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People power: Understanding the intangibles in asset management M&A

Point of View

There has been a flurry of deal activity in the asset management industry during 2021, and things are only getting hotter. What is driving all this M&A growth?

In this paper we explore why M&A in Asset Management is on the rise and explore why certain deals create a higher deal value or return on investment than others. We discover the secret sauce that makes a deal successful, that one essential element that often gets overlooked: **the human factor.**

2021 is piling on the pressure

So, what is going on in the asset management industry right now? The pressure on fees is one of the biggest challenges of the moment: increasing cost awareness from customers and a desire for greater price transparency puts pressure on firms to justify their prices and offer greater value. Similarly, passive investment models come with an expectation of lowered fees, since automation equates to lower costs in the eyes of clients. If you are not paying for human work and intuition, what are you paying for?

Nonetheless, these customers are continuing to demand a high yield even if they are reluctant to pay for it. This has led to a growth in the popularity of alternative investment products in areas like private equity, real estate, infrastructure and even blockchain and crypto. These innovative products are the cool kids of the asset management world, and everyone wants in on the action. They offer higher yields and better margins, although they also require new capabilities and talent.

Unsurprisingly, many firms are looking to add these alternative investment capabilities to their portfolio, and the fastest route is with consolidation. However, trying to integrate these cool kids and their disruptive approach into more traditional asset management firms risks erasing what makes them so valuable. A culture clash benefits no one.

Firms want sustainability and growth

Today’s investors have high expectations around sustainability and ethics, putting enormous pressure on asset managers to invest in what’s good for the environment or society. This affects many aspects of firms’ operations: internal governance, social and environmental impact, and even the products and their ESG ratings.

Watch for **newer**, **innovative players** coming up in this area, as they are likely to be **a key driver of M&A** in the industry.

These newbies provide an opportunity for more established asset managers to improve their image while gaining new talent and capabilities.

The need for scale and returns is another big driver for M&A. Bigger is generally better in this industry, so the obvious move is to consolidate. Smaller boutique investment firms can't scale up organically at the speed they need to, while their agility and innovation are particularly attractive to the larger more traditional firms looking to diversify their portfolio away from commoditized products. A takeover might be an interesting strategic opportunity for both players.

New customers, digital disruption and changing regulations

Until recently, institutional investors have been the main source of capital for asset managers, but that's changing. Smaller investors offer an untapped resource, given consumers' increasing appetite for long term personal savings and the growing mainstream demand for more alternative and less liquid strategies. A further consolidation of financial advisors and digital platforms will make it easier to harness the potential of these smaller investors.

As everywhere, digital and data are the big disruptions. Technology offers a route to greater operational efficiencies, smarter investments, and new insights into clients and behaviors. But on the flip side, tech-savvy clients are demanding innovative reporting, a better customer experience and lower fees. Tech-forward firms are making the most of the digital opportunity, while many more traditional firms have yet to catch up .

Other key trends include the seismic changes in industry regulations around longer vesting periods, which has a knock-on effect on hiring. And the tilt towards Asia, with increasing numbers of international firms seeking licenses for China plus a continued emphasis on fundraising throughout the region, where much of the world's wealth is located.

Making the deals

There are thousands of asset managers, but the big firms take the lion's share of business. The competition to join those firms in the $1 trillion AUM club is fierce, and simply scaling up won't get you there. At the same time, declining margins require either new capabilities, or economies of scale. What's the answer? Consolidation. That means either mega deals, or smaller acquisitions for new capabilities--or both.

But any M&A activity must create long-term value for investors as well as the firms and their clients. If it's just about cost cutting, investors will see through it.

Of course, consolidation is much easier in the US than Europe, where fragmentation and international borders make deals much more complicated. Nonetheless, speed in execution is key.

Intangibles are the secret of success

A deal can look great on paper, but if the human factor is not taken into account you will not get the full picture, which is bad news for your ROI. You must look at intangible assets--culture and people practices, organizational structure and job architecture--as well as financial. If those intangibles are not compatible, it is not a great fit.

We recommend that planning for intangible assets should start early in the deal process. In our experience, borne out by research, the vast majority of successful deals addressed culture and people practices during due diligence or within 30 days after M&A announcement. One great starting point is to undertake a talent analysis of leadership and key people. This might include data, analysis, and market comparisons for functional purview and organizational design, while also looking at leadership scope and expertise alongside compensation. This is work we frequently undertake for our clients, and it's an invaluable tool for assessing **the most important factor in any deal: its people**.

