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Cost and Growth in Asset Management

Benchmarking analysis and implications for asset managers

December 2022

Executive summary

In our sample of 46[1)] asset managers, **AuM grew by 20% from** 2019 to 2021, while **profits increased by a staggering 22%.**

Smaller asset managers with **active** business models and invested largely in equities remained among the **most profitable**, despite significantly higher costs per AuM. But larger asset managers with AuM of more than USD 1tn were also able to achieve a comparably high level of profitability with active AM business models.

Overall, the average **CIR improved significantly –** from ~65% to ~61% – despite a further increase in OpEx per AuM (26.4 to 27.5 bps per AuM). The latter was more than made up for by strong revenue growth.

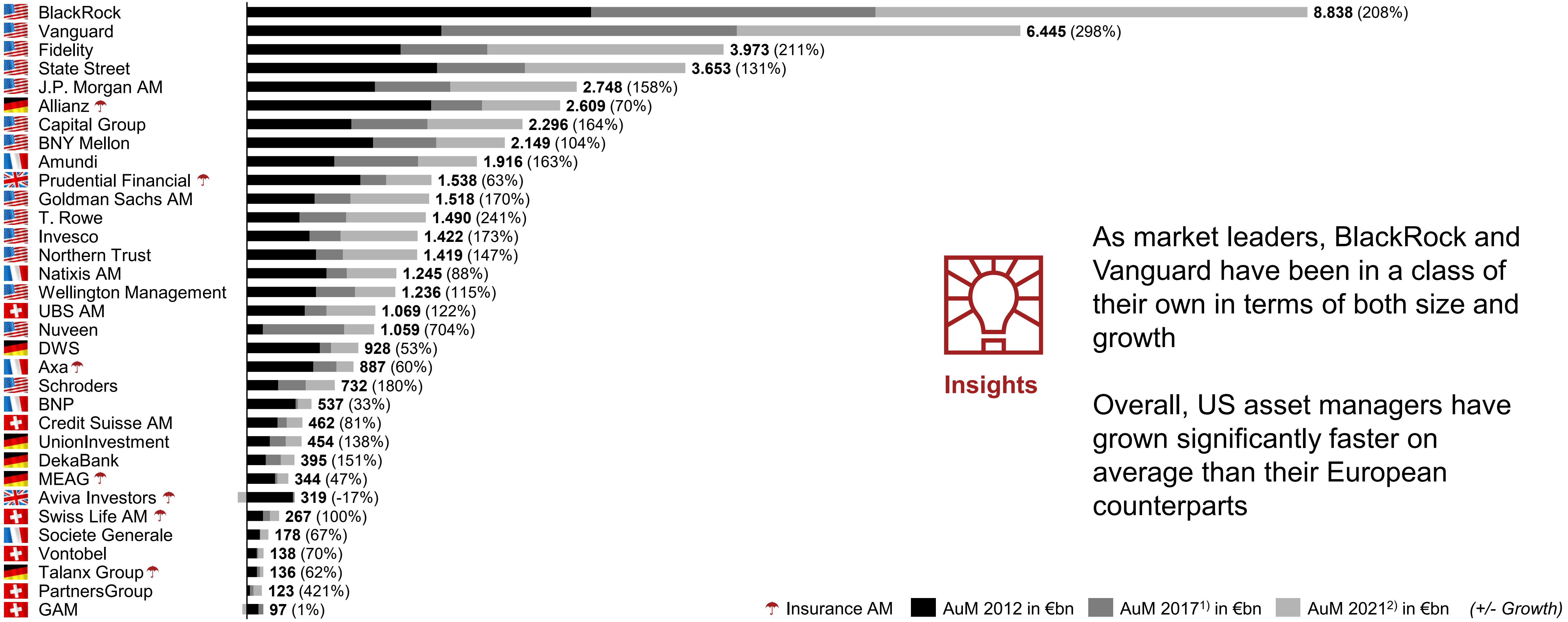
However, a select review of the **half-year numbers** of 10 asset managers reveals that the phenomenal **growth of AuM, revenue and profitability** in 2021 has been **reversed,** reflecting **the drop in stock market valuations**: AuM growth has gone from 16% to -9%; OpEx per AuM has increased by 22%; and profitability has fallen by 6%.

Given **continued global uncertainty** and talk of recession, we recommend focusing on "good" costs, i.e., supporting **differentiating capabilities,** while **cutting** "bad" costs, i.e., supporting **non-essential capabilities.**

1) 46 Asset Managers in sample with AuM reported at least for 2012, 2019-2021

US market leaders continue their growth story – few others able to keep pace

Growth of largest and selected AMs (2012 to 2017 to 2021 in €bn)



