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Even Last Year's AUM Growth Couldn't Save Managers from Profit Margin Pressure

By Lisa Fu May 22, 2020

Though asset managers experienced strong inflows and capital market performance in 2019, it wasn't enough to prevent a slight decline in profit margins, according to a recent report from Boston Consulting Group. As industry pressures continue to build in a turbulent 2020, firms are relying on strategies that bring greater revenue, including alternative investments, to maintain profitability.

Even though alts represented just 16% of global asset management AUM, they brought in 46% of the revenue in 2019, according the report. And by 2024, alts may account for close to half of industry revenue, Boston Consulting Group projects.

Managers' overall revenue growth is not keeping up with AUM increases, due to the continued popularity of passive investment products, says **Lubasha Heredia**, managing director and partner at Boston Consulting Group.

"Passive continues to grow and fees on passive, as you know, have been incredibly competitive," Heredia says. "Companies really have been slashing prices left and right. Some of the funds that have been launched in that phase have been effectively priced at zero."

Meanwhile, traditional active strategies have higher revenue realizations, but have decreased as a percentage of overall AUM. When it comes to revenue, alternatives are the bright spot for the asset management industry, Heredia says.

Private equity, in particular, is expected to represent half the revenue in the alternatives category by 2024, Heredia adds.

"This is kind of the next frontier where disruption will come from," Heredia says.

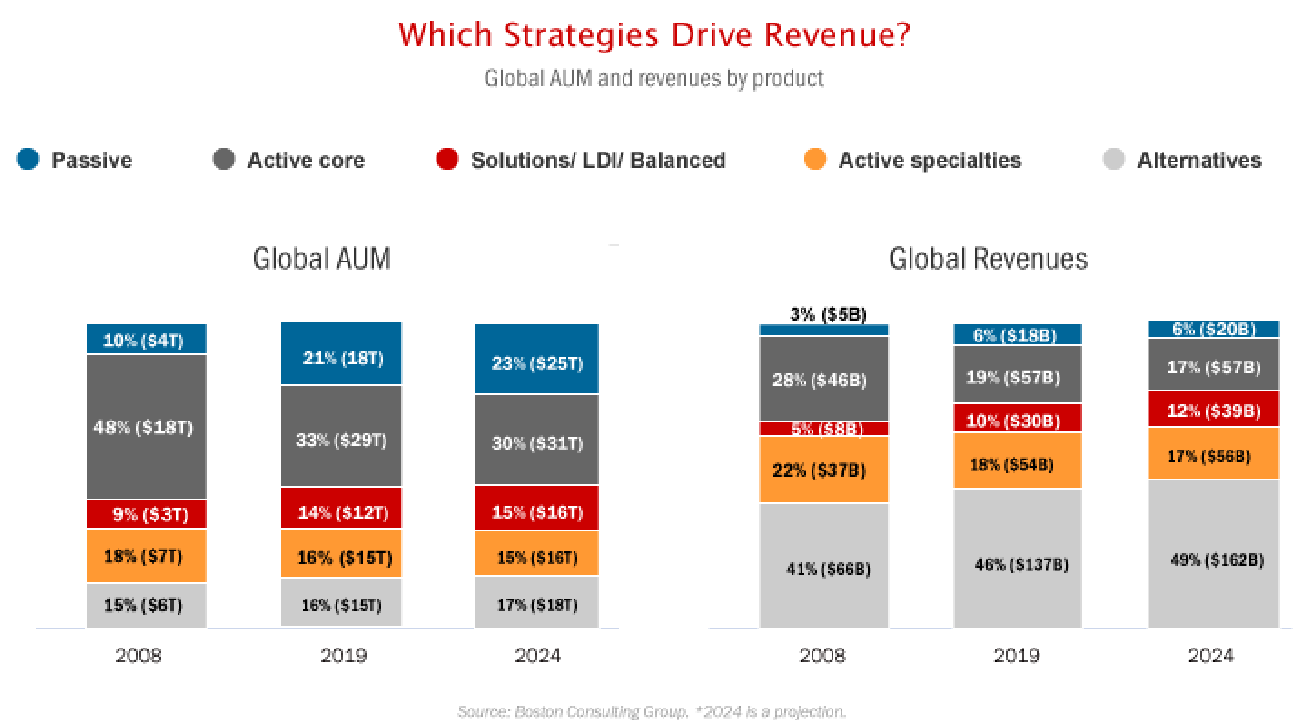
Asset managers' overall AUM growth was strong in 2019, and a lot of that was driven by strong capital markets performance, says Heredia. The U.S. asset management market grew 20% from $32.7 trillion in 2018 to $39 trillion in 2019, according to the report. Globally, AUM grew by 15% from $77.4 trillion to $89 trillion. In the U.S., retail assets grew

24%, and institutional assets grew by 15% during 2019, both outpacing global growth numbers. Global retail assets rose by 19%, while institutional assets grew 13% during the year.

However, this strong performance was not enough to prevent a slight decline in industry profit margins, as fee pressure took a toll. In addition, most of the net flows went to the largest firms, while small and midsized asset managers faced outflows, Heredia says.

Indeed, global operating profits as a share of net revenue fell from 35% in 2018 to 34% in 2019, according to the report. Global net revenue as a share of AUM fell from 26.2 basis points in 2018 to 25.3 basis points in 2019, marking the sixth consecutive year of declines.

“We expect to continue seeing fee pressure, and we expect to continue seeing asset managers struggling with navigating their cost structure,” Heredia says. “I think the challenges that the industry faces aren’t new. What I think is happening is that COVID-19 is accelerating some of these needs.”



The firms that will struggle the most are the midsized active managers, Heredia says.

“If you’re in the middle, you can either show an outstanding performance to justify [a] higher price or you can offer your product at such a scale that you can actually be competitive,” Heredia says.

For primarily active managers, there has been pricing pressure for quite some time, and the current environment might put additional pressure on some companies, says **Mark Bruno**, managing director at Echelon Partners. Traditional long-only active managers face the most pressure at this time because they charge higher fees and have typically seen more outflows, he says. These firms compete against passive products like index funds, and up until earlier this year, it was hard to make the case that one should spend more on an active manager than a passive fund based on performance alone, he says.

“It’s not just about Vanguard getting bigger and bigger and putting pressure on everyone,” Bruno says. “It’s also that advisors and institutional investors have more options right now, so the marketplace has evolved.”

The asset management industry has always been top-heavy, but there is a lot of industry consolidation happening because of coronavirus-related challenges, says **Sondhelm Partners** CEO **Dan Sondhelm**. The largest firms have always made up the majority of assets and attracted the majority of flows for both funds and separate accounts, he explains. If a firm has scale, the margins are strong, and it can afford to do the things required to grow even larger, such as building a sophisticated digital marketing team to build brand and visibility and hiring an army of salespeople, he adds.

“The biggest firms have multiple strategies, so there’s usually something in favor, and that’s not necessarily the case with midsized firms,” Sondhelm says. “It really is all about scale, and it’s going to continue to be about scale. I still think there’s a place for [niche firms] but you really need assets to compete because it’s tough.”

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