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Opportunities for asset management

Taking advantage of regional tailwinds during global turbulence

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EXECUTIVE SUMMARY

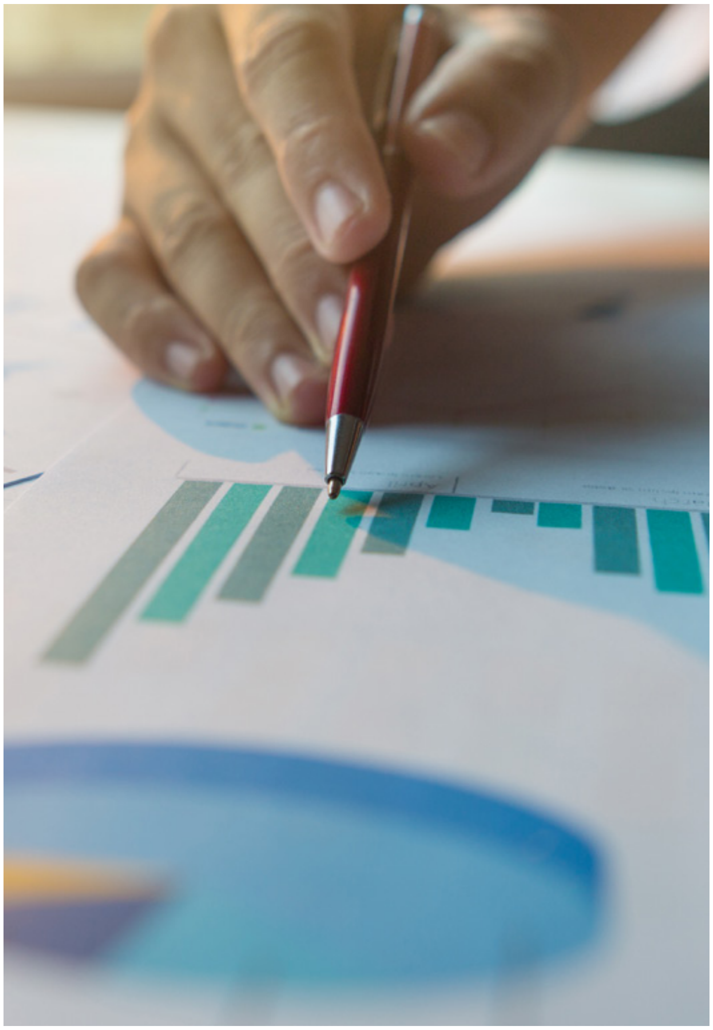
Today's complex economic environment is leading many global asset managers to reconsider their investment strategies. Rising interest rates; tightening liquidity; the fallout from high-profile bank failures; and increased competition for environmental, social, and governance (ESG)–related investments are pressuring the asset management industry to adapt quickly. These developments come at a time when asset managers face increasing challenges in generating alpha (above market average returns), while their traditional business models are struggling with declining margins, digital disruption, and competition for talent.

These global trends are amplified in the Gulf Cooperation Council (GCC)[1] countries. The GCC region has limited participation of institutional investors in the capital markets, an underdeveloped savings culture, and investors with a preference for offshore investing. However, business development in the region also benefits from tailwinds. In recent years, there has been a strong capital inflow into GCC countries from favorable oil prices, along with record growth in initial public offerings (IPOs). The region's asset management industry is also becoming more competitive with offshore investing thanks to increasing sophistication in product offerings and supportive regulatory initiatives.

These trends position GCC asset managers for significant growth in the coming years. We forecast that the industry will continue to grow above the global average, reaching nearly US$500 billion of onshore assets under management by 2026, up from $400 billion at the end of 2022. To combat the industry challenges and take advantage of the prevailing tailwinds, asset managers must create a winning strategy driven by six key actions. They should:

- Hone the performance track record
- Create segment-specific operating models and value propositions
- Build effective sales functions
- Revamp the product range
- Exploit digital tools
- Consider non-organic growth opportunities

