Invesco Ltd. Research and Analysis Report

Based on the current situation of the Portfolio Management Industry(NAICS:523920)

MG-GY 6023 Economics and Strategy Section A

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Introduction

Asset Management is the means of increasing wealth over time by maintaining, acquiring, and trading investments that have the potential to grow in value. The goal of asset management is to maximize the value of an investment portfolio over time while maintaining an acceptable level of risk. The asset manager is expected to conduct rigorous research using both macro and microanalytical tools. This research includes statistical analysis of prevailing market trends, reviews of corporate financial documents, and anything else that would aid in achieving the stated goal of client asset appreciation.

With the booming technology, we see a new trend every day, but not every trend will align with the company's requirements and goals. Hence, identifying and analyzing a trend is one of the most critical aspects for any fintech company looking to leverage the advantages of new technology. This report assesses how the key emerging technologies impact the portfolio management industry and how these technologies are expected to affect the sector in the coming years. In this paper, we will try to analyze these trends from the glasses of economic models, like PEST analysis, Demand & Supply graphs, Five-Forces framework, etc., and will see how companies are shaping their new strategies to make these trends compatible with their core values.

Using Macro and Micro Analysis, we will understand the business model of Invesco and how they cope up with the volatile market and keep up their business model.

Macro Analysis

Changes in the macro-environment can directly impact Invesco and other companies in the industry. Macro Analysis can help to analyze how macroeconomic factors affect Porter's five forces that help to shape a company's strategy and have a competitive advantage. Macro Analysis using the PESTEL framework provides great operating challenges that Invesco might face other than competitive challenges.

Factors affecting Invesco and the Asset Management industry:

Political Factors: Amongst all other factors, political factors are the most challenging to predict but significantly affect investment decisions.

In 2009, a study was published titled “Political Climate, Optimism, and Investment Decisions.” found that people’s optimism towards the financial markets and economy is influenced by their political affiliation. When an investor's political party is in power, they become more optimistic and believe the market is less risky. The current generic storyline is that investment markets can rely on government largesse. At the same time, in the medium to longer term, the debt burden has the magical hand of inflation to reduce its scale. This spells for a bumpy ride. Equity markets are pricing in a relatively benign outcome but will likely be highly reactive to even the slightest hint of a regime change. When politics begins to impact the economy materially, it would be remiss not to pay close attention when managing money.

Economics Factors: Economic factors provide the rewards for taking on the risk of economic uncertainty. The real question lies around the health of the global economy. Equities (public and private), real estate, and commodities rely on the health of the economy and can suffer when the economy is declining. According to PWC's research, the low-interest-rate environment has a significant impact on fixed-income strategy. Asset Managers are finding it difficult to find the right yield while keeping their expected level of risk. Central banks gradually lowered the interest rate to revive the economy from Covid -19. This prolonged low-interest-rate environment naturally affected the profitability, making them a major concern for asset managers.

Social Factors: Social factors have been a driving factor in the emerging market for a very long time. The relationship between a company and its employees - It is a given that companies with happy employees will have better performance, and this is particularly true in emerging markets where the gap between the median and best employment experiences is likely to be much larger. This is why employee attrition is a key metric we track for all our investee companies who disclose it and why we engage with those who don't disclose the measure and ask them to publish it. In emerging markets, social topics get magnified. The gap between the best and worst performers is wide, and the opportunities available to those who can address problems are vast. This is why integrating social issues into decision-making is vital for any emerging markets investment approach. While most previous studies have linked social considerations in investing to specific institutions and individuals, this study suggests that social concerns also factor into mutual fund managers' portfolios. The results indicate that next to explicitly socially conscious funds, various conventional funds display social dimensions in their holdings that can be explained by variables that describe the nature of funds' targeted clientele, local political preferences, and local religiosity. These variables are significantly related to funds' investment in stocks of firms that have their core operations in "sin" (tobacco, alcohol, and gambling) industries but less related to investments in a broader set of controversial stocks that may be more distantly associated with core controversies.