Insights

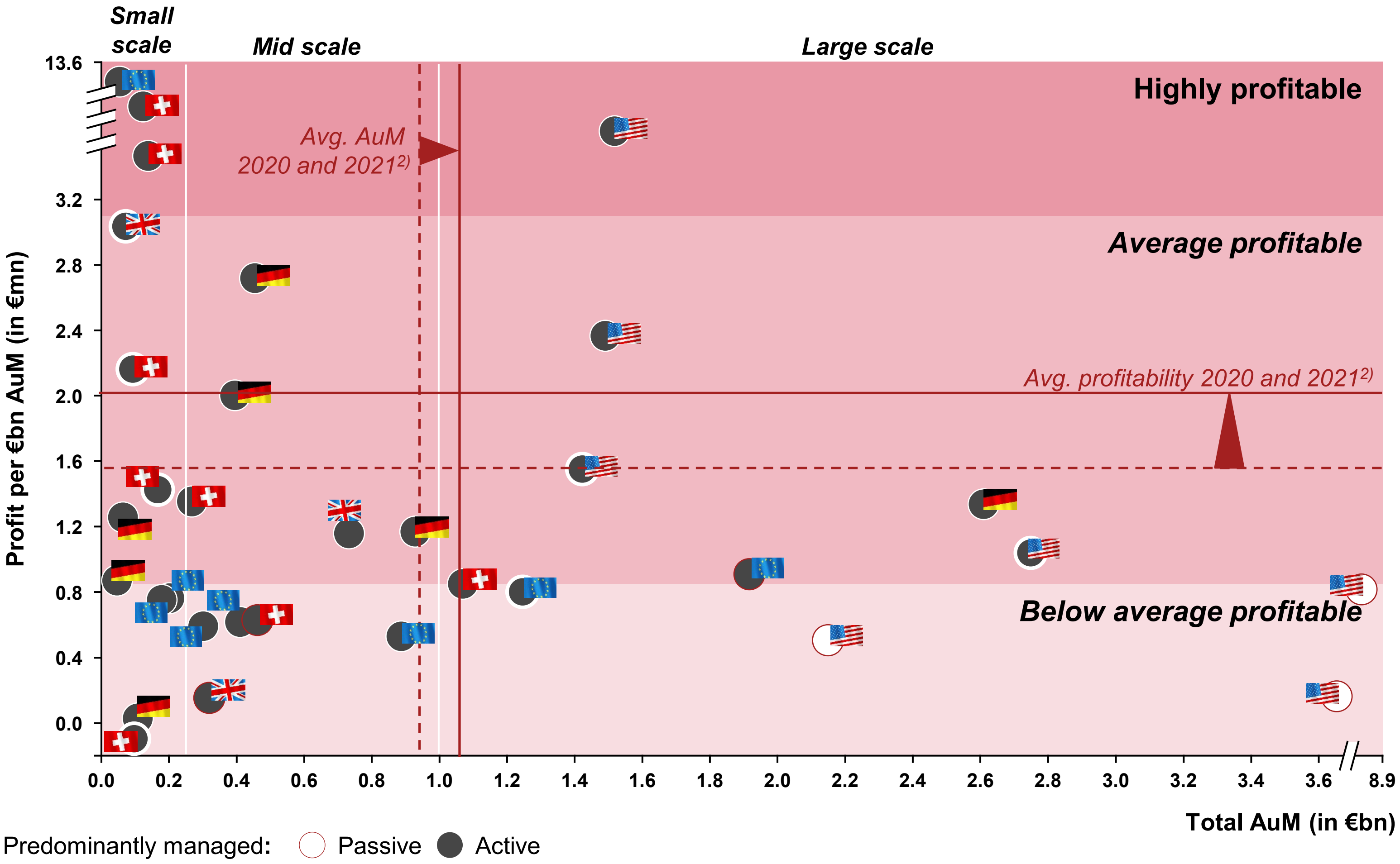
As market leaders, BlackRock and Vanguard have been in a class of their own in terms of both size and growth

Overall, US asset managers have grown significantly faster on average than their European counterparts

1) Additional AuM from 2012 to 2017; 2) Additional AuM from 2017 to 2021;
Source: Company reports 2021; Strategy& analysis

AM enjoyed favourable year in 2021 - AuM growth picked up and profits increased sharply, smaller PE/active AM most profitable

