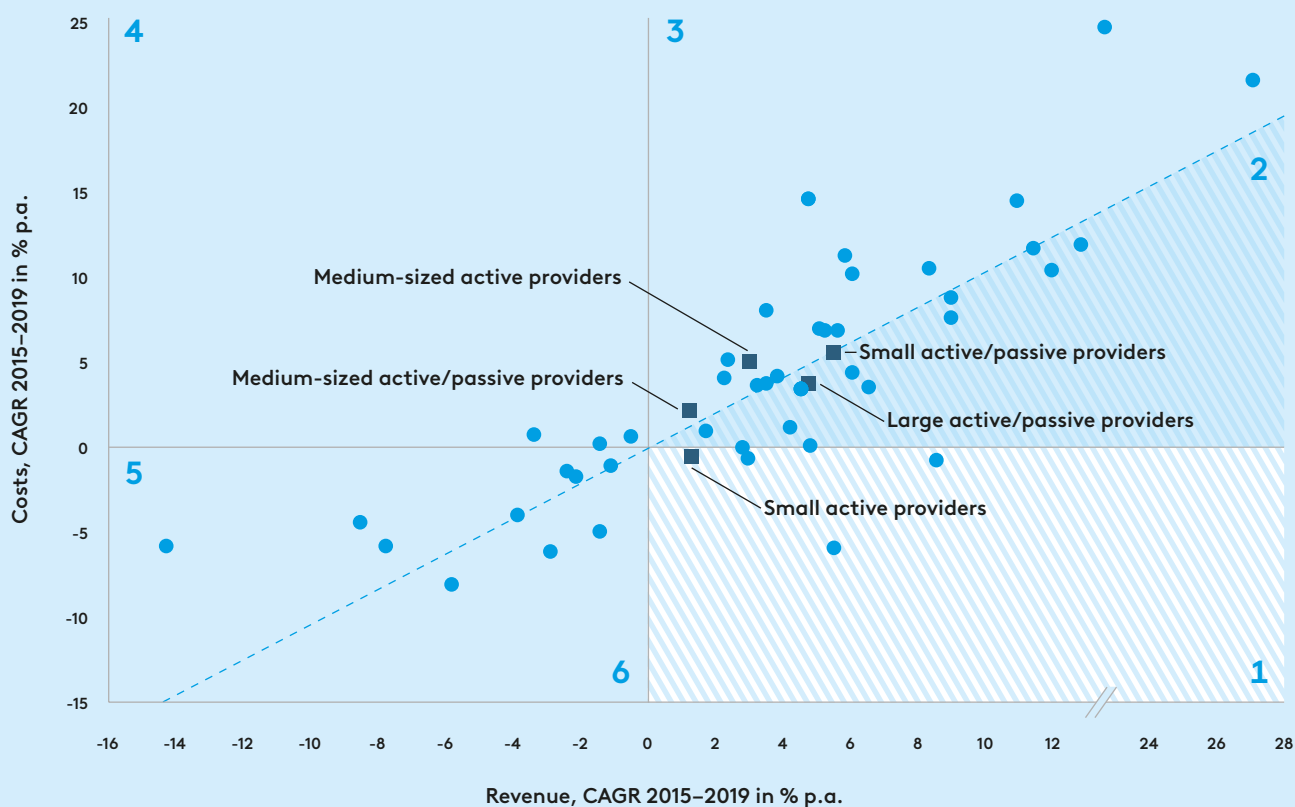
Despite strong AuM growth of 8% p.a. since 2015, the profit margin decreased to 10 bps, driven by a decline in the revenue margin



CAGR (Compound Annual Growth Rate) = average annual growth rate; AuM = Assets under Management; NNM = Net New Money; 1) Net Revenue / AUM; Operating Costs / AUM; Operating Income / AUM; Source: zeb.research; For comparison: total growth AuM 2013-17 46% (CAGR +10%), revenue 23% (CAGR +5%), costs 21% (CAGR +5%), profit 27% (CAGR +6%).

Figure 4: Cost and income development of the individual companies and AM categories | [← p. 9](#)

Obvious cost problem in the industry: cost growth exceeds revenue growth for most asset managers and accordingly, profits are increasingly falling



1 Costs fell and revenues rose

2 Costs rose, but revenues rose faster

3 Revenues rose, but costs rose faster

4 Revenues fell, but costs rose

5 Costs were only reduced to a disproportionately low extent while revenues fell

6 Costs were reduced disproportionately with falling revenues

On average, medium-sized companies are in the most uncomfortable position exhibiting greatest cost growth but declining revenue growth