GLOBAL CAPITAL MARKETS ARE IN FLUX

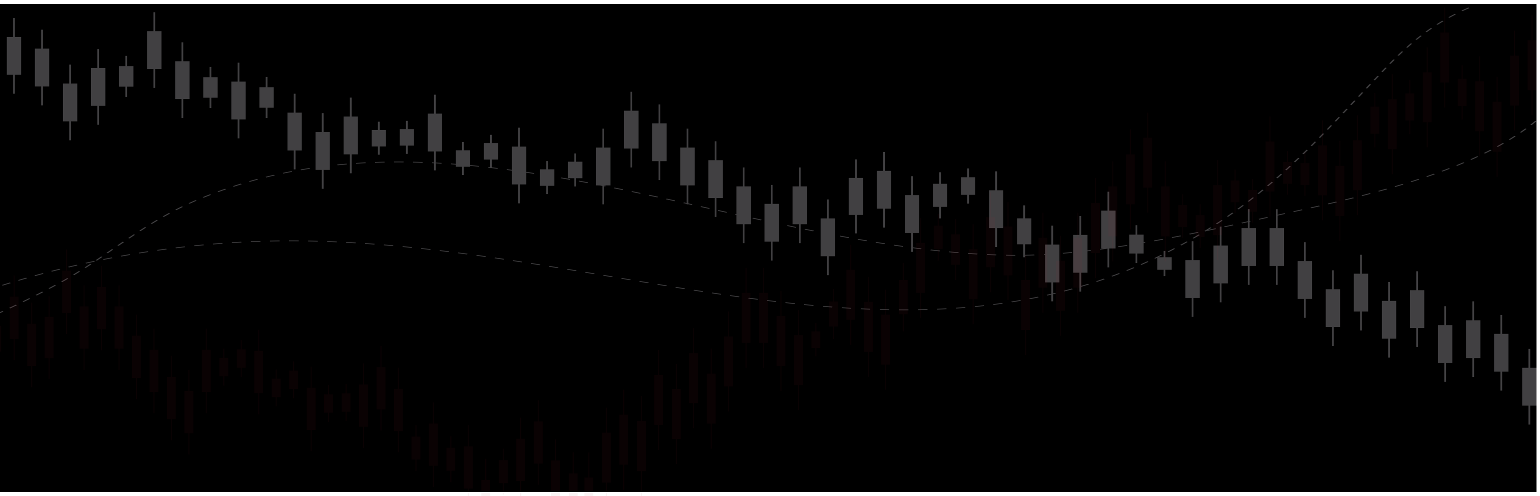


Several macroeconomic, social, and geopolitical forces have recently shaken global capital markets and forced asset managers to reconsider their investment strategies.

The most notable forces are macro changes. Since early 2022, there has been a reversal of long-running low interest rates and abundant liquidity in capital markets. Central banks have tightened monetary policy in response to rising inflation, leading to losses for fixed-income investment strategies, negative spillover effects to equity markets, and periods of liquidity crunch in government debt markets.

The already challenging macroeconomic environment worsened after several high-profile banking failures, leading managers to reconsider risk assessments in their portfolios. These banking failures are significant, as three of the banks—Silicon Valley Bank, Signature Bank, and First Republic Bank—had more assets on an inflation-adjusted basis than those that failed in 2008.[2]

Another force reshaping asset management strategies globally is growing competition for ESG investments, which have become a necessary part of the value proposition. A recent study by PwC found that in the next two years, almost 80 percent of institutional investors plan to increase their allocations to ESG products, and 90 percent either have stopped or would consider stopping investing in non-ESG products.[3] Retail investors, particularly millennial[4] and generation X[5] investors, female investors, and high-net-worth individuals (HNWIs), have similar intentions, leading asset managers to adopt ESG strategies to attract investors.



The asset management industry faces intrinsic challenges

The need to reconsider investment strategies arises when the global asset management industry confronts challenges in generating alpha and experiences pressures from margin erosion.

Studies of the asset management industry suggest portfolio managers struggle to generate incremental value for investors.[6] The role of asset managers is now diluted by technology, streamlined access to capital markets, lower transaction costs, and greater investor sophistication. Add to that digital disruption from fintech companies, such as those that provide distribution platforms and robo-advisory solutions powered by artificial intelligence (AI). The resulting commoditization of the asset management business and rising investor preference for passive asset management products have reduced profitability.

Profitability challenges, in turn, force asset managers to seek out cost reductions, innovative investment products, and scalable business models, including partnerships. In addition, asset managers must invest more in attracting and retaining top portfolio managers and must increasingly compete for talent with tech firms.