Technological Factors: Technology is about to transform the way asset management companies will make a profit. According to the research, around 80% of the companies will be using Artificial Intelligence (AI) for investment decision making and will also go under digital transformation for various tasks apart from the daily workforce. Advancements in AI, specifically NLP, will help asset management companies to extract textual data and leverage this information to have a competitive advantage. Due to an increase in recent cybercrimes, data leaks, and service outages, asset management companies are also building their focus towards cyber security and creating resilient cyber technology.

Economics Factor: A simple passive portfolio strategy based on environmental criteria allows environmentally responsible investors to adjust their portfolios without compromising risk-adjusted financial performance. Our results suggest that a combination of negative screening and an environmental-scoring-based asset allocation seems to be a viable option for environmentally responsible investors, leveraging both strategies' advantages. The constructed risk factor CMP (clean minus polluting) documents a significant factor loading for both regions when added to the Fama–French five-factor model, which suggests the existence of a risk premium based on the environmental performance of firms.

Legal Factors: Around the globe, regulations continuously evolve regarding the pursuit of economic growth and changing demands and behaviors of investors. Since the financial crisis, governments have imposed restrictive regulations and increased scrutiny on the asset management industry to have financial stability and reduce risks for investors. According to

Deloitte research, the CRA-III regulations, which prevented over-reliance on external credit agencies, had a significant impact at the European Union (EU) level, which imposed extra costs to hire credit agencies to provide in-house analyses. U.S. Securities and Exchange Commission (SEC) continuously analyzes the market stability and provides new regulations to keep the investors protected and make sure companies meet the disclosure requirements.

Invesco Ltd. Industry Analysis

a) Current Structure of the Industry

As an investment company, the performance of markets and the business environment have a significant bearing on the operations of Invesco. The investments industry is volatile with ever-shifting dynamics that require the organization to maintain a good understanding of market forces (Rauchs et al., 2019). Furthermore, the decisions made by other firms in the industry affect the performance of Invesco. The Porter's 5 Forces framework presents a reliable framework for assessing the portfolio management industry in which Invesco operates.

The threat of New Entrants: New entrants into the portfolio management industry have both positive and negative implications for the operations of Invesco. For instance, newcomers into the sector introduce new ways of doing business through the innovative strategies they intend to use to succeed (Danesh, Ryan & Abbasi, 2018). Progressive ideas in portfolio management are suitable for the industry as they help the existing forms, for instance, Invesco, to be risk-averse and boost their profits. However, new entrants also pose a significant risk to Invesco as they can potentially eat into the markets controlled by the company, thus reducing its profit-making potential. To counter the threat of new entrants, Invesco ought to be innovative, spend on research and development, and capitalize on economies of scale.