2021 Outside-in competitive profit benchmarking[1)]



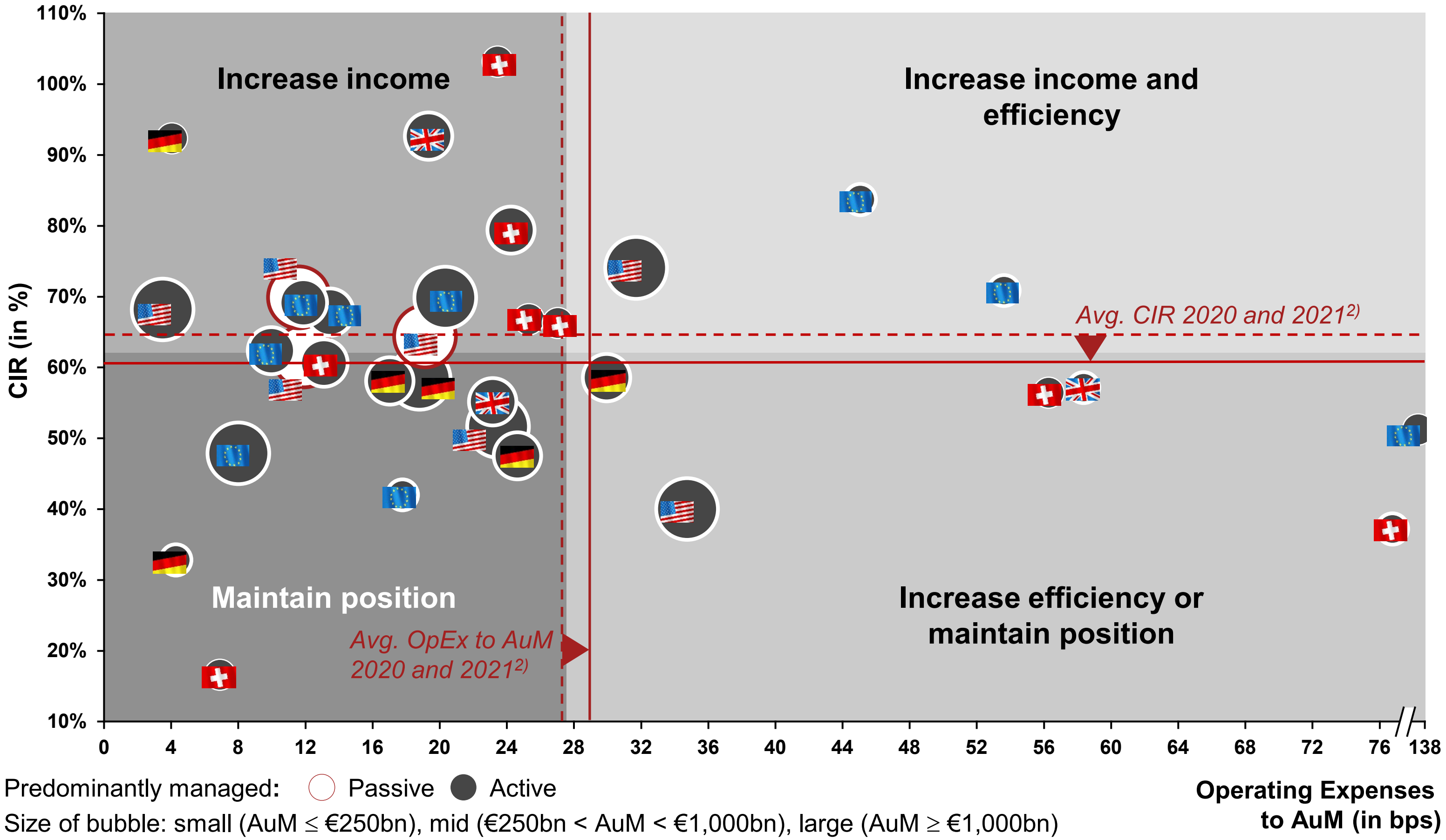
Insights

- In comparison with our 2020 sample study of asset managers:
  - **AuM grew by 18.5%** vs. MSCI World: 22.4% (6.6% vs. 15.9% in 2020)
  - Profit **increased by 22%** on average (by €0.47m per €bn AuM) (-14% in 2020)
  - Almost all AMs in our sample were able to **increase their profit per AuM,** a very different result to last year's study
- The **most profitable AMs** were mainly **small** and with **active** and/or **PE** type/private markets business models (all with at least around 50% share of equities in the portfolio)

1) Sample of 28 Asset Managers with 2021 figures 2) For sample included in 2020 study;
Source: Company reports 2021; Strategy& analysis

Soaring revenues more than made up for rising expenses – half of asset managers maintained cost discipline