The GCC market has region-specific constraints

In the GCC region, additional challenges amplify many of these global trends. For example, the region has limited participation of institutional investors in the capital markets. The retirement industry (made up of pension funds and life insurers) is the primary catalyst of asset management growth in developed markets. By contrast, in the GCC, the retirement industry is based mainly on state-administered programs, and resources available for the asset management industry are limited. Countries are implementing pension reforms, the most notable being the Dubai International Financial Centre's (DIFC's) introduction of the DIFC Employee Workplace Savings program in the United Arab Emirates (UAE) in 2020. However, this initiative is still small: In 2021, the scheme reported $127 million in assets under management.[7] The private insurance sector in the region is also relatively small—for instance, the total assets of insurers are about $20 billion in Saudi Arabia (2 percent of GDP)[8] and about $30 billion in the UAE (8 percent of GDP),[9] compared with around 100 percent in the U.K. and around 50 percent in the United States.

The GCC region also lacks a strong savings culture compared with other developed countries. For example, in Saudi Arabia, the largest GCC market, the ratio of retail savings in the banking system to GDP is less than 30 percent,[10] one-third to one-half the level of major developed countries. In absolute terms, the average retail deposit per capita equals about $8,000,[11] whereas for the U.S. and major European markets, it ranges from $30,000 to $45,000.[12] Furthermore, investment in the domestic capital market is still an unusual method of savings among the general GCC population, as indicated by the relatively low number of investment fund subscribers (less than 2 percent of the Saudi population).[13] Mass retail investors in the Saudi stock exchange (*Tadawul* in Arabic) account for less than 10 percent of the total free float[14] compared with roughly 30 percent of retail investments globally.[15] HNWIs and family offices have typically opted for offshore asset management opportunities. Strategy& estimates more than 70 percent of regional private wealth is currently in offshore accounts.

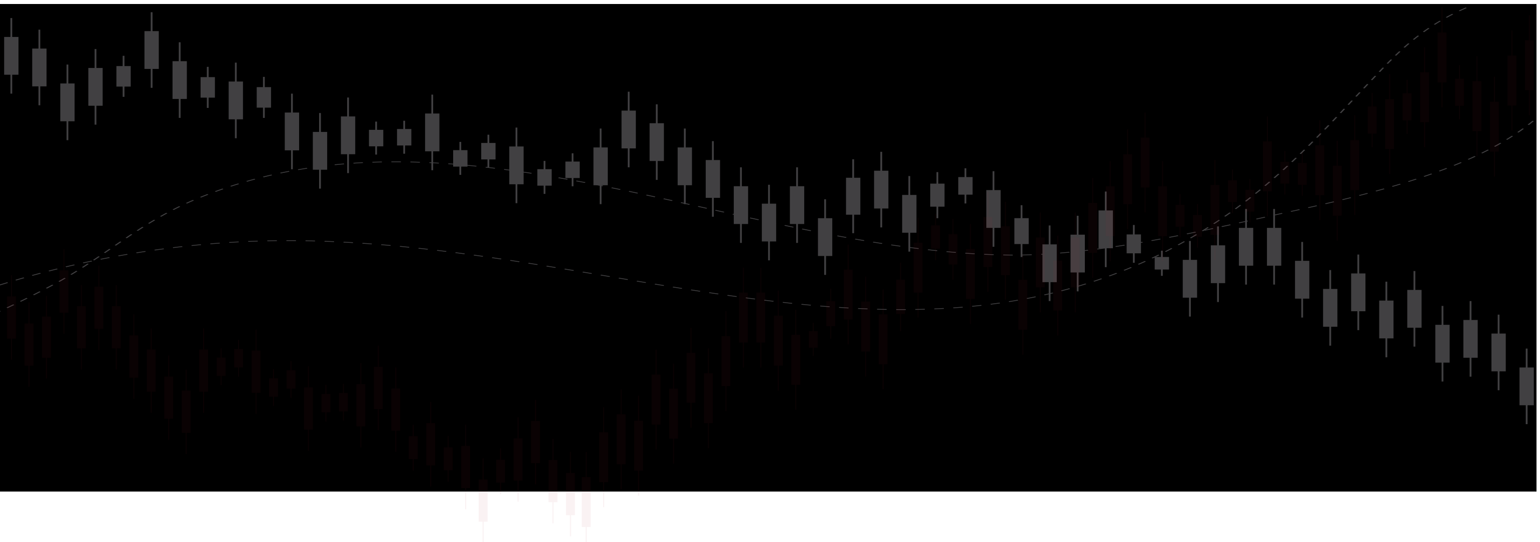
TAILWINDS PRESENT NEW OPPORTUNITIES IN THE GCC

Despite the problems in global markets, the GCC asset management industry has great potential. Several tailwinds support healthy growth in the GCC asset management industry, starting with strong capital inflows. Favorable oil prices provided GCC countries with large trade surpluses. According to IMF estimates for 2022, GCC countries together had a trade surplus of nearly $350 billion. The trade-surplus-to-GDP ratio was around 15 percent for Saudi Arabia and the UAE, and over 20 percent for Kuwait and Qatar.[16] In addition, wealthy individuals remain attracted to the region. For example, the UAE was forecast to have attracted the largest inflows of millionaires globally in 2022; 4,000 HNWIs were expected to have moved to the country, the largest number on record.[17]