The human dimension makes a great merger

To get the value of all parties, effective integration is an essential. That can be challenging when you are combining different cultures and idiosyncrasies across a remote and distributed working environment. But the effort pays off.

Culture integration is the most efficient enabler of improving ROI when merging (according to a recent FT Future of Asset Management conference). Successfully integrated firms have a much higher increase of net inflows, with a cost structure which is 8.5% lower than non-integrated firms, and profitability levels that are 20% higher. Companies that approached integration via thoughtfully implemented strategic organizational design made faster decisions.

Clearly, it is very important to get integration right, right from the start. Key building blocks to align from an organizational and people perspective include: operating model and organization design; leadership and talent; rewards; and an overarching change and culture implementation support.

The nine essential factors that can make or break a merger:

1. Alignment between strategy, operating model and structure.
2. Strong and visible leadership (not just at the top but at every level).
3. Retention of critical talent.
4. Early definition of future culture and related people initiatives.
5. Rewards that drive the right objectives and/or culture.
6. Creation of a long-term implementation and alignment plan (rather than focusing purely on financial, short-term wins and the first 180 days).
7. Employee engagement.
8. Frequent and effective communication.
9. Creation of a robust change management plan.

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Let's talk talent

During any deal, having the right leadership team in place to drive value creation is critical. Finding those leaders, and closing skill gaps, needs to happen quickly. We have seen that companies that appointed a new management early on—ideally, right after the due diligence phase, as soon as the deal has been completed—were twice as likely to reach full integration within a year. One big enabler of this is the ability to assess leadership skills, as well as look at a candidate's outstanding investment or asset-gathering track record.

Given our turbulent times, there is a huge need for seasoned professionals with strategic management skills and the ability to drive change and digital transformation. This unstable climate requires mature, agile leaders with a good tolerance for ambiguity. Of course, these exceptional kinds of leaders are in high demand, so what can you do to secure them?

Aside from the C-suite, it's also essential to identify the most talented and critical employees throughout the organization, so that you can focus on retention at every level and keep operations running smoothly.

Is your employer value proposition powerful enough?

Critical to appointing leadership and retaining key talent is the remuneration and incentives structure, which should enable the capture of enterprise value and participation in future upsides in the business. Of course, any rewards and incentive structure must support the implementation of the new business strategy of the merged entity.

But it is not purely about the money. The employer value proposition also comes into play. What can asset managers offer that their peers do not?

Today's most in-demand candidates will be weighing up the type of investment firm, the ownership structure, the commitment to growth and the commitment to impact and sustainability. Our research shows that companies that created a meaningful talent value proposition achieved a 10-point increase in the employee discretionary energy index, which relates to a 5.4% increase in EBIDTA margin. Clearly, optimizing your employee value proposition is a highly valuable strategy .

So, whose responsibility is it to make sure integration is effective and these intangibles are taken care of? We would argue that the human factor is so essential that it should be considered at the highest level, with a dedicated People Office reporting directly to the CEO.

Final thoughts

All too often, M&A is purely thought of in terms of the numbers. If the financial makes sense, then the rest should fall into place, right? We believe that it is actually the people that are the key element in any consolidation activity. It is easy to overlook the intangibles, but if you do not consider culture, talent and integration from the start, our advice is to look elsewhere for your future plans.

The 'intangibles' checklist:

How to take the human factor into account when you are making a deal.

- Have you developed an organizational structure that drives the strategy of the new merged entity?
- Do you have the right leaders at the top to drive the integration (and if yes, are they currently in the right roles)?
- Have you identified the critical talent you need to retain during the deal and integration process?
- Are the cultures of the two merging entities compatible (and if not, do you have a plan to ensure alignment)?
- Does your reward and employer value proposition reflect and enable your strategic objectives through people?
- Are you working closely with all the other business leaders during implementation?

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About Korn Ferry

Korn Ferry is a global organizational consulting firm. We work with our clients to design optimal organization structures, roles, and responsibilities. We help them hire the right people and advise them on how to reward and motivate their workforce while developing professionals as they navigate and advance their careers.