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Financial Services Practice

Nine key observations about the European asset management industry

European asset managers are contending with profit contraction, shifts to passive funds, growth in unmanaged assets, and more. Observations from our recent survey suggest what to prepare for.

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The asset management industry experienced dwindling profits and increasingly divergent growth trends in 2023, according to interim results of the 26th annual McKinsey Asset Management Survey. These trends have widened the gap between the best and the rest. Following are nine observations about these and other results from the survey (exhibit).

1. Industry profit is down by a third versus its recent all-time high

Market performance in the fourth quarter added a more polished finish to 2023, with assets under management (AUM) increasing by approximately 9 percent since 2022. However, that polish is only surface deep. A look underneath shows an industry undergoing contraction. Industry profits dropped for the second year in a row and are now 32 percent down from their all-time high in 2021.[1]

2. The gap between the best and the rest has widened

The profitability gap between top- and bottom-quartile asset managers has widened, with a profit margin delta of 28 percentage points (54 percent versus 26 percent) in 2023. That's ten points higher than in 2018. Despite headwinds, the top-quartile players managed to grow their revenues while actively managing costs. In contrast, the bottom-quartile players experienced a profitability decrease due to higher cost increase than revenue growth.[2]

[1] McKinsey Performance Lens Global Growth Cube; McKinsey Performance Lens Global Asset Management Survey 2023 (interim results based on 55 participants).
[2] McKinsey Performance Lens Global Asset Management Survey 2023.

Exhibit

Dwindling profits and increasingly divergent growth trends in 2023 have further widened the gap between the best and the rest.

Key observations about the European asset management industry

1. Industry profit is down by 1/3 vs its recent all-time high	–32%	Western European asset management profit pool decrease vs 2021
2. The gap between the best and the rest has widened	28 p.p.	profit margin delta between top- and bottom-quartile Western European asset managers
3. Passive continues to outgrow active, especially in years of market volatility	~€470 billion	total net flow delta between passive and active funds in 2018, 2022, and 2023 in Europe
4. Private markets have entered a slower era	–27%	European private markets fundraising in 2023 vs 2021
5. Pricing can mitigate low performance in active fixed income but not in equity	€83 billion	cumulative active fixed income inflows of European mutual funds in top 3 pricing deciles since Jan 2021
6. ESG is at a crossroads: lower overall growth but impact and thematic opportunities	~$80 billion	European fundraising of private markets impact/decarbonization funds with final closing in 2019–23 period
7. The unmanaged assets opportunity is huge, especially the dash for cash	~€22 trillion	sidelined cash in Europe (~€20 trillion in deposits and ~€2 trillion in money market funds)[1]
8. Gen AI will provide a shot in the arm for productivity	~$60 billion	combined global value at stake from AI and Gen AI in asset management
9. Consolidation pressure is growing, after years of uncertainty	9 p.p.	increase in average cost-to-income ratio of Western European asset managers since 2021

[1]Retail and institutional; deposits in Western Europe (excluding deposits from banks); money market funds domiciled in Europe.
Source: McKinsey analysis

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3. Passive continues to outgrow active, especially in years of market volatility

Passive funds' AUM have grown much faster than active AUM over the last decade. The difference in growth rates has averaged 11 percent annually since 2014. This shift to passive was even faster in years of market volatility: in the three recent years with significant market volatility—2018, 2022, and 2023—the difference in total net flows between passive and active funds amounted to approximately €470 billion.[3]

4. Private markets have entered a slower era

Macroeconomic headwinds persisted throughout 2023, with higher financing costs and an uncertain growth outlook taking a toll on global private markets. European fundraising of $243 billion in 2023 broadly matched the 2022 total (–3 percent) but was down 27 percent against the 2021 peak, largely because of the denominator effect. Private equity was the only asset class to increase fundraising in 2023 (+57 percent),[4] and it set a record high for the region.

Despite persisting headwinds, a recent McKinsey survey of over 300 LPs globally indicates continuous commitment to private markets, with 43 percent of respondents anticipating an increase in their private market allocations over the next three years.[5]

5. Pricing can mitigate low performance in active fixed income but not in equity

Active fixed income has significant potential to mitigate low performance through pricing. Mutual funds in the top three deciles by fees have experienced inflows of €83 billion since 2021, against outflows of €59 billion for other funds. In contrast, active equity flows are powered by performance: funds in the top three performance deciles had cumulative inflows of €83 billion over the period 2021 to 2023, while other funds recorded outflows totaling €127 billion.[6]

6. ESG is at a crossroads: lower overall growth but impact and thematic opportunities

The Europe, Middle East, and Africa (EMEA) region leads the way in terms of AUM allocated to environmental, social, and governance (ESG) investing. ESG accounted for 20 percent of EMEA's AUM held in mutual funds in 2023, compared with 1 percent in the Americas and 3 percent in Asia–Pacific. But even in EMEA, growth has stumbled: ESG funds[7] have grown just 1 percent annually since 2021.[8] The story is different in private markets, where impact/decarbonization funds continue to attract robust net inflows. For players with a differentiated offering, attractive opportunities still exist, especially given the need for more capital to achieve net-zero targets.

7. The unmanaged assets opportunity is huge, especially the dash for cash

The interest rate hikes and market volatility of 2022 and 2023 have increased the share of unmanaged financial assets by about two percentage points since 2021. Total unmanaged assets, which now stand at just under €70 trillion, account for 73 percent of total financial assets. When central banks reduce interest rates (perhaps later this year, according to financial markets), the sidelined cash of about €22 trillion—roughly €20 trillion in deposits and €2 trillion in money market funds[9]—will present an opportunity.

8. Generative AI will provide a shot in the arm for productivity

According to recent research, the combined global value at stake for the asset management

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[4] Preqin.
[5] McKinsey GP-LP Private Markets Survey, January 2024.
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[9] McKinsey Panorama Global Banking Pools; EFAMA. Funds include retail and institutional funds deposited in Western Europe, excluding deposits from banks, as well as money market funds domiciled in Europe.

industry from traditional and generative AI is about $60 billion.[10] Asset managers are urged to be mindful of the potential to be derived across the four Cs—content synthesis, coding, creative content generation, and customer engagement—where productivity gains of up to 80 percent are cited in the extraction of content (for example, during investment research and client reporting). Leaders are moving even further toward transforming domains such as their middle and back offices. However, the risks need to be assessed and addressed before AI tools are rolled out at a broader scale.

9. Consolidation pressure is growing, after years of uncertainty

Consolidation pressure is growing in response to low efficiency, with the average cost-to-income ratio of Western European asset managers increasing by nine percentage points since 2021 (to 65 percent from 56 percent).[11] Globally, however, M&A activity among asset managers in 2023 was at its lowest level since 2016. In all, there were 98 deals, including 73 with alternative asset managers.[12] The slowdown came at a time of uncertainty and higher costs of capital, suggesting that M&A activity could increase when confidence in the medium-term economic outlook improves. Meanwhile, the impact of expected rate cuts on deal growth will be influenced by the extent and pace of decisions by the main central banks.

European asset managers are contending with profit contraction, a growing gap between the best and the rest, the shift to passive in years of high market volatility, and different underlying growth dynamics in private markets and ESG. Transforming these changes into opportunities will involve significant investments into the business. This presents an opportunity for asset managers that position themselves to thrive in an industry undergoing radical change.

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[10] "The economic potential of generative AI: The next productivity frontier," McKinsey Global Institute, June 14, 2023.
[11] McKinsey Performance Lens Global Asset Management Survey 2023.
[12] Piper Sandler.