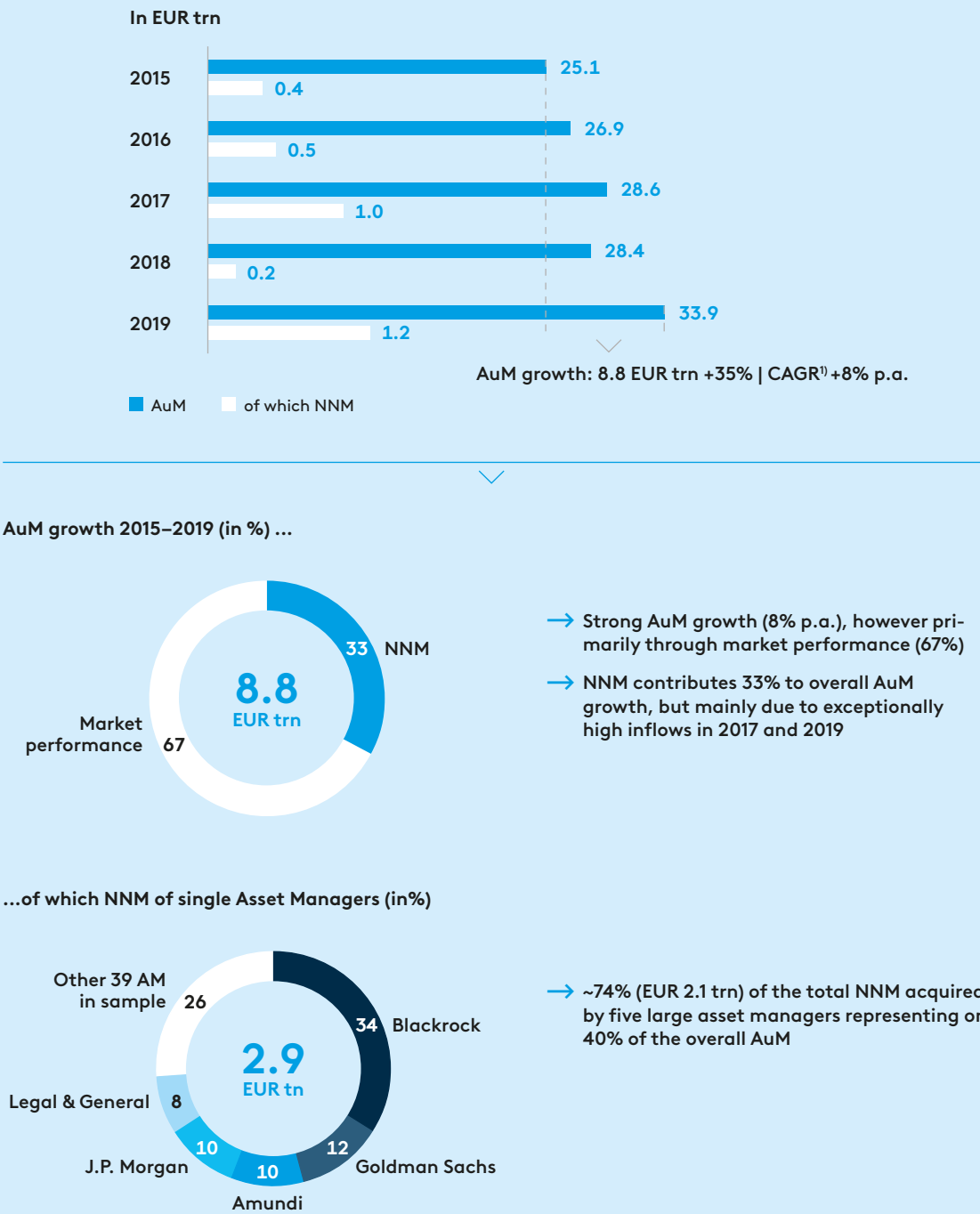
■ AM category ● Company

CAGR (Compound Annual Growth Rate) = average annual growth rate; Source: zeb.research; based on sample

Figure 4 plots cost growth against revenue growth (CAGR for 2015–19) for the individual companies in our sample (blue circles) and different categories of asset management companies (dark blue squares). Only the players in segments one and two are in a favorable position. Players in segment one, which include small active providers, decreased their costs while their earnings rose. Players in segment two, which include small active/passive and large active/passive providers, saw their costs rise but their earnings rise faster. On average, medium-sized companies fared the worst, with costs growing as earnings shrank.

Figure 5: Growth of the study’s AM sample | < p. 13

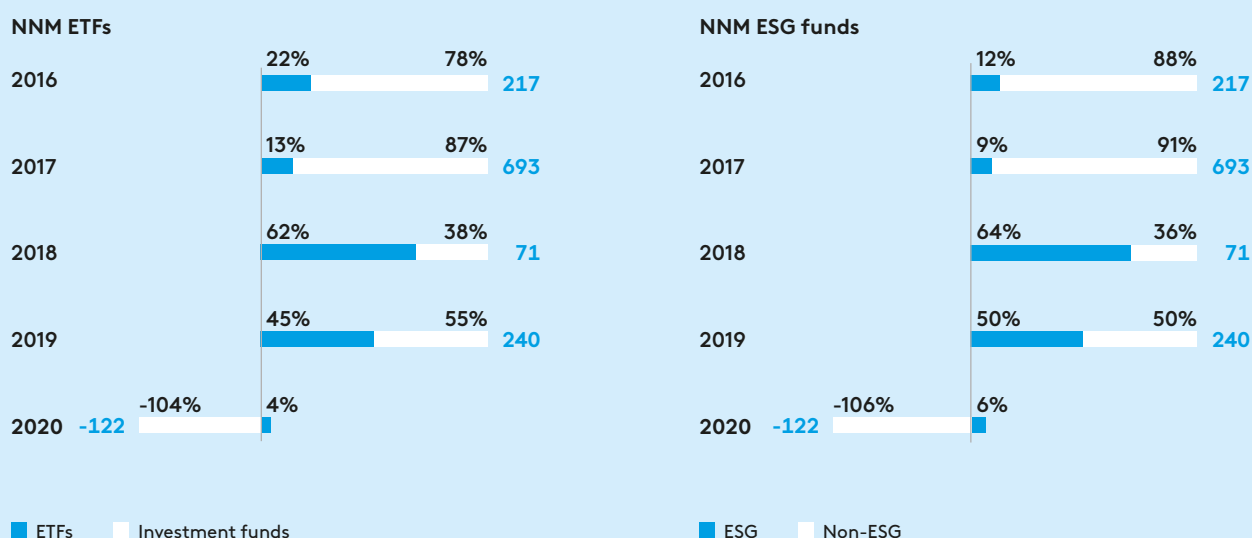
Market performance 2015–2019 as main driver of asset growth (~70%) – continued industry concentration and winner-takes-all phenomenon – large asset managers with ~74% share



1) CAGR (Compound Annual Growth Rate) = average annual growth rate, for comparison: CAGR 2013–17 10%; AuM = Assets under Management; NNM = Net New Money, for comparison NNM share 2013–17 26%; NNM share of the 5 major AM 2013–17 73%; Source: zeb.research; based on sample

Figure 6: NNM in EUR bn in various mutual fund share classes based on Morningstar database | [← p. 13](#) | [← p. 14](#)

ESG-compliant asset management rapidly growing in importance – main driver of NNM together with passive investments



NNM = net new money; Source: zeb.research; Morningstar; institutional and retail investment funds (incl. ETFs) distributed in Europe; [https://www.morningstar.de/de/news/199485/ohne-nachhaltigkeit-geht-bei-fonds-\(fast\)-nichts.aspx](https://www.morningstar.de/de/news/199485/ohne-nachhaltigkeit-geht-bei-fonds-(fast)-nichts.aspx)

Figure 7: ESG rating in terms of implementation level | [← p. 14](#)

