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A comprehensive impact analysis of COVID-19 on the asset management industry

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Abstract
Asset Management industry offers enhanced diversification and quick liquidity to the investors by pooling money from widespread population and investing it further depending upon the risk profile of their investors. Due to COVID-19, asset management has seen a decline of nearly $1.7 trillion in global assets under management for the first time in a decade. This has led to fundamental shifts in the strategy and operations of the Asset Management companies. Asset managers must rethink their strategy to keep their existing customers invested in their portfolios and ensure their cash reserves are not declining. Any mass sell-off in their portfolio will have a contagion effect on other portfolio of the firm due to unwarranted panic. To entice new investments, asset managers also need to restructure their fees & charges to keep the overall cost for investors at minimum. Asset managers must leverage artificial intelligence to crunch huge amount of financial data to draw valuable insights and design strategic initiatives that are investor centric.

Keywords: Asset management, asset under management, COVID-19, HNIs AMC, AUM, artificial intelligence

Introduction
In general terms, Asset Management Companies (AMCs) collect funds from their clients and further invests pooled funds on their behalf for a fee. AMCs offers more diversification, enhanced liquidity, and professional fund management services to its clientele. AMCs invest raised money through various securities options including equity shares, mutual funds, bonds, real estate, limited partnerships, etc., bearing different level of risk and rewards. Besides managing the portfolios of High Net worth Individuals (HNIs), asset management companies also manages hedge funds and mutual funds. Asset management companies that manages exchange traded funds and mutual funds are called mutual fund based companies. Money is collected from clients through these collective investment options - mutual funds, private funds, ETFs etc.

How Asset Management industry works
Since AMCs have large pool of resources from widespread individual clients, they provide the benefits of diversification and enlarged investing opportunities to their clients. By pooling their resources and paying some proportional return to asset management firms, clients can avoid the stipulation of minimum investment which needs to be fulfilled while purchasing securities from the market on their own and can avail the benefit of investing in a larger assortment of securities with a small stake in it. In return, Asset management firms receive a price discount on their purchase thus allowing them to leverage economy of scale. Asset management firms also usually charge a fee proportional to clients per their Asset under Management (AuM).

In general, there are a few broad types of asset management. The most common are the financial asset management or investment management. This sector of financial services industry manages segregated client accounts and investment fund schemes, looks after the investment of clients, and provide recommendations based on the financial health and risk-taking capabilities of client. While financial asset management may be the most observed element of the asset management industry, the other major type of asset management is infrastructure asset management. It applies a bundle of practices including economic, management, financial and engineering to physical assets with the value proposition of offering best customer service experience for the costs involved. It also includes management of end to end life cycle including phases such as designing, construction, and replacing & disposal of physical and infrastructure assets.

Enterprise asset management makes up the third category of asset management. To manage organization's assets, information systems (which may include asset registry, computerized maintenance management systems, geographic information systems) are implemented to facilitate informed decision making by asset managers.

Given the rapid progress and innovation in technology, every organization that manages assets – whether it is an AMC managing client's assets or an asset owner managing its assets in house – leverages technology as part of its investment operations. Asset management industry has not been able to embrace technology as early as other sectors of financial services industry. They do not take into consideration the need of innovation in labor intensive models because of their high profit margins and rather focus on sales and growth which derogate client service and retention.

Today, target customer segments of asset management industry, mainly consisting of millennials and Gen Z, have seen a drastic change in their investing behavior as compared to their parents'. They prefer to have a 24x7 access to investment advice on smart phones by engaging online and mobile channels along with a low minimum initial investment amount. Moreover, experienced segments (Gen X and Baby Boomers) want to take advantage of online investment and on-demand.

Review of Industry Reports

As per Deloitte report (2019) [2], besides the increased use of technology, asset management industry is undergoing change due to change in regulatory framework. Securities regulations in Europe, US, and Asia are changing drastically due to diverse priorities. In addition, the introduction of new rules and regulations globally will also confound the compliance process for asset and wealth management firms in coming years.

PwC report (2019) [5] took into consideration the desired changes in asset management sector in the coming years. The various asset classes including hedge funds Assets under management will go up from 63.9 trillion dollars to 101.7 trillion dollars by year 2020, a compound growth rate of nearly 6%. PwC observed the correlation between the relevant economic factors and assets under management for a period of 13 years comprising of two major financial crises. It considers the impact of GDP growth in strong economies assuming a normal growth of GDP at 5.15% based on IMF prediction and took into account the population of Europe and Asian part. PwC model predicts that the Asset management industry will control the 101.7trillion dollars of customers of pension funds, insurance sector, high net worth individuals and it is believed that the share of AM industry will go up from 36.5% to 46.5% which is around 10%.

The pressure will mount on asset management industry because of rising cost on account of regulation, commercial cost pressure to expand distribution network, diversification of product sets for global clients, increased investment in technology and data management and entrance of new technology or social media company in AM industry. Clarity and transparency will be considered for all the investments related activities along with the regulations across the world.