2021 Outside-in competitive cost benchmarking[1)]



Insights

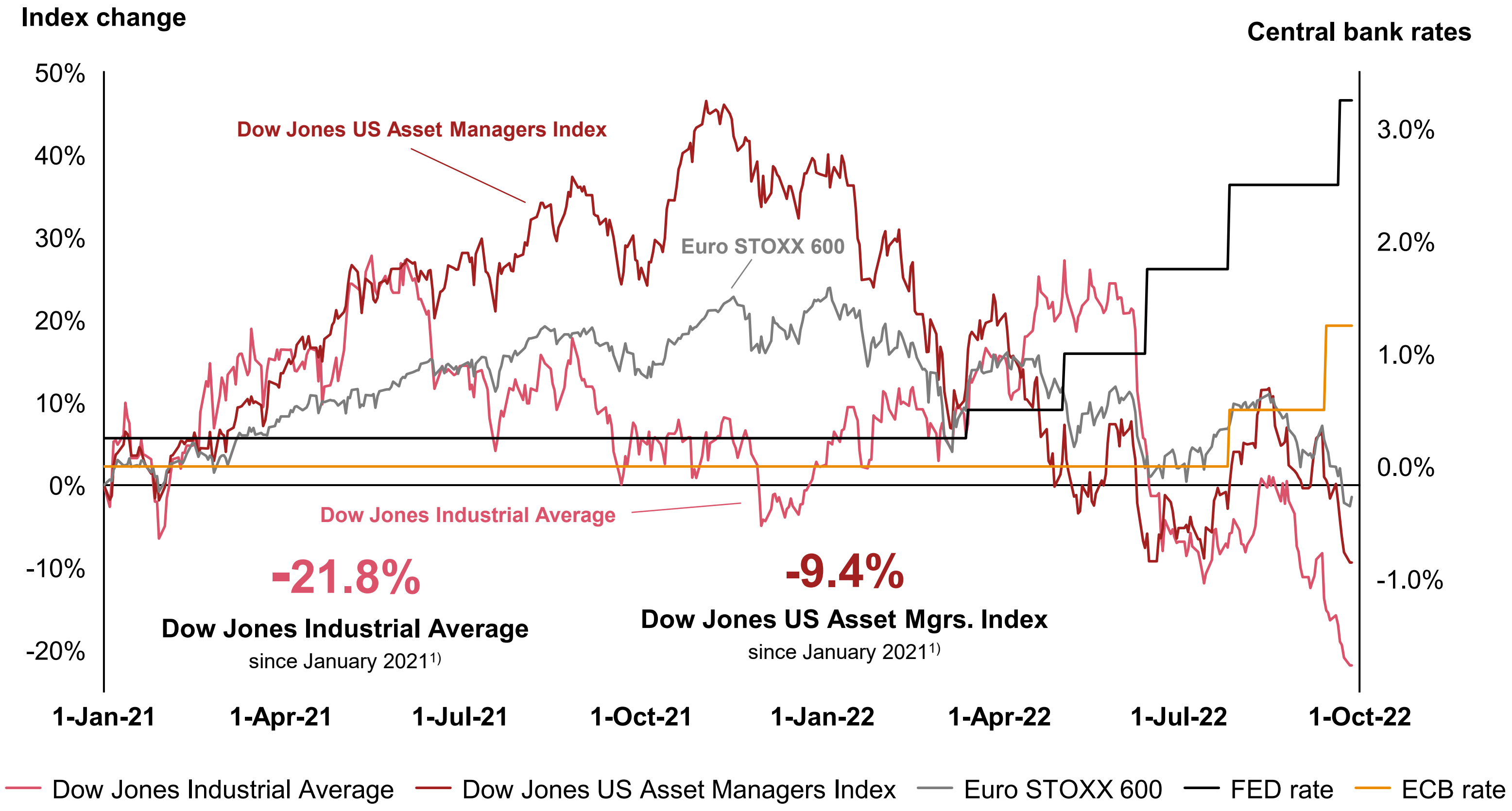
- **Significant increases in revenue** helped asset managers to achieve a further reduction in their CIR despite (on average) rising operating costs
- **Half** of asset managers kept up the cost discipline from the previous year and **reduced OpEx per AuM** (by 1.7bps), while the **OpEx per AuM of the remaining half increased** by 5.1bps
- The group of asset managers with the **highest cost increases** are smaller firms with **active investment management models**
- Most of this group nevertheless generate a high income and operate profitably **with high costs and low CIR**
- However, cost reductions may be necessary, as **revenue growth might slow due to global uncertainty**

1) Sample of 28 Asset Managers with 2021 figures; 2) For sample included in 2020 study
Source: Company reports 2021; Strategy& analysis

Falling stock markets and rising interest rates have put pressure on asset manager valuations

Development of asset manager valuations

Dow Jones Industrial Average vs. US Asset Managers Index and central bank rates



Comments

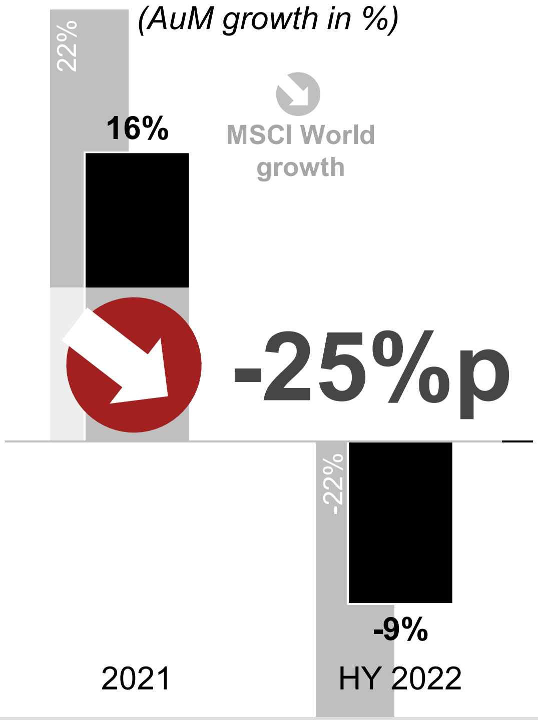
- The Dow Jones Industrial Average index has fallen by 21.8% since January 2021
- During the same period, US asset managers have on average lost 9.4% of their market capitalizations
- In light of persistently high inflation rates, central banks have instituted a global interest rate reversal (e.g. Fed raised the base rate to 3.25% in September 2022)
- The major drivers for the decrease in asset manager valuation are challenges to profitability due to reduced fee-based income as overall markets decline, as well as rising interest rates
- With further rising interest rates and decreasing overall market valuations, it is likely that asset manager valuation will remain under pressure

1) Period covers time span between 1 Jan 2021 and 27 September 2022
Source: Bloomberg, Strategy& analysis

