

# EVOLUTION IN ASSET MANAGEMENT:

The wealth management industry is changing at an exponential rate. Successful adaptation hinges on understanding the underlying trends and putting a robust and flexible operating system in place.

Propelled forward by the rapid pace of innovation, the business of managing wealth is being reshaped before our eyes.

Five interwoven factors are driving the change; we'll briefly address each over the coming months:



## Fierce competition

Competing effectively may be more complicated than it once was, but the barriers to entry are still relatively low.

You are here



## Vulnerable economics

Growing competition means benchmarks for excellence are moving targets, and firms are spending more, persistently pushing up costs and pressuring margins.



## Emboldened investors

Investors have been conditioned by their experiences outside the industry to expect a more integrated solution that seamlessly caters to their needs.



## Complex regulation

The proliferation of regulatory bodies worldwide means firms must contend with an increasingly complex set of rules and rule makers.



## Transformational technology

Unstructured and previously inaccessible data sets are now full of promise, and there is little doubt the flood of usable data will continue to grow, sometimes in unpredictable ways.

# 2 Vulnerable economics

## Trends

**Stable and robust economics have always been attractive features of the asset management business, particularly in contrast to some of the more volatile parts of the financial services sector.**

Even amid sweeping changes in the wake of the global financial crisis, asset growth sustained many managers. Slowing revenue growth, however, hints at trouble: While global assets rose almost 54% between 2012 and 2017, revenues grew only 38.5% over the same five-year period.<sup>1</sup>

Fee pressure is widespread and easily apparent in the retail fund world. It may be even more noteworthy in parts of the less transparent institutional market.<sup>2</sup> Zero or near-zero fees for passive strategies is driving much of this, causing investors to ask themselves how much they are willing to pay for alpha. This is somewhat problematic for firms offering inexpensive beta as a loss leader and a means to sell other products with higher fees.

Revenue pressure is not limited to active, long-only managers. Many managers of alternative strategies have also felt compelled to lower fees and align their interests more closely to their investors. Management fees of 1% are now common among hedge funds,<sup>3</sup> and in some cases have fallen to zero. Some managers have radically altered their fee structures, trading a guaranteed management fee for the potential of higher performance fees. “One or thirty” is an approach pioneered by investors such as The Teacher Retirement System of Texas (commonly known as Texas Teachers) that appears to be gaining momentum.<sup>4</sup> Research from PwC suggests this trend will continue: Management fees for alternative products are expected to decline by another 13% to 15% by 2025 (Figure 1). Deteriorating economics are not limited to the top line. Growing competition means benchmarks for excellence are moving targets. Firms are spending more to deal with compliance, security and other concerns, persistently pushing up costs and pressuring margins. Having recovered to levels seen prior to 2008, margins are once again under pressure.

## Implications

**Fee pressure is likely to become a fact of life for a growing number of firms. Some may appear immune, but resistance may not be sustainable.**

It is difficult to pinpoint the ultimate degree of impact, but there will be no safe harbor. One plausible outcome will be a barbell-shaped market, with adoption focused on virtually cost-free beta products at one end and value-added strategies at the other, reflecting approaches that are not replicable in passive approaches. Many of these will be alternative strategies. Others will be multi-asset approaches. Customization and risk management will feature prominently.

As it stands, many firms report falling fees, but it's much less common to find anyone claiming it was a major issue. The lack of immediacy may in fact pose a threat in its own right. The slow pace of change can encourage complacency, and any firm that does not

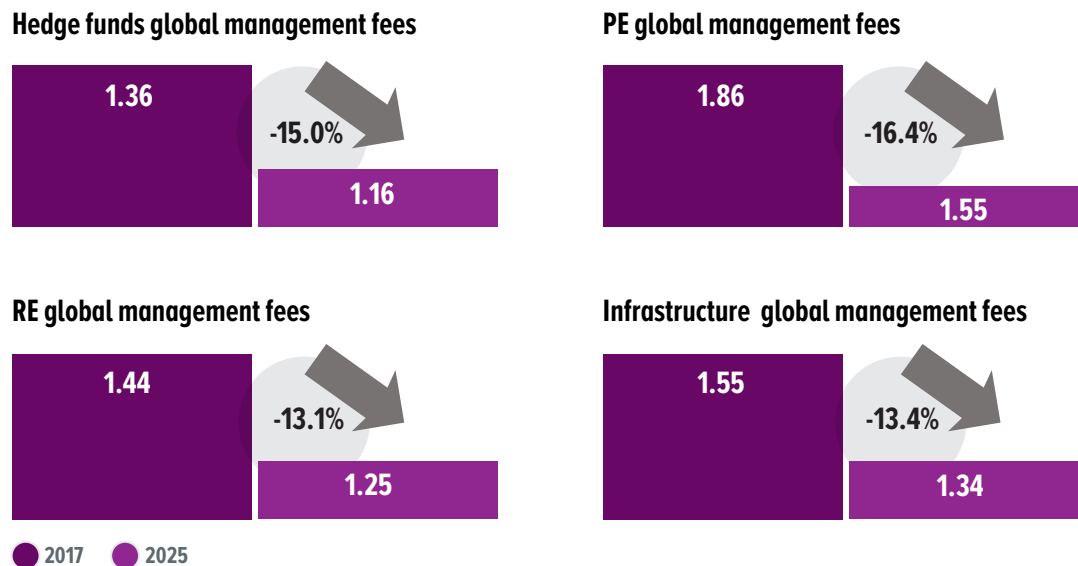
change runs the risk of succumbing to the boiling frog syndrome. The absence of acute pain in the present does not mean that adaptation is not necessary. Long-term survival may depend on it.

Operationally, there must be a focus on cost containment, efficiency and scalability. Counterintuitive as it may sound, this could mean hiring more talent. Building a resilient enterprise that can survive sustained margin pressure means upgrading operations and technology teams. New technology hires are more likely to be charged with reducing the amount of rote work, enabling other employees to focus on higher value activities, improving the overall client experience and driving revenue.

Technology budgets will also need to become much more strategic. Simple maintenance, incremental upgrades, or reactive technology adoption will be inadequate. Cost savings might be a goal, but it cannot be the only one. Sustained competitive advantage should be the primary objective, especially in light of the likely disruption caused by migrations to new systems.

Outsourcing is already pervasive. All aspects of asset management, including fund administration, middle office, data management, compliance, and even portfolio construction and investment selection can already be outsourced. The growth and maturation of specialist providers offering these services means outsourcing will increasingly become the new normal. Ultimately, technology and operations should provide leverage for organic growth, product launches and entering new markets.

**FIGURE 1 | Global Alternative Management Fees Decline**



Source: PwC Global AWM Research Centre analysis; past data based on Preqin and Hedge Fund Research

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## References

<sup>1</sup> *Asset & Wealth Management Revolution: Pressure on Profitability*, PwC, October 2018.

<sup>2</sup> *Where Fee Pressures Hurt the Most*, Institutional Investor, February 22, 2019.

<sup>3</sup> *Asset & Wealth Management Revolution: Pressure on Profitability*, PwC, October 2018.

<sup>4</sup> *The Texas Teachers' "1-or-30" Fee Structure*, Jonathan P. Koerner, Albourne Partners, September 2018.

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