WNS Global Services (2016) explored three major disruptive trends and suggest best responsive strategies shaping the AM industry not only to counter but also to capitalize on these trends. The major trends include:

1) Digital Disruption Bringing Structural Changes in Business Models: Technology-led disruptive innovation leads to creation of new market demands in investment management because of cheaper pricing, simplicity and transparency and millennials also prefer to online reviews and peer recommendations than the advice of financial advisers.
2) Complex and Frequent Regulatory Changes: On account of their operation in different countries asset management companies need to face different regulatory mandates which needs not only to be complied with but also to be utilized to enhance operational efficiency. Regulations leads to re-alignment of business structure and discontinuation of certain products.
3) Increasing Pressure on Margins: In 2015, the asset management sector's cost base has increased by 44 percent since 2007. Although regulatory expenditure can be anticipate asset managers can be unaware because of the scale of regulatory change and the ability of a company to absorb cost spikes.

The Responsive strategies include

1) Asset management companies should establish frameworks, create innovative strategies, re-focus strategy and operations, lower investment barriers, provide investment tools, facilitate interaction among clients and re-align business Models and business relationships.
2) Asset management firms can use centralized approach, technology, big data analytics and taxonomy mapping to track regulatory developments and plan the requisite change programs, re-align business structure and can take up idea of outsourcing of regular activities to third party.
3) Asset manager should conduct an as-is assessment of the nature of regulatory changes and their impact, automate manual process like introducing robo-advisory for Millennial clients and explore alternative product strategies like peer to peer lending, using ETFs and social channels to attract investors.

Impact of COVID-19 on the asset and wealth management industry

Though stock market has bounced back from the lows of March 2020, asset management industry seems to have a prolonged low growth performance due to COVID-19. As per Boston-based Cerulli Associates, total global assets under management would fall from $104.4 trillion to $102.7 trillion, a decline of $1.7 trillion. Pandemic also ended the decade long continuous growth of the industry. This poor performance is expected to be concentrated in USA and Europe, whereas Asia is going to drive the recovery and growth of the industry. From investors perspective, mutual fund investments are riskier than the money market funds that are riding high on long term potentials amid lower interest rates at present.

As per PWC (2020) [6, 7], the COVID-19 pandemic has led to widespread economic hardship and concerns for consumers, businesses, and societies across the globe. The business leaders should possess critical qualities which includes crisis management, improvising operations, workforce management and enhance supply chain, finance, taxes, and innovative strategy resulting in sustainable competitive advantage. Most companies typically have business continuity plans (BCPs), but it may not address their ever-changing priorities and unexplored parameters of this global outbreak. Any contingency plan of old normal world was designed without considering the widespread quarantines and lockdowns, small and medium sized business disruptions, and enforced travel restrictions of a global health emergency like this one. The crisis raises several unique challenges for asset managers.

KPMG (2020) [4] said that ongoing pandemic has presented stakeholders of any AMC with multi-faceted challenges such as asset managers, pension fund managers and sovereign wealth fund managers, as well as managers of different assets like private equity, hedge funds, real estate etc. In such a fast changing time, the importance of decision support systems, correct information and possible challenges must be clear to the teams who are managing the current assets and adapt to the new normal in the only chance to prepare for the future.

As per HCL (2020) [1], the focus of the AMCs should be on controlling their cash reserves for next few months. Market volatility has created serious issues with the efficient calculations of Fund's Net Asset Values (NAV). From investors perspective, there is a need for proactive communication to spread awareness and educate investors on the recent divergence of fund performance.

Low liquidity in the market and reduced-price discovery are forcing asset management firms to reassess their valuation controls and processes. Investors are in dire need of funds and liquidity to meet their expenses are forced to go for liquidation of their portfolios and using redemption of their investments in large. But this could result in tax ramifications for certain investors which may prevent a certain set of investors from liquidating their assets. Majority of debt market is depicting stress symptoms. The liquidity of passive products is still untested. For sure, there is need to have two separate market impact analysis – one for market linked products and the other for market unlinked guaranteed products.

In the ongoing lockdown scenarios, even the physical backup locations are prohibited from access. The social distancing norms now demand that workers and businesses should adopt the remote working scenarios and develop work from home cultures to the extent possible.

Service providing firm are essential drivers of AMC's key processes could run into issues due to pandemic. Besides focusing on social distancing of their employees, suppliers and clients, companies need to work on their disclosure on the impact of COVID-19 on own business in their current financial statements and, of course, their regulatory filing. It may be reflected with the use of risk factors, quality of debt, impairment, and management discussion.