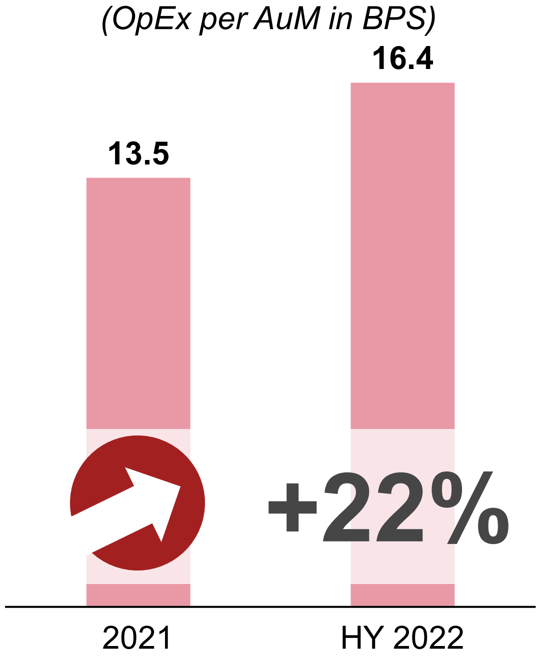
AuM and asset manager profitability have already been heavily affected in the first half of 2022

HY 2022 trend

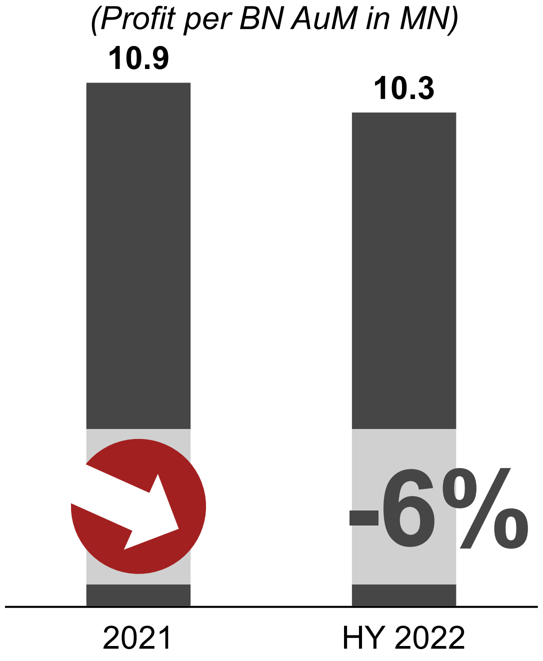
AuM Growth



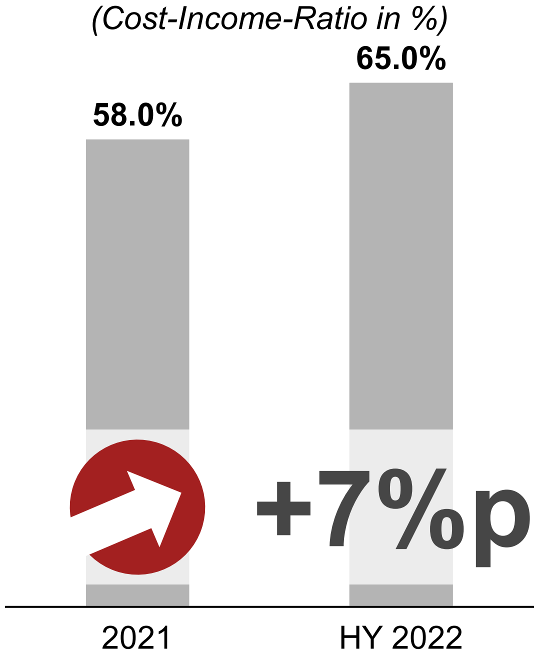
Operating Expenses



Profit per AuM



CIR



Reduced asset prices have put cost discipline back on the agenda, after it had ceased to be the focus of many asset managers during the period of persistent asset price increases in recent years

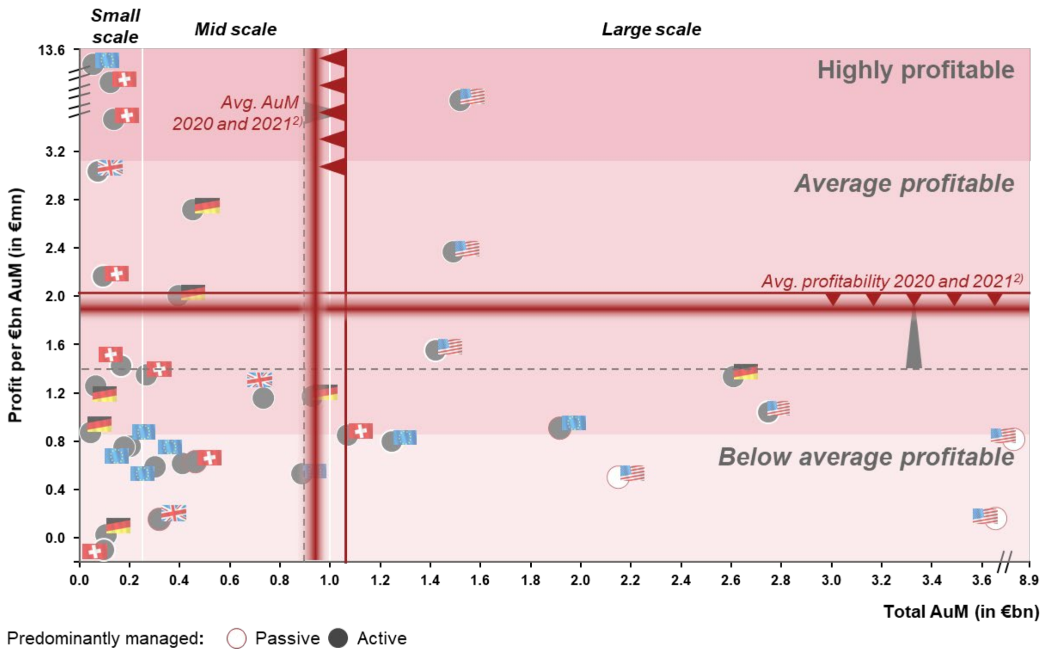
1) Sample of 10 Asset Managers
Source: HY reports, Strategy& analysis