There is also considerable appetite for IPOs in the region. Although IPOs slumped globally in 2022,[18] the Middle East set a record, with total funds raised from IPOs a little over $20 billion.[19] As a result, the Abu Dhabi Securities Exchange's (ADX's) market capitalization rose by more than 60 percent, to AED2.7 trillion (US$740 billion) by the end of 2022, up from AED1.6 trillion (US$440 billion) at the end of 2021.[20] That secured the ADX a place among the 20 largest exchanges globally.[21] Investment banks expect the strong IPO momentum in the GCC to continue throughout 2023.[22]

Despite the trends toward passive investing and robo-advisors, many individual investors are increasingly seeking professional advice to manage their portfolios as global markets have become less buoyant. In response, the GCC asset management industry has been gradually transitioning from standard strategies to more advanced products that meet the needs of more demanding investors. As the regional industry matures, it can attract and retain investment portfolios previously placed offshore with international players.

Financial regulators in GCC countries have assisted with initiatives to develop the asset management industry. For example, Saudi Arabia's Capital Market Authority enacted several amendments to investment funds regulation in 2021,[23] providing more flexibility for investments in privately placed instruments, increasing the single instrument concentration limits, and providing more opportunities for fund leverage. The Securities and Commodities Authority (SCA) in the UAE also introduced measures to improve the competitive position of the local asset managers, including the foreign funds promotion regulation, which discontinued promotion of foreign funds to retail investors.[24] At the same time, the SCA introduced a number of new fund categories and streamlined the requirements for fund setup in an effort to reinvigorate the asset management industry in the UAE.[25]



A WINNING STRATEGY FOR GCC ASSET MANAGERS

These tailwinds mean that GCC asset managers are positioned for healthy growth. They need a strategy to address the region-specific challenges and to harness the tailwinds. That strategy should consist of six actions.

Hone the performance track record

The importance of a performance track record is hard to underestimate in the asset management industry. It is the key source of competitive advantage for retail and institutional markets. Winning asset managers demonstrate consistent overperformance through a number of means. They make significant investments in talent acquisition. They build smart retention and performance management mechanisms. Critically, they organize their internal processes so that their portfolio managers focus on core value-adding activities.

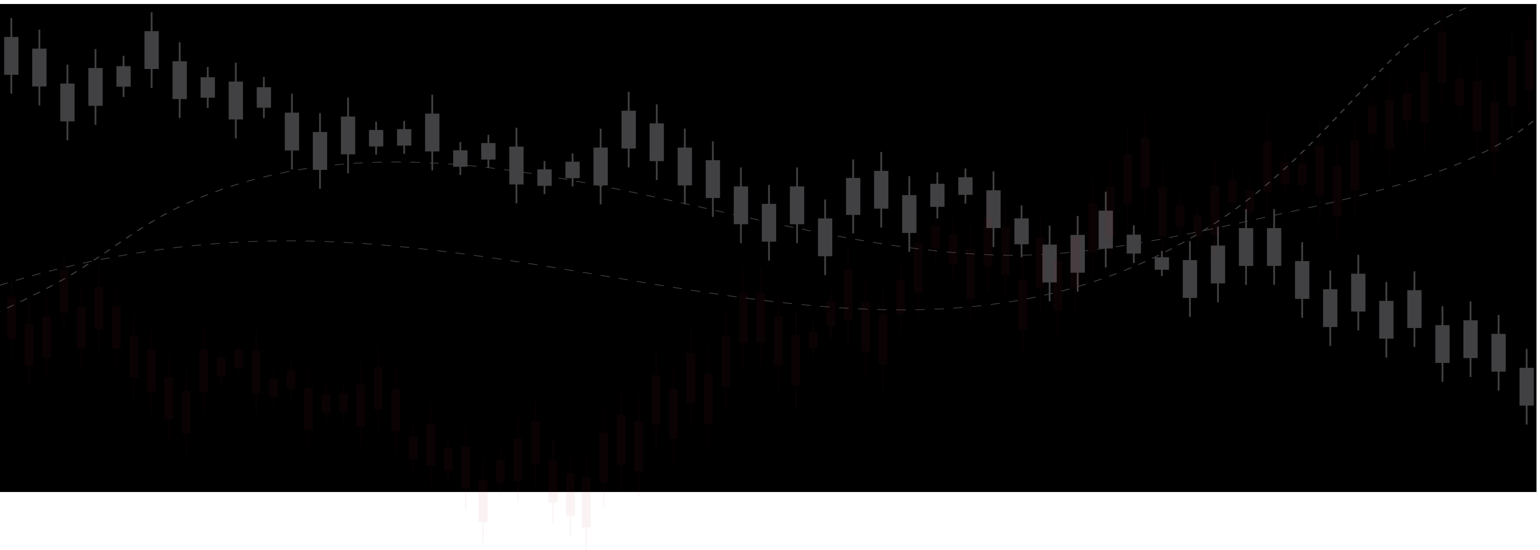
Create segment-specific operating models and value propositions