Societe Generale (2020) said that COVID-19 continues to have major effect on financial markets, making it difficult for asset managers to manage active funds as well as passive investments. The implications of COVID-19 have been compelling which can be understood by infusion of around $100 billion by central banks to boost investment funds being majorly disturbed due to the market turmoil, posing questions on the systematic risk inherent in the industry. In view of the magnitude of impact of COVID-19 on the global economy, high level of volatility and exigent market conditions are inevitable for asset management industry. Although the instantaneous reaction to this situation gives variant results for different financial and investment strategies. Passive funds (equity or bond indices), which used to be the most sought out funds among the investors in past few years, prove to be very vulnerable in these periods of high market volatility since the initiation of the crisis. The investors suffered high amount of losses in the month of February and March. But these were not the only funds which suffered significant losses, even the funds using traditional quantitative methods have been through the similar rough patch. These funds are based on the presumption that the market follows a certain pattern which can be found by analysing the historical data and using this data to form investment decisions. However, the current crisis brings out the shortcomings of these type of funds of mitigating risk and providing positive performance or growth. Some analysts even termed COVID-19 as a 'black swan' event. Active equity funds, in contrast to passive funds, gave positive results during the late February and early March period. According to a research from FE Fund Info, 89% of UK active equity funds outperformed the market. However, asset managers and even actively managed funds failed to perform in these challenging market conditions once COVID-19 starts getting worsened. In the commodities sector, for example, there were high market anomalies mid-February. This hinted towards the twisted environment awaiting traditional and quantitative portfolio managers to generate alpha. Likewise, other industries, asset managers are adapting to a new normal because of the COVID-19 crisis. Asset managers need to start taking a retrospective look at their current investment strategies to re-evaluate their portfolios and ensuring their preparedness for the coming high levels of volatility.

Future Prospects of Asset and Wealth Management firms

All the markets across globe are very hopeful that the respective governments will gain victory over COVID-19 within a quarter or two. As the COVID-19 recedes, asset management firms are expected to take measures to improve and reconstruct customer faith and confidence in their investment schemes. Possible restructuring of fees and charges would be needed as many of their clients would be credit strapped.

Sheffield Haworth (2020) [8] examined the initial impacts and likely longer-term ramifications of the outbreak on the fund management industry. They considered the knock-on effect to hiring and human capital requirements. The narrative across the asset management industry now is that it is simply too early to tell what the longer-term impacts of the pandemic will be. Recent events have been the fastest bear market on record and many managers we have spoken to feel that the effects of the pandemic will be felt for some time. The impact on listed equities will continue to be particularly severely felt. European equities suffered their worst quarterly performance in Q1 2020 since 2002, struggling to stand firm in the face of plummeting share prices and increasingly fearful investors as the pandemic took hold. However, many feels that there are attractive positions to be taken in the equities market, with several stocks at a significant discount having come off by more than 40% from year highs. Investors with a medium-term horizon and an active value focus may be interested in increasing their allocations, especially as there appears to have been a slight rallying in the equities markets at the time of writing. However, several other equity investors we spoke to have seen a huge increase in allocation to passive equity funds and a notable shift away from active equity management.

The consequences of the Coronavirus outbreak will be far-reaching and significant. With economists, strategists, governments, and Central Banks all warning of an economic impact of unprecedented scale and depth, it is challenging to see where the opportunities for asset managers may lie. However, as with all macro events, the pandemic will no doubt also provide opportunity to those who are well positioned relative to the market and proactive in managing how their businesses responds. Throughout their 27-year history, Sheffield Haworth has supported their clients through challenging market conditions and several periods of uncertainty. They remain well positioned to help their clients ensuring that they have the best product, distribution, and people to succeed in the most challenging of market conditions.

Asset managers are working towards using artificial intelligence systems are proficient enough to deal with the anomalies in the market. It will enable them to integrate learning which will be helpful in analyzing more complex, non-linear patterns in asset behavior, making use of expanded alternative data, thus allowing them to adapt to the dynamic market conditions. Artificial intelligence will enable managers to construct more advanced portfolio by using abundant unprocessed data, thereby going beyond using only historical data. The managers will gain by such innovations since they can focus on making strategies to overcome the crisis in the future. Understanding the concept will enhance the skills of mangers in the investment process which includes the allocation of assets based on the future performance of different classes of securities. Across the world, COVID-19 crisis has undoubtedly disrupted the whole economy. Eventually, this will lead to managers adapting to new technology which is very essential in light of this new normal.

Conclusion

The emphasis should be both on the short-term and long-term goals for the Asset Management industry. The asset managers must keep in mind the discussed disruptions going on in the financial markets for the new prospective investors. Accepting the downtrend and adapting itself to the new normal is a necessity for the industry today. Those companies that are rigid to change are at higher risk and are destined to an exit from the market.

Artificial Intelligence is a significant tool available to asset managers and has promising benefits for the firms. Real time analysis of sales and marketing interactions and client services, predicting future state of the market by analyzing abundant amount of data available and using processed data in making strategic decisions are some of the major application of Artificial Intelligence for asset managers. Moreover, use of intelligent bots in making investment and distribution decisions provides an opportunity for asset managers to focus more on client's relationship and business strategy than routine tasks. Though Artificial Intelligence comes with relatively high entry costs and uncertain gains but in coming 10 years it will prove to be the game changer in Asset management industry. COVID-19 crisis has undoubtedly disrupted the whole industry. It will lead to asset managers adapting to new technologies and gain competitive advantage in this new normal.

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