With the increase of OpEx per AuM accelerating further, profit increases from 2021 are melting away

2022 trend benchmarking

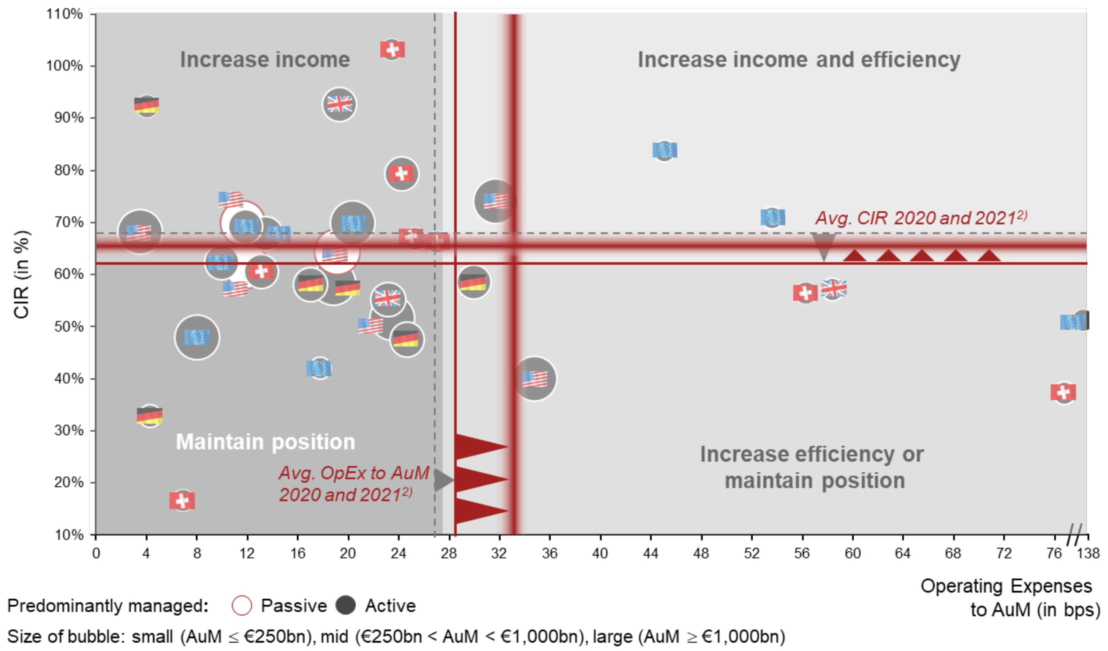
Trend outside-in competitive profit benchmarking

Declining profits and AuM



Trend outside-in competitive cost benchmarking trend

Increasing OpEx per AuM lead to increased CIR



To maintain profitability, support growth within differentiating capabilities and cut costs for non-essential capabilities

In order to counteract pressure on profitability, asset managers need to focus on realigning their cost structure

Strategic considerations for asset managers

Status quo

Revenue pressure

Looming recession risk

Decreasing AuM growth

Asset manager profits are declining

Further pressure on OpEx/AuM

Stagnating/ increasing OpEx

Increasing salaries and inflation

Cost pressure

Measures to counteract pressure on asset manager profitability

Bottom-line optimization		Top-line growth acceleration
Cost structure realignment	**Organizational rightsizing and M&A**	**Product and distribution strategy review**
• **Protect "good" costs** that help to differentiate capabilities (e.g. digital innovation, etc.) • **Reduce or eliminate "bad" costs** (e.g. non-performing sales channels, etc.) • **Aim for best-in class cost levels** in non-differentiating capabilities (e.g. Finance, Back-office support, etc.)	• **Benchmark current organizational size** and potentially restructure • Ensure **org. flexibility** and prepare cost base for external shocks (pandemics, wars, etc.) • **Identify JV/M&A opportunities** to leverage cost synergies and increase scale effects	• **Achieve higher share of wallet** with existing partners by e.g. extending service portfolio • **Accomplish integration into open platforms** to increase reach of product offering • **Target high-growth areas** (e.g. equity offerings and APAC region)
Improve OpEX/AuM and strengthen differentiating capabilities		**Capitalize on high-growth areas to counteract declining AuM growth**

Source: Strategy&

Lack of scale can only be partially tackled by consolidation, but further potential for cost reduction lies in outsourcing non-core activities