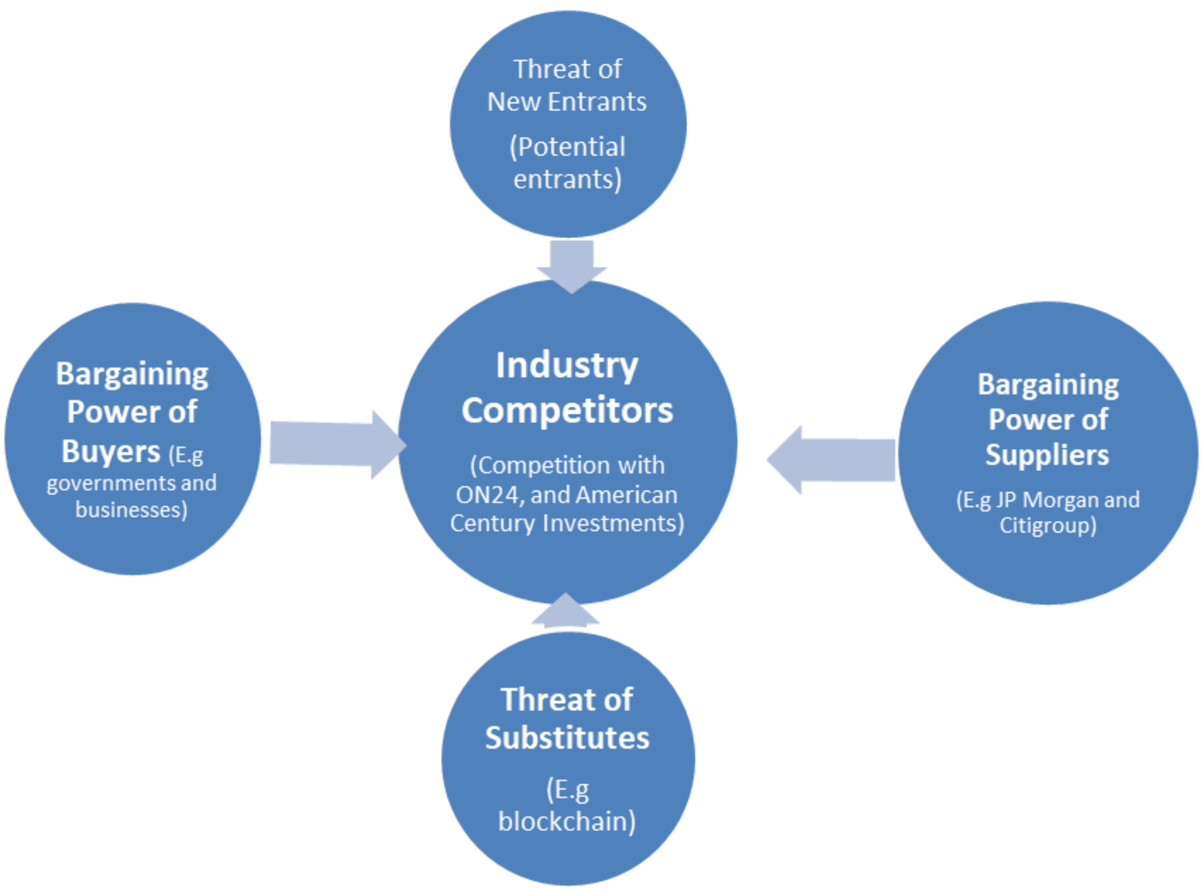
Power of Suppliers: Powerful suppliers in the investment management industries have the effect of influencing prices. In this case, the suppliers include investors and banks such as JP Morgan Chase, Goldman Sachs, and Citigroup. Consequently, the bargaining power of the suppliers drives down the profit-making potential of Invesco. The company can combat supplier power by building an effective and efficient supply chain and engaging multiple suppliers with which the firm can reach agreements on favorable operating terms. Without dedicated suppliers who base their business on the operations of Invesco Ltd., they are exposed to being subjected to high supplier prices.

Bargaining Power of Buyers: Buyers also significantly influence the pricing of investments in portfolio management. The buyers entail those parties who seek capital, for instance, businesses, governments, and individuals. In most cases, the customers have a lot of demands that are difficult to meet by the investment firms (Bruijl, 2018). Furthermore, the buyers in the investment industry make their demands at unfavorable prices to the portfolio managers. Investment management companies such as Invesco Ltd. require maintaining a robust customer base to manage the dominant bargaining power of the customers. Furthermore, portfolio managers ought to be innovative on new products for which the customers cannot seek significant discounts.

The Threat of Substitute Products and Services: The competitive nature of the portfolio management industry makes the threat of substitute products and services rife. With the progressiveness introduced to technology, new investment options offer a significant threat of substitute products and services (Juliana & Nyoman, 2019). For instance, digital products such as blockchain threaten traditional investments such as stocks (Rauchs et al., 2019).

The Rivalry with Existing Competitors: The intense rivalry with portfolio management companies drives the prices of investments down, thus hurting the profitability of Invesco. Some of the notable competitors of Invesco Ltd. are Franklin Resources, ON24, and American Century Investments (Comparably, n.d). These competitors command a significant market share in the portfolio management industry, thus making it essential for Invesco to maintain a firm grip on its current customers to remain profitable.

The figure below illustrates the relationship between the various actors in the industry under Porter's 5 model.



b) How the Findings of the Macro-Analysis affect the Industry's Structure

From the PESTEL Analysis, the portfolio management industry is significantly affected by political, economic, and social factors. Further, the technological advancements and environmental and legal forces also shape how the sector operates.