A vital step is to build all components of the operating model specific to each client segment, including institutional, retail, and HNWI clients. The client strategy should pull together the product offerings for each segment. It should include the sales coverage model, marketing plan, legal structures, and back-office capabilities.

For example, the HNWI segment requires asset managers to design tailored, one-off strategies with legal structures that secure ownership and client-specific succession planning. Meanwhile, the retail segment requires an operating model with low-touch service delivery and easy-to-understand product features, supplemented by educational components to build customer confidence in capital market operations. A relatively underserved expatriate segment could require solutions that easily place funds from cross-border accounts into investment products. The value proposition for institutional clients, on the other hand, should center on attracting star portfolio managers, building process efficiency to minimize the need to repeatedly generate a new price for individual products, and creating robust risk and compliance systems.

Build effective sales functions

An effective sales function is critical. It starts with a results-oriented, properly motivated salesforce engaged in regular account planning processes and pursuing actionable outcomes from client meetings. Asset managers can support their salespeople with a “need identification tool” powered by advanced analytics to facilitate product-oriented discussions with prospects and clients. They also should connect sales and product development teams to enable regular product updates in line with client needs.



Revamp the product range

To compete with global leaders, asset management companies should actively experiment with their product range. They can test client interest in various asset classes, such as real estate investment trusts, private debt, or distressed debt products. They can also try different products, such as IPO funds, international, and sharia (Islamic law)–compliant funds. Such experimentation can help them secure a competitive position when dealing with quickly changing client needs. Often, new products may not provide large margins, but can be a point of entry for new clients and offer a useful complementary value proposition. When considering the future product pipeline, however, it is essential to innovate by building on existing capabilities incrementally. Otherwise, the asset manager may risk overextending its resources and losing competitiveness.

Exploit digital tools

Asset managers need to explore digital tools along the entire value chain. Digital tools, and the capabilities to use them fully, are critical, especially given how fintech companies are disrupting the industry. The leading digital platforms provide portfolio management and optimization tools to help manage investment strategies. These platforms can build tailored investment proposals by modeling portfolios, running stress-test analyses, and identifying key investment trends. The tools allow managers to stay ahead of the competition and introduce an interactive sales approach to client meetings. Digital platforms also allow for electronic reporting, custody reconciliation, compliance, and performance management. They bring efficiency to asset managers' internal processes and enable seamless integration into the systems of institutional customers.

Consider non-organic growth opportunities

The fragmented nature of the GCC market offers many opportunities for M&A and partnerships. For example, the Saudi market has approximately 40 midsized, independent asset managers holding from $100 million to $3 billion in assets under management.[26] These firms specialize in one or several asset classes. They could be a natural target for acquisition for companies willing to enter the market, expand their capabilities to leapfrog their peers, or acquire a new customer base.

Partnerships have great potential in the region as well. They can take the form of sales management agreements, including "reverse inquiry" deals that enable foreign asset managers to market their products through GCC-licensed partners. Alternatively, companies may collaborate by offering co-branded products, taking advantage of complementary capabilities, and sharing management fees and related business risks.

CONCLUSION

GCC asset managers are positioned for significant growth in the coming years—if they adopt the right strategy. With revamped products, digital tools, and non-organic growth opportunities, asset managers can overcome region-specific difficulties, while taking advantage of the tailwinds.
They can beat the competition and capture new market share.

ENDNOTES

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