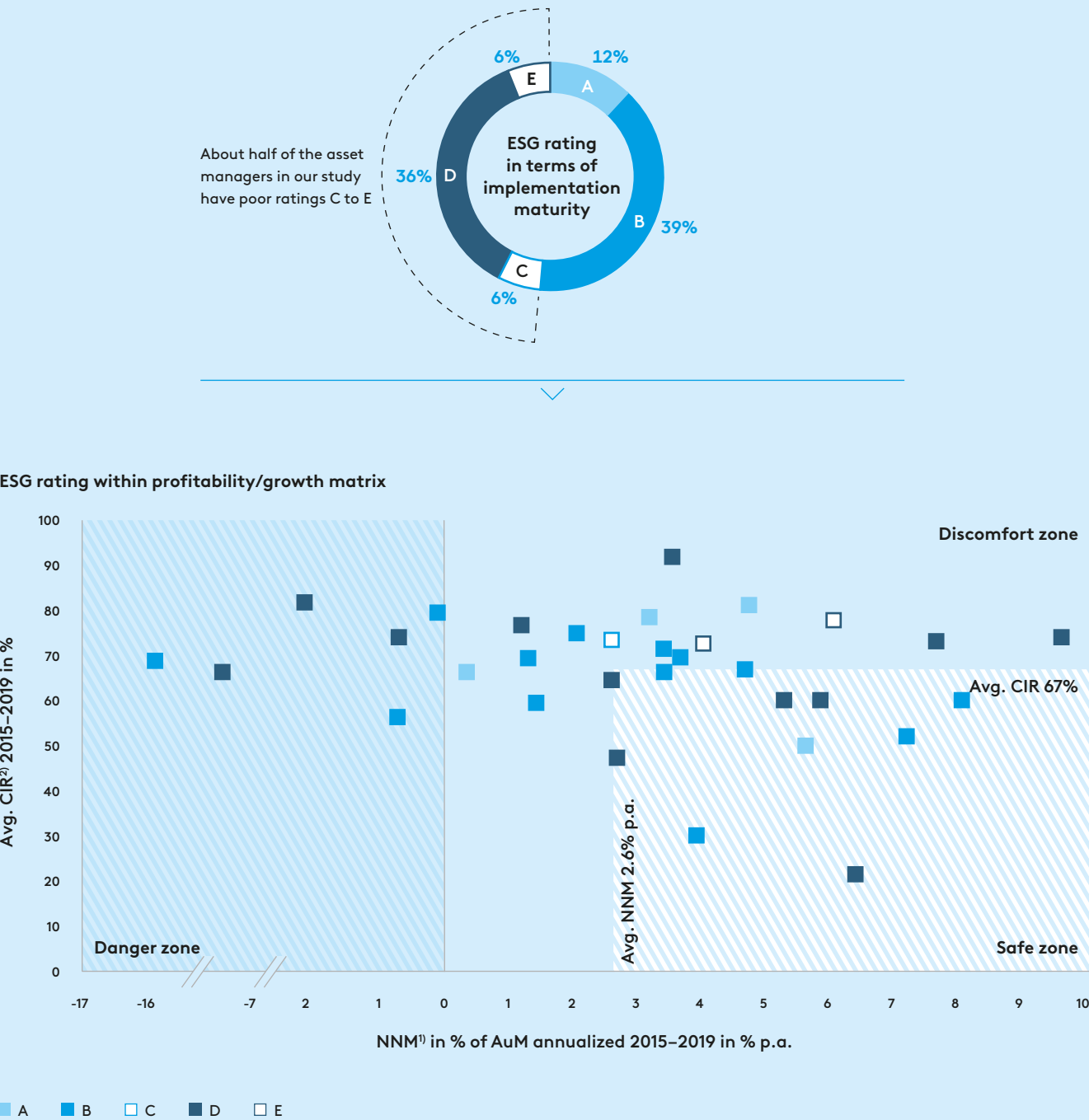
Globally successful providers holistically integrate ESG as a key component in their strategy, but the defined level of ambition is often not fully implemented yet



Source: zeb.research; annual reports; ESG rating by ShareAction: Point of No Returns 2020, 75 largest AM, scoring evaluates 36% sustainable investment governance, 28% influence on climate change, 19% respect for human rights, 16% biodiversity; CSR = Corporate Social Responsibility

Figure 8: ESG conformity in the AM study sample and correlation to growth and profitability | [← p. 15](#)

Holistic integration of ESG criteria insufficient, however no correlation between ESG conformity / ambition and historical growth / profitability – this may change in the future!



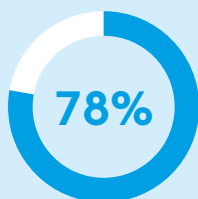
Source: zeb.research (annual reports; ESG rating: Point of No Returns 2020; only 32 of the sample AM have an ESG rating in Point of No Returns

Figure 9: ESG stock indices compared to non-ESG indices | [p.33](#)

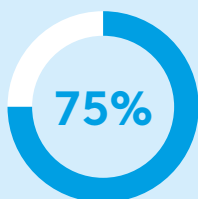
ESG investments in litmus test – positive risk characteristics confirmed in COVID-19 crisis:
ESG market as a trend accelerator?

ESG indices outperforming not only in times of crisis, ...

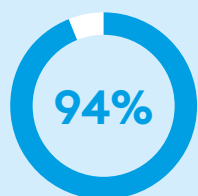
Percent by which ESG indices
have outperformed during crises



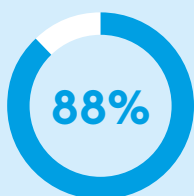
Jul 21, 2015–Feb 11, 2016
EM/energy crisis



Sep 20–Dec 24, 2018
Reaction to Fed policy

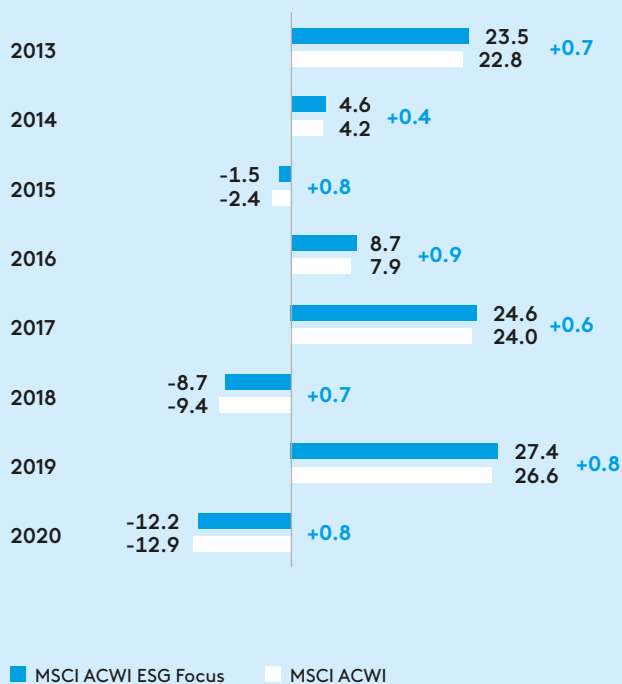


Q1 2020
COVID-19 crisis



YTD 2020
(as of May 11, 2020)

... but have systematically outperformed over the last few years.



Source: zeb.research, Blackrock - Sustainable investing 2020, Performance of the MSCI All Country World Indices in USD in % in the respective year, Factsheet MSCI ACWI ESG Focus dated Apr 30, 2020

Danger ahead

How will asset management fare in 2020 and beyond?

The COVID-19 crisis caused the assets under management of mutual funds distributed in Europe to shrink by around six percent in the first half of 2020, and NNM contribution was negative, down -109% from 2019. March 2020 was the worst month for mutual funds, with more capital from funds distributed in Europe withdrawn than in any of the worst months since 2008.

Assets managed via segregated accounts for institutional investors are not covered by this data provided by Morningstar but institutional money was also withdrawn significantly. However, this dramatic impact did not last long. The markets rebounded quickly, some reaching all-time highs as little as three months later. This development was driven especially by sectors profiting from the crisis, such as companies in the tech and health sector.

The long-term picture is not yet clear, particularly as financial markets have to a large extent decoupled from the real economy due to the introduction of economic support programs and corresponding measures by central banks around the globe. The COVID-19 crisis has prompted a range of negative economic forecasts, the consensus being that interest rates will remain very low or negative, credit risks will increase substantially, and the future development of financial markets is uncertain.

These factors will have a major impact on the asset management industry. The question is, really, when the recently even stronger decoupling of financial markets from the real economy will end – and the economic effects of COVID-19 on the real economy will increasingly be reflected in the asset prices.

In March 2020 ...

... more capital from funds distributed in Europe was withdrawn than during the whole of 2019, which was a strong year for the stock market!

... more capital was withdrawn from funds distributed in Europe than in any of the worst months before since 2008!

