



Wealth and asset management: acquiring to stay ahead of disruption

Wealth and asset managers are under mounting cost pressures and fighting for growth by strengthening their capabilities via inorganic strategies. How can institutions maximize cost and revenue synergies and drive long-term stakeholder value? Identifying and realizing synergies will represent both a great opportunity and a challenge for anyone pursuing a deal in this sector.

The wealth and asset management (WAM) sector is undergoing unprecedented levels of change driven by evolving demographics and customer expectations, ongoing technological disruption and globalization. To remain competitive, sector incumbents are acquiring firms for new or complementary capabilities.

2019 is proving to be a strong year for M&A activity in the WAM sector. According to EY analysis of global WAM deal data, in the first nine months of 2019 alone, both deal volume and value have already surpassed the strong performance in 2018. There were 291 deals with a total disclosed deal value of US\$18.9b, up 17% compared with the same period last year. Acquirers are willing to pay full price for the targets that fit their long-term strategic agendas, making it easier for the targets' boards to approve the sale.

This robust set of M&A data is consistent with the findings of our most recent Global Capital Confidence Barometer, where more than half of WAM executives surveyed say they'll pursue M&A in the next 12 months as part of a multi-faceted growth strategy.

2018

(first nine months)

278 | **\$16.1b**
deals | deal value

2019

(first nine months)

291 | **\$18.9b**
deals | deal value

17% increase in deal value

4.6% increase in deal volume



EY

Building a better working world

WAM firms remain competitive despite changing market dynamics

As wealth transfers from baby boomers to a generation of technologically savvy and increasingly cost-conscious clients, WAM firms are pursuing more cost-effective investment products, transparent fee structures and a seamless digital customer experience. Traditional distribution models are being upended by new market entrants bringing innovative direct-to-client digital solutions to the investing marketplace. This allows WAM firms to quickly offer new products and experiences to customers. Firms considering acquisitions and strategic partnership models to maintain this pace are taking steps to remain relevant and build optionality into their long-term business models.

The following are a few trends we've seen in WAM sector deals:

WAM firms are fortifying their digital (and other) technological capabilities: The dizzying pace of technological disruption means traditionally dormant WAM players are no longer waiting on the sidelines. According to WAM sector respondents to the EY Capital Confidence Barometer published in April 2019, the top priority for WAM deals was in fact to bolster other digital, technological and production capabilities. Recent WAM sector deals reveal consistency with this deal rationale: new customer segments or distribution channels (Morgan Stanley and Solium in 2019), enhancing customer or field experience (LPL Financial and AdvisoryWorld deal in 2018) and simply acquiring talent.

WAM firms are rounding off product portfolios: They are constantly searching for new investment products and solutions to diversify their portfolios and to better satisfy investing demand. They are also seeking to differentiate themselves by acquiring specialized managers, enhancing their ability to offer niche products across nontraditional asset classes and strategies (PIMCO and Gurtin in 2018; Franklin Templeton and Benefit Street Partners in 2018) with increasing focus on alternatives and illiquid asset classes.

Many firms are building scale to drive operational and financial excellence: They are renewing their focus on operational efficiencies. Increased regulatory costs, pressure on pricing and a shift to lower-margin passive products have all put pressure on margins in the WAM sector. In addition, some large traditional asset managers have been experiencing significant asset outflows and have been unable to scale down operations quickly, putting pressure on their operating model. To address this challenge, many players have combined in order to drive cost synergies by eliminating duplicative corporate structures and building greater leverage into the operating model (Invesco and Oppenheimer, 2018). Furthermore, cost synergy targets in WAM have grown over the past decade.

How to enhance value in your deals

Though the strategic rationale for an acquisition may be clear, capturing synergies within a planned time frame can be difficult. The first step in maximizing deal value is to have a clear understanding of synergy sources. Acquirers should have strong hypotheses regarding specific synergies – including realistic timelines – even before they announce the deal.

Build an ecosystem to internalize customer demand but be clear on when and what to cross-sell: WAM players are buying targets to create financial ecosystems that can help retail clients get control of their fractured financial lives. This strategy can capture substantial client wallet share by providing end-to-end financial solutions and internalizing all relevant demand. To drive these revenue synergies, acquirers must ensure that the type of growth (e.g., revenue versus assets versus specific customer segment) the target provides fits the overall vision of the company. Management should also develop hypotheses for near-, mid-, and long-term cross-selling opportunities, as their clients move through various financial stages in their lives.

Bundle complementary offerings while retiring subscale solutions: Merging firms must maintain a dispassionate approach about which solutions should survive post-close, as subscale offerings will continue to require valuable resources. Integrated businesses should combine products that enhance their value proposition for customers and create long-term stickiness with the platform. Fund rationalization is a key focus area in the integration of asset managers but often requires careful planning to ensure that investors are not adversely impacted and to ensure that appropriate approvals are received (e.g., from fund boards and regulators). Decisions on fund rationalization are a key precursor to any planning for fund migrations.

Leverage analytics to drive focused selling: Some of the most significant synergy value in WAM deals is the ability to cross-sell products, and this can be boosted by performing predictive data analytics about customers. For example, buyers can leverage disparate customer data following an acquisition and, if applicable, augment this with social media data to create customer profiles. This will allow the integrated business to develop digitally driven custom campaigns for specific segments and customers. Of course, confidentiality and privacy considerations may affect the ability to capitalize on these synergies and need to be evaluated based on the specific circumstances.