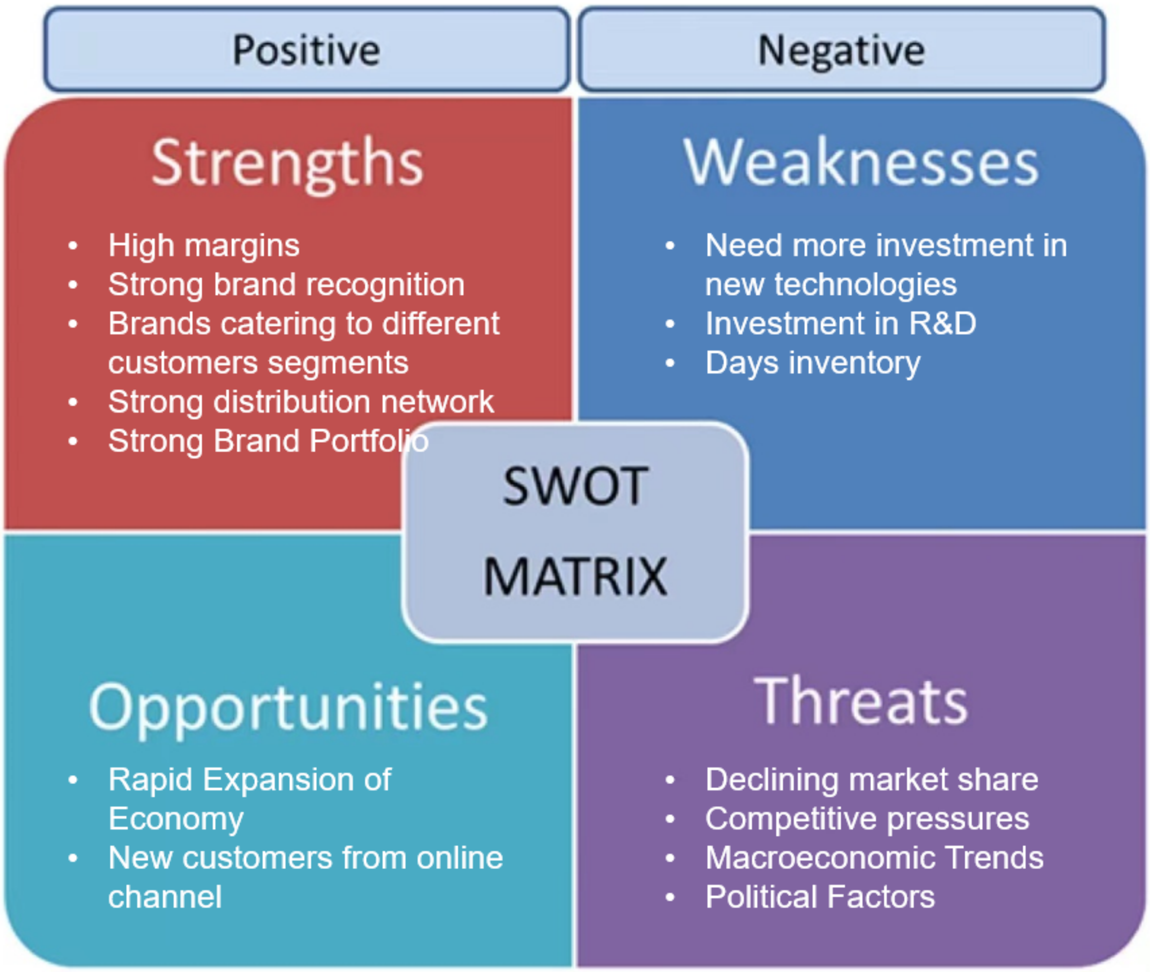
Global politics shape the investment climate, especially in the movement of funds and how they are invested in different sectors. Therefore, the nature of regimes that take over countries where customer organizations are interested in investing shapes the dynamics of portfolio management. An example of such situations is the experience of economic transitions attributed to the change of regimes aligned to the Democratic and Republican ideologies in the United States. Investment portfolios of different companies change significantly after elections and tend to adjust afterward.