European investment funds market 2020 (in EUR trn)

The Morningstar funds database includes approx. EUR 9 trn of investment funds distributed in Europe and serves as an indicator for the overall development of European asset management in 2020.

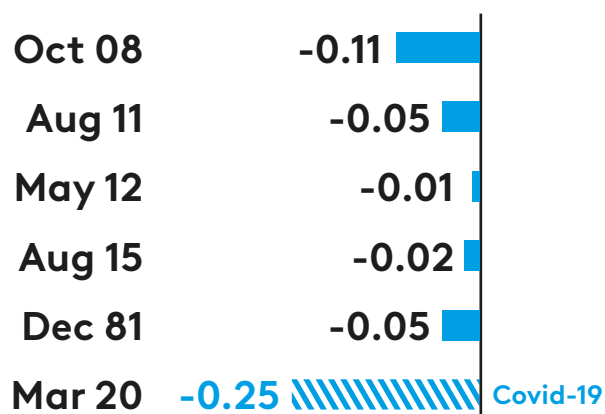
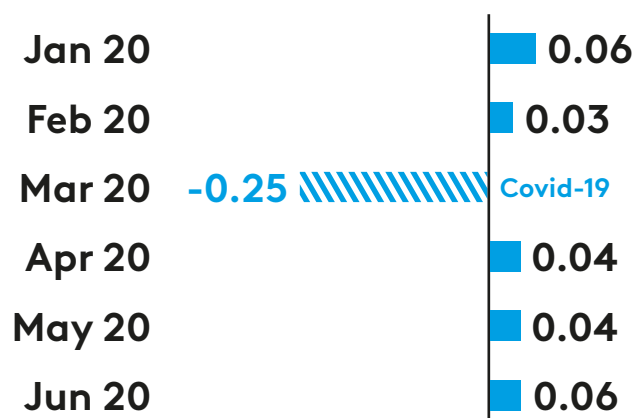
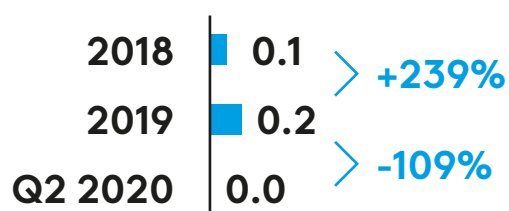
AUM drop

of which

Negative NNM contribution

of which

COVID-19 March 2020 as worst month for mutual funds



To investigate what the future may hold for asset management as the global economy starts out on its tentative path to recovery, we carried out a simulation for a period of five years, based on data from the end of 2019. Below, we describe potential scenarios for the future of the market and discuss their impact on different types of players and business models over the next five years. The scenarios are based on varying assumptions about the development of assets under management, inflows of NNM, revenue development and changes in cost margins.

We simulated three different scenarios for the next five years, each reflecting different views on the extent and speed of the global economic recovery and its effect on financial markets:

"COVID-19 will lead to a significant decline in economic performance at least until 2021.

After that? It's still too soon to say."

Maria Katharina Heiden,
Manager, Hamburg



Scenario one

In Scenario 1, everything will stay as it was, i.e. the historical growth rates for assets under management (7.8% p.a.), revenues (3.4% p.a.) and costs (3% p.a.) from 2015 to 2019 continue. With asset prices already at or above pre-crisis levels after the markets were hit in March and new money from governments and central banks steadily flooding the markets, this obviously very optimistic scenario assumes that the financial markets continue to be rather decoupled from the real economy over the next five years. It also assumes that the development of benefitting business sectors like Tech & Digitals, Health, etc. may more than offset the adverse effect on traditional industries.

Scenario two

Scenario 2 assumes a decline in asset growth to 2.5 percent, half the rate of the last five years. The pattern is more or less V-shaped, reflecting a fast recovery of the economy. Individual growth rates for NNM continue as in the last five years, leading to an overall growth rate of 5.1 percent a year for assets under management. Reflecting ongoing demand for passive strategies, Scenario 2 assumes 20 percent growth of NNM for firms offering both active and passive products, at the expense of core active providers. The scenario also reflects the ongoing pressure on fees by assuming a drop in revenue growth to levels comparable with the big US asset managers, leading to a 30 percent decline for firms offering both active and passive strategies, and a 15 percent decline for core active managers. Acknowledging a certain amount of flexibility with regard to variable costs and cost-cutting efforts, 50 percent of the historically observed cost growth rate is adjusted down in line with the reduced growth rate for assets under management, resulting in an average overall cost growth of 2.5 percent a year.

Scenario three

In Scenario 3, assets under management stagnate, with a market performance of zero percent over the next five years. This reflects a U-shaped economic recovery. We assume that NNM grows at half its historical rate and apply the shifts from active to passive as in Scenario 2. Growth of assets under management is thus 1.3 percent a year, purely driven by NNM. In this scenario we assumed only half of the cost growth seen in the past assuming that the variable costs will not increase which results in an average overall rise in costs of 1.5 percent a year.

Applying the three scenarios to our sample of asset management firms reveals some of the challenges ahead. Overall, we see a decline in profit margins over the five-year simulation period. Even in Scenario 1, the most optimistic scenario based on historical parameters, namely a continuous asset growth as overserved in the previous five years and thus assuming no long term effects of COVID-19 on asset growth at all, profit margins fall by 20 percent over the next five years. Considering long term negative impacts of COVID-19 on the development of assets combined with more realistic assumptions on both the direction of net new money and fee level developments, the picture deteriorates – even though all of the respective scenarios also model in some cost-reduction efforts. In Scenario 2, profit margins fall by 30 percent over the next five years; in the more pessimistic Scenario 3, assuming no market performance at all, they fall by about 60 percent.

The simulation paints a negative picture regarding the asset management industry's performance indicators in the next five years. Even before COVID-19, margins were already depressed. Could the industry be slipping into a danger zone now? The pressure on earnings will persist no matter whether assets under management grow or shrink. Passive products will continue their success story whereas the performance of active managers will continue to be viewed critically. There is also not much leeway for asset managers for increasing fees regardless of their investment philosophies. The bulk of passive strategies is highly transparent and follows plain vanilla indices where the fees are the main differentiator. Bond managers face the already low interest rate levels which do not offer potential for price adjustments either. As pressure on the earnings side continues, cost reduction and cost discipline will be essential, now more than ever. The absolute level of costs will be critical, meaning that cost margins will be fragile. Costs will also be key for generating positive performance.