Enhance existing distribution capabilities: Complementary distribution capabilities can drive synergies over time by enhancing digital enablement, providing new opportunities for cross-selling products and driving an integrated advice delivery model. If an acquired distribution mechanism might disrupt current channels, field teams may need to be restructured or a separate value chain may need to be created to minimize that risk.

Reduce your corporate overhead and shared services footprint: Considerable synergies can be achieved by de-layering redundant corporate overhead and shared services. Indirect procurement, simplified location footprint and shared services vendor optimization can also produce early high-value cost synergy realization relatively easily.

Drive economies of scale in the middle and back offices: In any large-scale asset management transaction, management should aim to achieve significant economies of scale by rationalizing investment platforms, fund administration, custody arrangements and merging middle office teams. Consideration must also be given to third-party administration (TPA) and platform provider contracts that typically have long durations and significant exit fees.

Mitigate the key hurdles in realizing synergies

Given typical deal velocity and confidentiality, the leadership driving any deal is normally unable to bring executives focused on execution into the tent. This creates a disconnect between executives who anticipate synergies and those the execution team is willing and able to deliver. People on both sides of the deal will need to take steps to avoid these and other challenges that may arise during the process.

Clarity of investment philosophy: Merging businesses may espouse different investment philosophies. While it is possible for a single house to have multiple investment strategies, investors and market participants will expect to see a coherent, overarching house view. Lack of clarity on the investment proposition can lead to AUM outflows and can be a significant inhibitor to progress on downstream activities relating to operational integration and the realization of synergies.

Identify leaders in the distribution channel and use their experience and stature to design and execute change adoption strategies: Financial advisors (FAs) in WAM firms tend to be leery of efforts to acquire digital direct-to-consumer platforms and robo-advisor capabilities, as these threaten disintermediation in the future. This can restrict digital solutions and the cross-selling opportunities they afford, which can either impede the growth trajectory or kill the adoption of new solutions all together. Leaders from the distribution channel, appropriately incentivized and empowered, can help design and execute change adoption strategies that will supercharge adoption rates.

Be clear about the need to simplify the technology footprint: Technology synergies can be difficult to achieve due to the complexity of legacy systems, the challenges of platform migration and long-term contracts with technology providers, which may contain onerous exit clauses. Leadership must send a clear message to the organization about the need to simplify legacy systems, as well as expected timelines. Additionally, business, finance and technology teams must determine the best path for new technology adoption and a legacy technology sunset road map.

Perform in-depth diligence to understand data lineage and analytics capabilities before signing: Acquirer and target alike often lack foundational customer data and analytics capabilities. Depending on the maturity of the target, it can take significant resources to deploy the foundational capabilities needed to capture appropriate customer data. This is a prerequisite for segmentation analysis and identifying prospects for cross-sell opportunities. Buyers need to conduct detailed diligence on any prospective target to identify its data and analytics capabilities. If not performed, acquirers may have to create a new analytics capability within the target from scratch to leverage existing data – or discover that the data collected by the target cannot be legally leveraged to support new sales activities at all.

Key employee retention is critical to the success of WAM transactions: Key client relationships and knowledge of certain asset classes may be concentrated in a small number of individuals. Significant AUM outflows have been experienced in recent transactions, where star fund managers have left the business once the deal was announced. Retention of key talent is vital to the preservation of value.

Assess the cultural gap and deploy suitable integration strategies on both sides: Cultural differences can produce opposing long-term strategies as well as impede day-to-day execution. This may create misunderstandings about the scope of effort needed for synergy execution, resulting in mismanagement and potentially missed deadlines. For example, targets that are smaller and have a startup mentality are typically used to agile delivery and quick decision-making; individuals on these teams may not appreciate the methodical approval process required by the buyer. These types of situations can ultimately lead to tension between the joint delivery teams, negatively impacting revenue creation and cost synergies alike. Leadership needs to demonstrate assimilation and partnership. Depending on the scale of the acquisition, management should conduct an in-depth cultural gap assessment and deploy strategies for acquirer and target teams to determine the most successful way to work together.

Conclusion

Synergy identification and realization is a challenge for even the most experienced business managers and continues to be key to successful deal execution. WAM deal managers must cast a sharp eye on the link between the deal rationale and potential synergies, within the envisioned timeline. This rationale is simple, given the market trends: outsized deals are primarily focused on realizing cost synergies with bolt-ons driving the growth agenda. As growth becomes sluggish, that rationale will become more complex. Acquirers will expect both revenue and cost synergies from all deals. Deal managers must maintain unwavering focus on synergy opportunity areas and corresponding challenges working against successful synergy realization.

Contacts

Global

Nadine Mirchandani

EY Global Wealth & Asset Management Transactions Leader,
EY Americas Financial Services Transactions Leader
nadine.mirchandani@ey.com

Brian S. Salsberg

EY Global Buy and Integrate Leader
brian.salsberg@ey.com

Americas

Aaron Byrne

Principal, Transaction Advisory Services,
Ernst & Young LLP
aaron.byrne@ey.com

Asia-Pacific

Dustin Ball

Partner, Transaction Advisory Services,
Ernst & Young - Hong Kong
Dustin.Ball@hk.ey.com

EMEA

Ari Constantinou

Partner, Transaction Advisory Services,
Ernst & Young LLP
aconstantinou@uk.ey.com

Michael Wada

Partner, Transaction Advisory Services,
Ernst & Young LLP
mwada@uk.ey.com

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