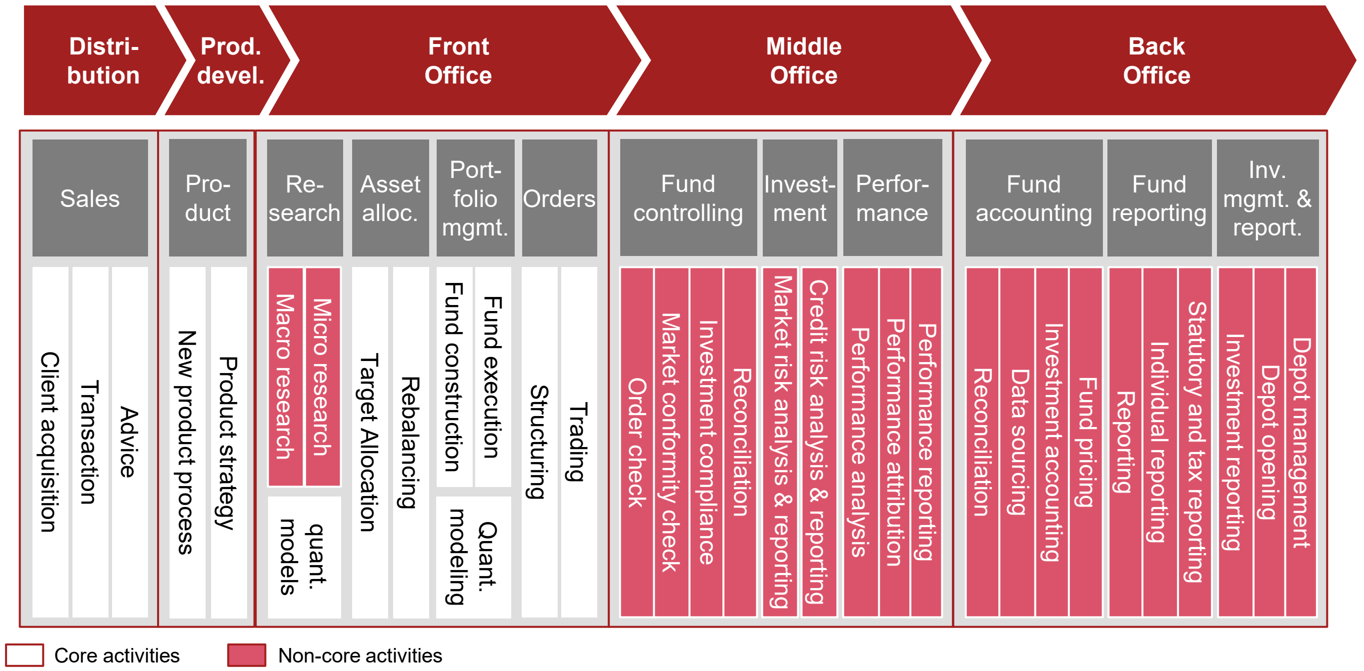
Deep dive: Outsourcing

Situation and challenge

- Smaller and mid-sized asset managers **lack the scale to address cost pressure** on their own – this can **only be partially rectified through consolidation** and cooperation
- **Outsourcing of select functions** along the value chain (i.e., primarily non-differentiating middle and back-office activities) to specialists offers **additional potential for cost reduction**
- This opportunity is reflected by a **growing trend in recent years,** with large asset servicing providers **extending the scope of their service platforms**:
  - BlackRock reinforced the market leading positioning of its Aladdin software
  - State Street created Alpha, building on its acquisition of Charles River Development
  - BNP Paribas, through selected partnerships, is shaping a best-of-breed solution
- **Key challenges that** asset managers often need to address include:
  - **Legacy IT** that lacks the flexibility to integrate services
  - **Standardization** of processes to allow leveraging of synergies

Opportunities

Asset management value chain



Value-added data analytics/ AI-based capabilities that allow additional differentiation and alpha at reasonable costs

Middle and Back Office as a service – cost-efficient handling of non-differentiating activities