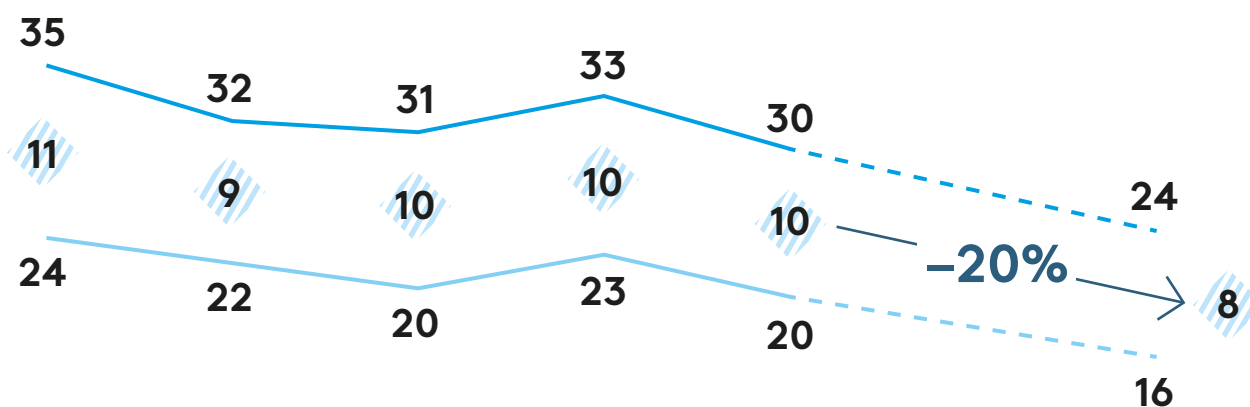
The implications for companies differ depending on their specific business model. **Large active and passive providers** will further win NNM, as they have done in previous years. They will be able to engage in aggressive pricing thanks to their economies of scale, reaping the benefits of their passive offering and extensive distribution networks. However, according to our simulation they have little scope for improving their cost income ratio, which would increase significantly.

Medium-sized asset managers face the biggest challenges regarding profitability. Managers offering both active and passive products will partly benefit from the trend towards passive investments, experiencing growth here. But at the same time most of them will see their profitability deteriorate due to their low level of scalability and the increasing price pressure in both active and passive spheres. We also identified this trend in our comparison of the periods in this and our previous report.

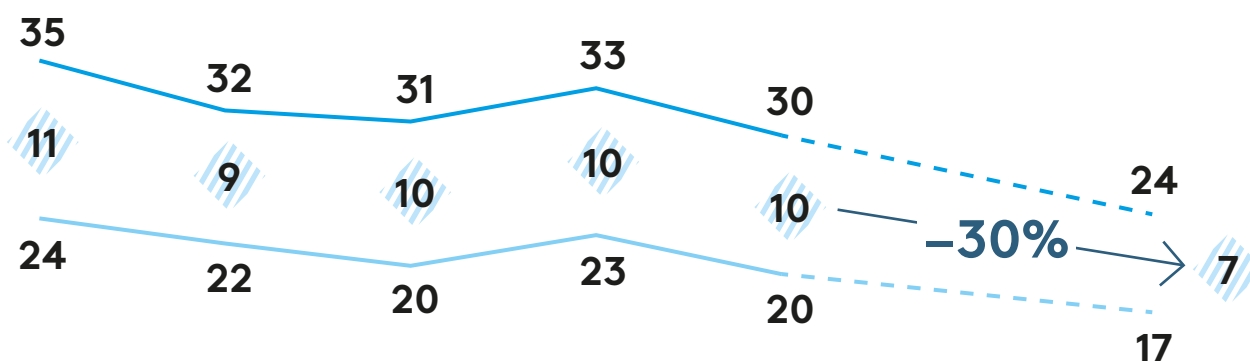
Finally, **small active and passive providers** are expected to lose market share but further increase their profitability levels, as they already have done over the past two years. Certain passive products will attract above-average volumes of NNM, but the overall growth rate will decline as these players lose share to large active and passive providers. Increased profitability will result from systematic cost savings (a trend expected to continue as the smaller players have focused on cost optimization rather early) and above-average revenue levels, the latter achieved by focusing on product quality and specialization, allowing players to charge higher fees.

Simulation results – margin development of total sample

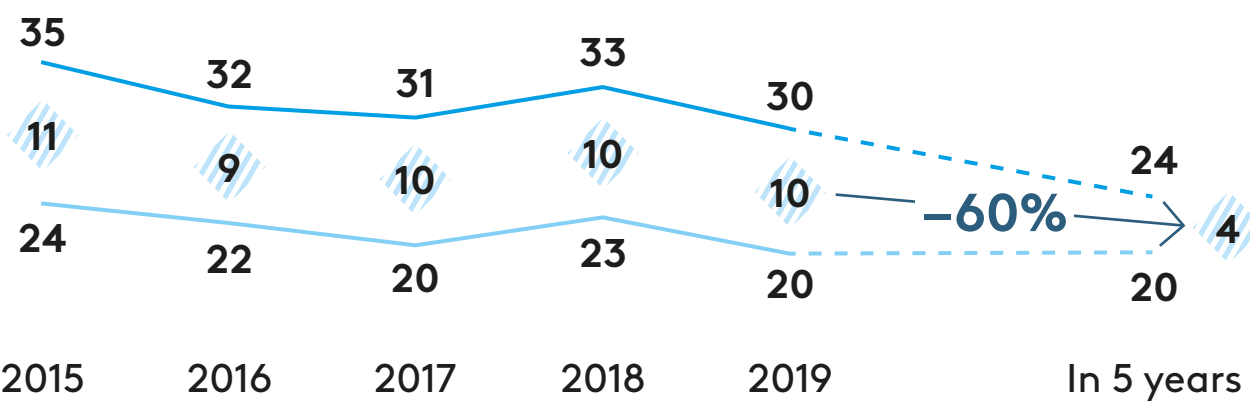
Scenario 1



Scenario 2



Scenario 3



— Revenue margin (bps) — Cost margin (bps) -/- Profit margin (bps)

Simulation assumes diversified portfolio of bonds, shares, alternative investments; Source: own calculations

The road to recovery

Long-term profitable growth is the primary goal

What, then, do we recommend for asset management companies in a world characterised by high uncertainty with regard to the pandemic but also with regard to other geopolitical and environmental risks? We believe that our recommendations from the 2019 report remain as relevant as ever. Indeed, they have become even more pressing in the light of COVID-19. In this sense, COVID-19 has been an accelerator rather than a game-changer. It has, as all crises, also thrown a spotlight on the vulnerabilities of specific asset management business models, no matter what the future will look like.

Our recommendations address the key questions that asset managers must ask themselves, taking into account their individual business situation. Their primary goal? To achieve long-term profitable growth.

Our analysis shows that many companies' profitability situation has deteriorated, as reflected in their rising cost income ratio even before COVID-19 appeared. Particularly badly affected are medium-sized asset management firms with standard business models that are not distinct in any way from those of their competitors. Net sales performance, measured by calculating NNM as a percentage of assets under management, has also declined, a development affecting both medium-sized and small asset managers. This trend shows the increasing market dominance of large asset managers, who are able to realize economies of scale. Small and medium-sized asset managers need to rethink their strategic positioning as a matter of urgency. They must ask themselves what their USP (unique selling proposition) is: what sets them apart from the competition?

"The COVID-19 crisis has made it crystal clear **how quickly the cost problem can become a matter of life or death."**

Dr. Carsten Wittrock,
Partner, Frankfurt / London



Key challenges



Clearly defined strategic positioning: scalability or specialization



Holistic approach to the integration of ESG requirements



Radical and disruptive cost reduction



Digital target picture as the basis for future-proof positioning



Efficient data management together with a strategic digital target picture

What investment capabilities do they have beyond the usual “me-too” capabilities? Which customers and sales channels can they target? Which geographic markets and regulatory regimes can they serve with which products? And how can they expand or gain new expertise through mergers and acquisitions?