The global economy dictated by exchange rates and inflation also influences the decisions made in portfolio management. International trade depends on the strength of foreign currencies, whose stability determines the decisions made by the various investment firms.

The social dynamics of various communities and trends influence portfolio management decisions. For instance, the association of stocks with socially problematic issues such as gender discrimination and racial injustice are significant determinants of investment prospects. Companies that adhere to socially-appropriate ideologies will likely record positive returns from their investments.

The trends associated with technology are likely to have a significant bearing on portfolio management. Contemporary investment options are dependent on technology since transactions and insight on investment decisions are handled virtually. The regulatory environment will determine the nature of investors' contracts, thus shaping investment scope and ideas. International laws on trade and the regulations set by the SEC will set the tone for large transactions and company mergers.

Situation Analysis



Strengths

Brand recognition - Invesco Ltd. products have strong brand recognition in the asset investment industry and are often ranked at the top every year. Investors trust well-known brands, enabling the company to charge a brand premium.

Distribution network - Over the years, Invesco Ltd. has built a reliable distribution network spanning many countries in Europe, America, and Asia, covering most potential markets.

Investment portfolio – As one of the best ETF providers in the US, Invesco has invested in building a strong brand portfolio. Invesco's representative product ETF has excellent investment performance and returns. If the company wants to expand into new product categories, this brand portfolio can serve as a strong reference for management capabilities.

Weakness

Days inventory is higher than that of competitors- The turnover efficiency is lower, making the company need more capital to invest. This weakness could impact Invesco's long-term growth and financial planning efficiency. If considering the current asset ratio, the company may find a better way of using cash and improve efficiency.

Opportunities

Booming market - At the end of 2020, the assets managed by registered investment institutions in the United States reached 29.7 trillion US dollars, with an average annual compound growth rate of 7.3% in the past 20 years. The rapid development and large scale of the

US asset management business is a prerequisite for the company's rise. With this economic growth, the assets of American households continue to increase rapidly. At the same time, the tax system and pension system of the United States make American families have a particularly large demand for asset management.

Geographical location - Headquartered in Atlanta, Invesco recently expanded and received strong support from the Georgia State Government.

Online Services - The increasing adoption of online services by clients, especially in the post-pandemic era, will also enable Invesco to offer new products to clients in the investment services industry.

Threats

Declined market share - While overall revenue increased, the main reason was the rapid expansion of the investment services industry, which grew even faster than the company itself, rather than its active expansion. In this context, Invesco Ltd. must carefully analyze various trends in the financial sector and figure out what it needs to do to drive future growth.

Macroeconomic Trends - Macroeconomic control policies, such as the Federal Reserve Bank's interest rate hike policy, may change people's preferences for investment demand. People will reconsider the structure of economic assets due to changes in the overall financial situation.

Competitive pressure - The release cycle of new products in the financial industry is getting shorter and shorter, and large companies such as Invesco Ltd. face additional competitive pressure. The company's size makes it incapable of releasing or customizing products as flexibly as a small company. Invesco Ltd. cannot respond quickly to market concerns given its large customer base.