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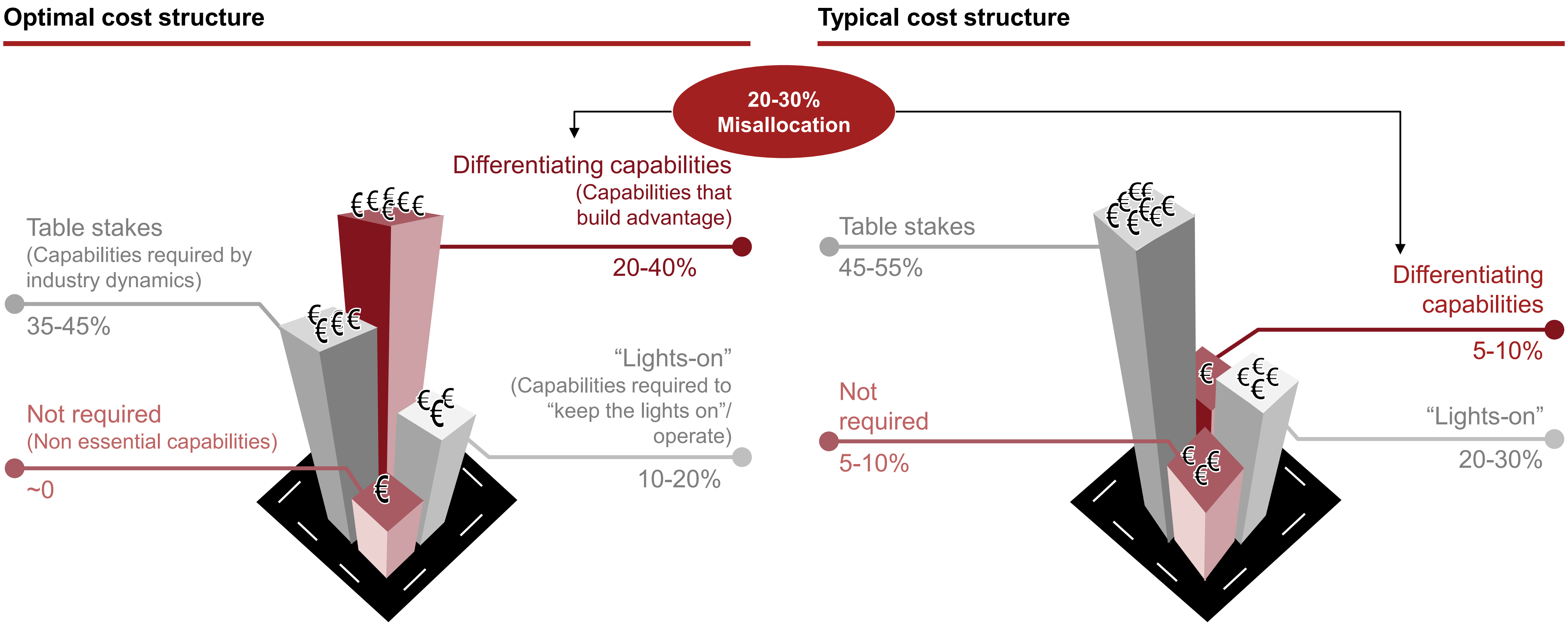
Classification of costs into four categories and investment focus on differentiating capabilities

Cost structures



Source: Strategy&

Alignment of costs with capabilities needs investments on differentiating "good" costs and elimination of "bad" costs

Cost structure alignment

- Branches (if applicable)
- Call center
- Marketing (Communications)
- CRM and Experience
- IT build and ops
- Fraud detection

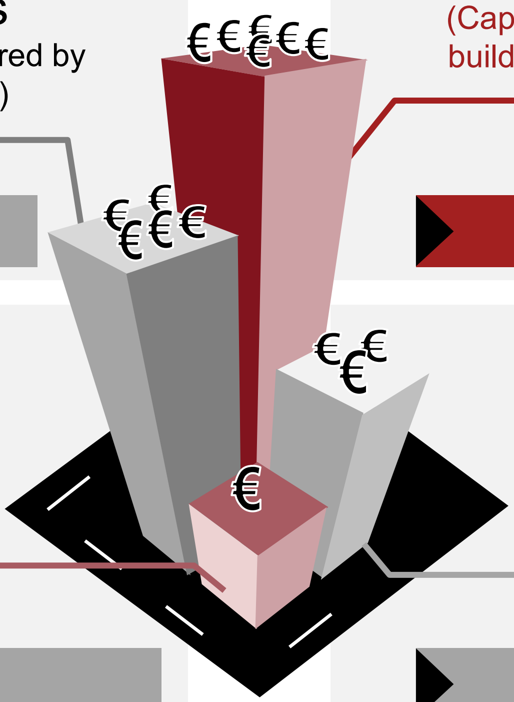
Table stakes
(Capabilities required by industry dynamics)

Aim for best-in-class cost levels

Differentiating capabilities
(Capabilities that build advantage)

- Digital innovation / experience in Agile
- Customer centricity / service?
- Marketing and analytics?
- HR and talent?
- Agile product development?
- Customer journeys?
- Omni-channel experience?
- …

GOOD COSTS: May spend more



- Non-performing sales channels
- Discretionary projects
- Long-tail brand portfolio
- Non-core marketing activities
- Duplicate functions on group and local level
- Unnecessary reporting activities

Not required
(Non essential capabilities)

Eliminate or be parsimonious

"Lights-on"
(Capabilities req. to "keep the lights on"/ operate)

- Finance & Accounting, Controlling
- HR (Admin.)
- Legal/Regulatory
- Back office customer service, if not STP
- …

Aim for best-in-class cost levels

Source: Strategy&

Fit for Growth is about enabling sustainable growth – not just cutting costs

Key differences of the *Fit for Growth* approach

Cost-reduction approach		*Fit for Growth* approach
Benchmark-driven approach focused on matching competition	**Philosophy**	Strategy-back approach that **protects "good" costs** (differentiating capabilities) and reduces "bad" costs
Applies a broad suite of **cost reduction levers** across all cost pools in a uniform way	**Methodology**	Prioritizes capabilities, segments costs, and applies reduction **levers at tailored intensity**
Focuses on structure – "lines and boxes" and "spans and layers"	**Organization Linkage**	Views **holistic organization design** as key to transforming and sustaining the new cost structure
Pushes for a **top-down** cascade of leadership alignment and **communications**	**Change Management**	Advocates **culture-led** change focused on scaling a **critical few behaviors** and leveraging employee "pride builders"
Addresses sustainability during implementation as an **afterthought**	**Sustainability**	Includes **org. process, talent** and **cultural enablers** of enduring cost management from Day 1
Makes you smaller		**Makes you stronger**

Source: Strategy&