Developments observed over the past few years show that shaping a business model aimed at realizing economies of scale and scope is only possible by means of aggressive pricing and building a worldwide distribution network. The large US asset managers are a prime example.

Fields of action

Focus on key fields of expertise in which competitiveness can be secured vs. realization of high scalability of business

Evaluation of the effects on the existing strategy, definition of the level of ambition and development of own unique selling propositions – necessary (but not sufficient) condition for success in the future

Review of the investment expertise and product range, realization of economies of scale and potentials of new technologies

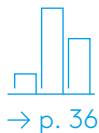
Digitalization of the customer experience, Artificial intelligence-driven alpha generation, integrated investment and execution platforms, clear data strategy and governance

Data management as fundamental basis for future-proof positioning: cost reduction, expansion of digital opportunities, involvement in developing business opportunities

Particularly in passive business, which continues to grow quickly, it is almost impossible for companies to make themselves stand out from their competitors. Moreover, due to the extremely low margins, adequate profitability is only possible by means of high volumes. Partnerships and mergers are therefore a good option for small and medium-sized asset managers with strengths in local markets. Failure to act, on the other hand, could result in these players losing the market to large providers, or finding themselves caught up in a spiral of declining profitability.

"Successful business models are increasingly data-driven. Collecting, processing and managing data is now a decisive factor for profitability and growth."

Marius Bauer,
Senior Manager, Munich



Demand for passive investments is growing, as indicated by the significantly stronger drop in net sales for purely active providers than for players offering both active and passive products. As the behavior of young investors and those inheriting their parents' assets changes, sales figures will most likely continue to decline. Asset managers offering actively managed plain-vanilla strategies are particularly at risk here; players catering to this market must urgently rethink their approach or try to establish partnerships with other asset managers.

Asset managers who follow an approach of specialization, designing their business with a focus on solutions and performance, aim to distinguish themselves from their competitors through their investment expertise, selling their investment strategies primarily through local or exclusive distribution channels. The critical challenge for these players is to focus on a few, specific investment sectors, strategies or solutions, potentially combined with a focus on specific client segments.

For these chosen areas they must offer a high level of expertise, while at the same time continuously modernizing the investment processes in order to ensure persistent alpha generation and a minimum degree of diversification to stabilize their business model in adverse market environments.

The European Union's Markets in Financial Instruments Directive (MiFID II) has created a paradigm shift in the European industry with regard to benchmarking. Under the Directive, with some exceptions, the performance of products must be shown to the investor relative to a comparative index or strategy, in order to provide more transparency with regard to value for money for the end customer. This, in turn, puts constant pressure on providers to engage in systematic innovation management and replace strategies that are unprofitable for themselves and their customers with more profitable strategies. The same applies to the markets and sales channels served. Thus, only by focusing on core competencies, together with targeted sales management, will it be possible to achieve profitable growth in the future.

The key insight for decision-makers must be that a business-as-usual approach with minor adjustments will further aggravate the situation. Only disruptive change will ensure future success.

ESG strategies have distinguished themselves not only by their success in securing NNM inflows during the COVID-19 crisis, but also by their performance. For example, 94 percent of the ESG indices in Q1 2020 and 88 percent in 2020 (YTD) outperformed their non-ESG counterparts. Their performance during earlier crises in 2016 and 2018 was equally impressive. → p. 23/Fig. 9

In fact, an analysis of the MSCI All Country World Index compared to its ESG version reveals that ESG strategies are historically superior to other strategies not only during crises, but also in more stable times. So, it is no surprise that statements about sustainability feature prominently on most asset management companies' websites. Asset managers' level of ambition regarding ESG has increased radically and clients expect their actions to match their words. Yet, many asset managers still only offer isolated products with an ambitious ESG profile, while clients, especially younger investors, expect a more holistic or even pioneering approach to ESG – a strategy that encompasses both sustainability and proactively striving to influence areas such as climate change or social justice, for example by using voting rights or investing in companies that have a positive impact on the environment or social justice. → p. 36/Fig. 10

The large number of people who have joined the “Fridays for Future” movement indicates that tomorrow’s investors think and act sustainably.

They expect the same from their asset manager. Many asset managers say that sustainability is a priority for them, but research shows that the reality does not always match up, or that what they advertise as sustainability does not stand up to critical scrutiny. Decision-makers must wake up to the fact that society’s attitude towards ESG has changed fundamentally: in the future, ESG investments will not be niche products but rather the new normal.

Accordingly, sustainability belongs right at the top of the management agenda and asset managers must strive to resolve the inevitable tensions between impact on results and impact on the outside world.

The perennial problem of costs is another priority area for managers. In fact, costs are one of the few things influencing profitability that management can actively, and relatively quickly, influence. A number of actions can deliver considerable cost savings. The biggest cost-savings potential, at around 10 to 20 percent, can come from reviewing the product range and making radical changes where necessary. In other industries, it is normal to regularly adjust and refine products and services. Asset managers, by contrast, tend to stick far too long to strategies even if they are unprofitable. Streamlining products and services enables both enormous potential cost savings and systematic innovation management. Asset managers should consider concrete steps, such as systematically reviewing their investment competencies and product range with regard to profitability, critical size and relevance, and closing or merging suboptimal funds or mandates and transferring assets to other funds where possible.

Reducing complexity and optimizing processes offers a further 10 to 15 percent in potential cost savings. As business processes have been automated and digitized in recent years, many asset managers have built up varied collections of isolated applications. Often, they shy away from replacing outdated in-house developments with standard software available on the market. Regularly modernizing the system landscape and centralizing processes harbors enormous cost-saving potential. As a starting point, asset managers should consider simplifying platforms and aligning the system landscape with the business strategy (using SaaS, cloud-based solutions or third-party providers, for instance). They can also centralize middle-office activities, make use of selective outsourcing, optimize manual support activities (such as order management) at the same time as automating processes.

With the technical possibilities constantly evolving, companies can realize cost-reduction potentials by systematically joining up activities. For example, they can create end-to-end automated processes, simplify and standardize workflows for customer onboarding, or automate repetitive, rule-based activities, collateral reporting, pre-trade compliance checks and reconciliation of securities data using robotics process automation (RPA).

Digitalization and data management are further building blocks for increasing efficiency and reducing costs, as well as opening up new growth areas and generating additional sources of income.

Many companies pay lip service to digitalization, but the actual measures that they take appear arbitrary rather than strategically planned. Experience shows, however, that having a clear vision and structured target picture of the future IT architecture forms the basis for a future-proof positioning. A digitalization strategy should cover four essential cornerstones: technology, data (and the resulting analytical possibilities), innovation, and organization. → p. 36/Fig. 11

Exploiting new technical possibilities is one of the key components of future business success. A word of warning is merited here, however. Digitalization can quickly become a cost driver without the hoped-for efficiency or growth benefits, so companies must carry out regular strategic reviews of their own aspirations and the actual level of implementation. A clear vision and strategy is also vital in the area of crypto-currencies and tokenization. Rapid developments in this area will potentially call entire business and operating models into question. For example, legal wrappers such as UCITS and certain other kinds of funds may become obsolete once these technologies become established. The tradability of illiquid assets will also be easier in the future, creating a growth impetus for asset classes currently subject to numerous restrictions.

Asset managers need data, the basis for every action they take. Data is fundamental for both business activities and investment strategies, and hence the generation of investor returns. A strategic data management system is needed in order to make use of machine learning and artificial intelligence. This system must be both effective and cost-efficient, especially given the continuous increase in data volumes. In practice, asset managers often underestimate the strategic importance of data management, whose goal should be to use data as effectively as possible, exploiting its full potential. Data quality and data protection are also important elements of the system.

Our analysis shows how data management forms the foundation for a future-proof business model geared towards profitability. Efficient data management is structured around five levels that must be consistently aligned with each other: a clear data strategy, an overarching data governance system, effective data quality management, an integrated IT architecture supporting automated end-to-end processes, and exploiting the potential of existing data. The result of efficient data management is better information, leading to cost savings, better fulfillment of customer requirements and increased employee productivity. In addition, effective data management helps reduce business risks and ensures compliance with legal and regulatory obligations. Good information, and above all the right information, enables companies to protect their reputation, spot competitors' strategies, identify market dynamics and tap into new alpha sources. Modern data management solutions include applications using artificial intelligence that enable asset managers to capture data regardless of its type, source or structure, simplify that data, and then share it across multiple vendors, deployments and workloads. → p. 37/Fig. 12

"COVID-19 has sped up digitalization in the asset management industry, too. Process automation, system rationalization and state-of-the-art data management offer huge potential."

Norman J. Karrer,
Partner, Zurich



Related facts and figures

Figure 10: Approaches to integrating ESG requirements | < p. 33

ESG is becoming the new global standard – revising ambition levels relating to growth, efficiency and market positioning

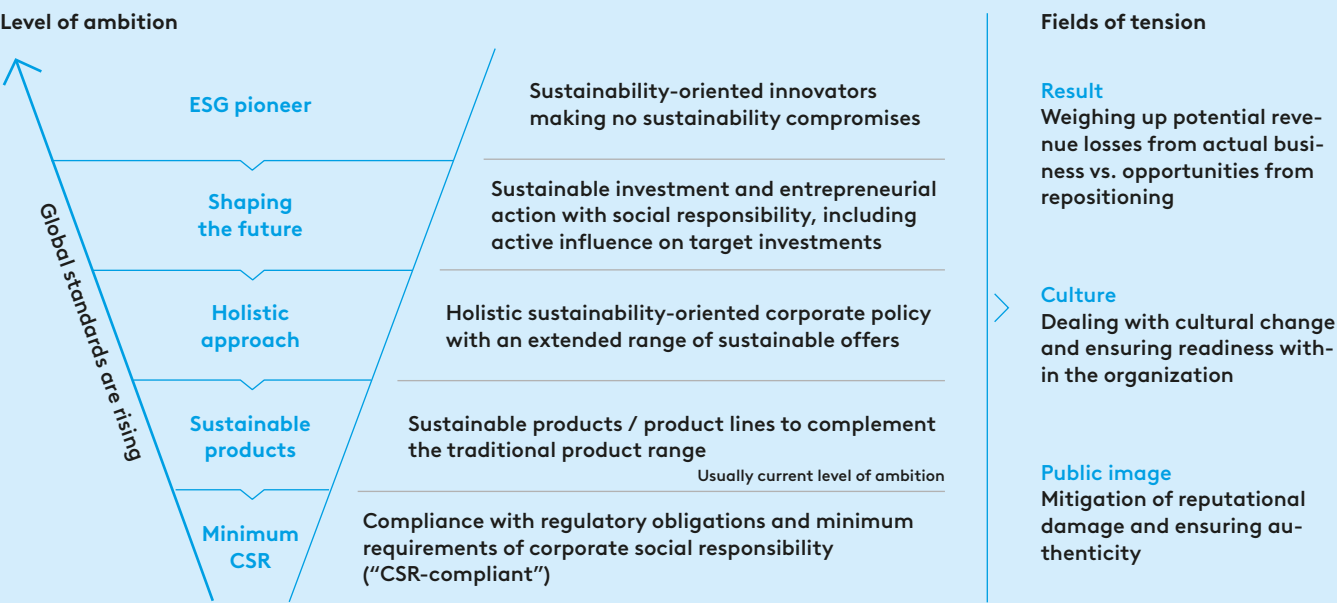


Figure 11: Strategic digital target picture – selected instruments and technologies | < p. 34

Clear vision of digital target picture required as a basis for future-proof positioning

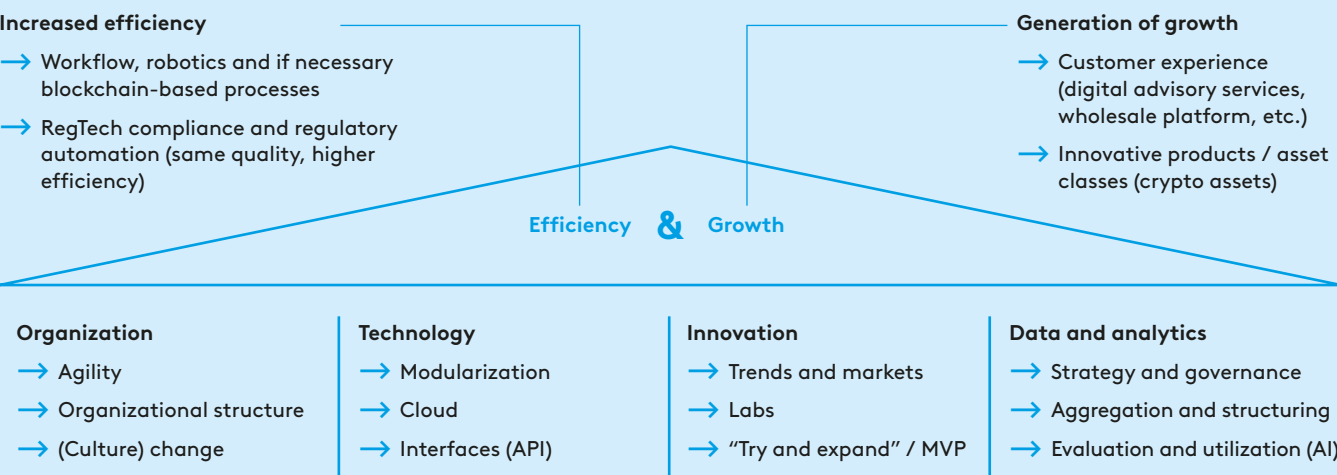
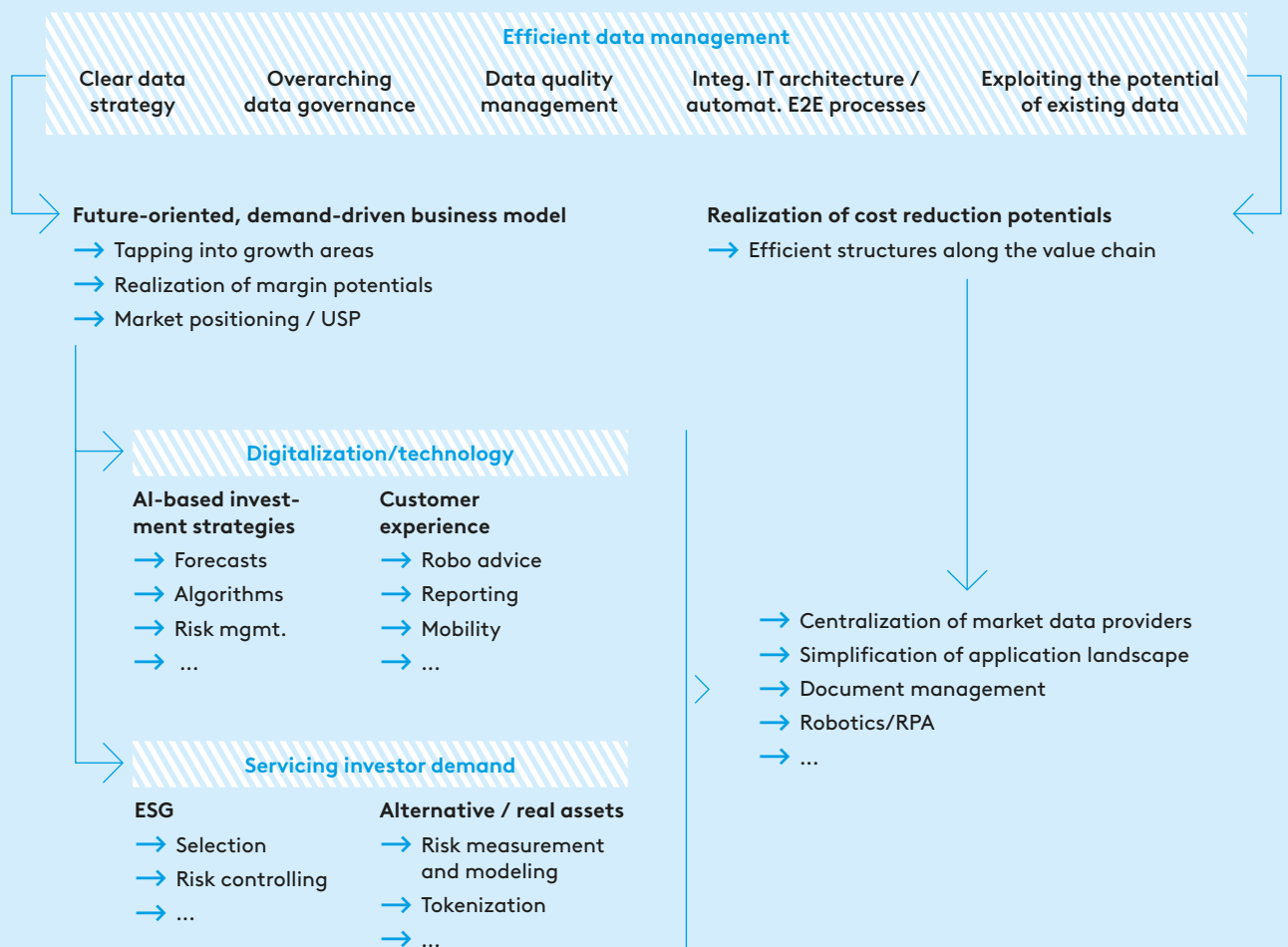


Figure 12: Efficient data management combined with a strategic digital target image | ← p. 34

Efficient data management is the basis for a sound profitability-oriented business model – data (analysis) as the most valuable asset for asset managers



Lessons to be learned

Taking action cannot be put off forever

As the world emerges slowly from the crisis, what lessons can companies learn from the past few months? How should they be rethinking their strategy for a post-pandemic world?

This year's study confirms the view of the industry presented in our 2019 report and the forecasts that we made for how asset management will develop.

But the short-term market distortions caused by COVID-19 represent a significant wake-up call for asset managers, especially with regard to the ongoing cost problems which significantly affect the profitability in even the most optimistic scenarios regarding future asset growth.

As stressed in our previous study and confirmed by analyzing the success factors of asset managers which managed to grow profitably, the key is to shape the business models in a clear direction – towards specialism or scale.

Either way, this means focusing rather than getting stuck in the middle in terms of production, service offering and distribution.

In addition, only focusing on core strengths will provide the foundation for stringent cost management. Cost reduction measures need to be applied based on an enhanced tool kit so that digitalization can take full effect.

The market bounced back strongly after a sharp decline when COVID-19 first appeared, but the long term effects remain uncertain. What is certain is that the pandemic has – so far – acted primarily as an accelerator for trends that were already visible in the industry, rather than being a fundamental game-changer.

Sustainable investment, for instance, was already on the agenda of most asset managers when COVID-19 emerged. The pandemic triggered a boost in the ambition of companies to integrate ESG criteria into their investment processes as demand from increasingly environmentally and socially-conscious clients grew, and the favorable risk and return properties of such products proved their worth during the times of market turbulence.

Overall, then, the need for action by the industry and the kind of action it must take remain unchanged. What is new is the exponential increase in the pressure on companies to do something to secure profitable growth.

When rethinking their strategy for a post-pandemic world, asset managers must retain their focus on keeping costs as low as possible. What the COVID-19 crisis teaches us is that taking action cannot be put off forever.

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Contacts



Dr. Carsten Wittrock

Partner

Phone +49.69.719153.437

Mobile +49.171.3537563

cwittrock@zeb.de

Frankfurt office



Norman Karrer

Partner

Phone +41.44.5609.771

Mobile +41.794606277

norman.karrer@zeb.ch

Zurich office



Maria Katharina Heiden

Manager

Phone +49.40.303740.251

Mobile +49.151.12054295

maria-katharina.heiden@zeb.de

Hamburg office

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Münster
Hammer Straße 165
48153 Münster, DE
zeb-consulting.com

Amsterdam
Barbara Strozilaan 101,
1083 HN Amsterdam, NL
zeb-consulting.nl

Berlin
Friedrichstr. 78,
10117 Berlin, DE
zeb-consulting.com

Copenhagen
Arne Jacobsens Allé 7,
2300 Copenhagen, DK
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Frankfurt
Taunusanlage 19,
60325 Frankfurt, DE
zeb-consulting.com

Hamburg
Kurze Mühren 20,
20095 Hamburg, DE
zeb-consulting.com

Kiev
42-44 Shovkovychna Str.,
1601 Kiev, UA
zeb-consulting.com

London
107 Cheapside,
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Luxembourg
37A, Avenue John F. Kennedy,
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20123 Milan, IT
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Moscow
Testovskaya St., 10,
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Oslo
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Stockholm
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Vienna
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Warsaw
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Zurich
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8002 Zurich, CH
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