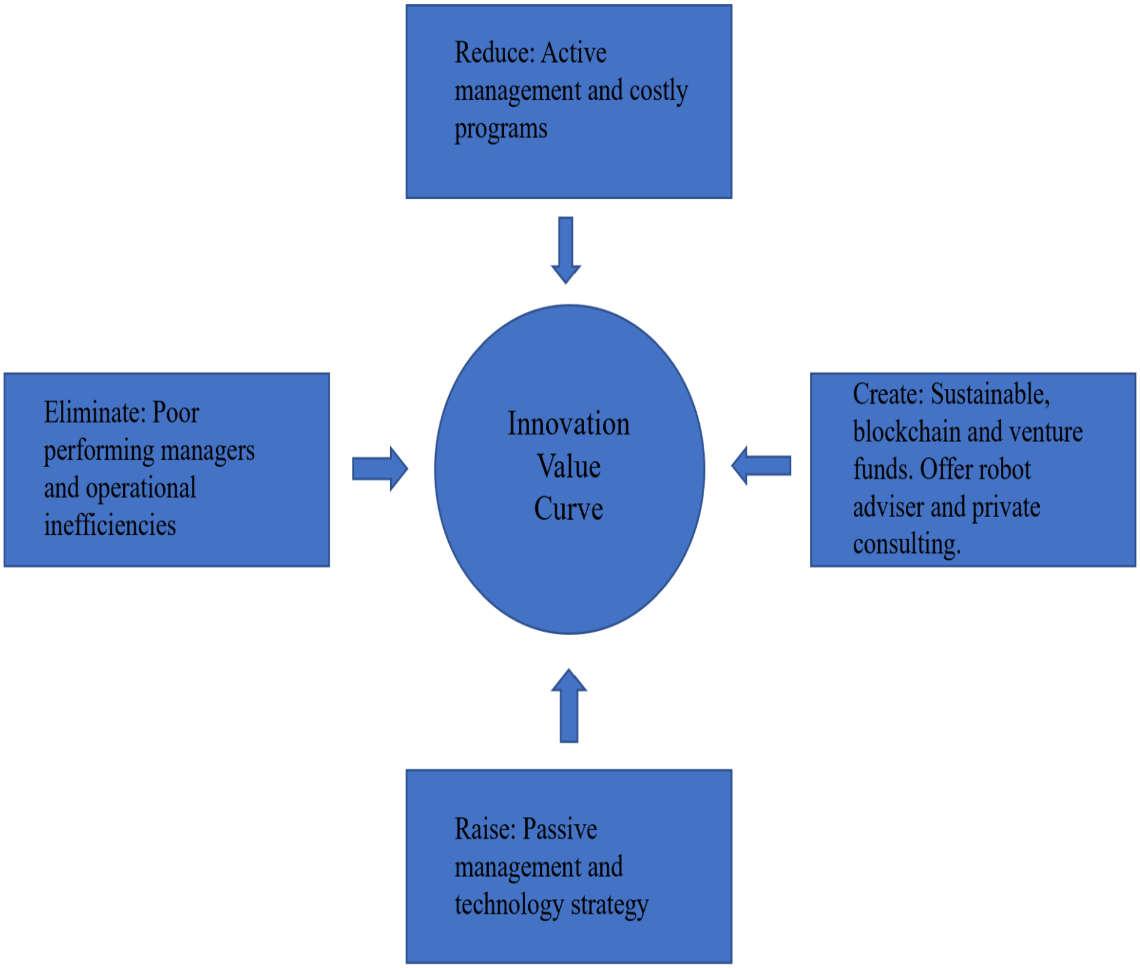
Political Factors - With the U.S.-China trade war, Brexit affecting the European Union, and the changing situation in Russia and Ukraine, the unstable political environment may affect Invesco's business in both local and international markets.

Business Model Innovation

Given the expected changes in the structure of the industry, the focus company should implement the proposed business model modifications: -

Accelerate the cost-cutting initiatives(currently at 70%) and operational efficiencies with the lean methods to improve further shrinking margins from management fee revenue and operating margins and then concentrate on managing high debt levels.

The rise of passive investment management options mainly tracks indexes has led to industry-wide fee compression. Invesco Ltd.'s critical advantage is its global presence and variety of investment options for retail and institutional channels. This critical advantage would allow it to shift in any direction it wants, a possibility only a few top competitors are capable of with strategic economic decisions. The current business model of any asset management company is to earn revenue as the function of the capital they manage. Therefore larger net new flows lead to more significant income earned by the asset managers. Until now, the performance of asset managers, when compared to the index, would not matter as there was no awareness and options to make passive investment decisions.



Recommendations based on four key areas:

Channel

1. Retailers want less risk and wish to make educated safe investments, and therefore, they should be offered more passive investment options.
2. On the other hand, institutions can afford to take higher risks for a higher tradeoff return. So, active money management for clients with big money is opportunistic that allows them to capture some trends or bet against them.

Investment Strategy

1. Passive Strategies for retailers may include strategies with indexes, dividends, bonds, notes, and real estate investment trusts.
2. Active Strategies for institutional investors may be more flexible with indexes but with securities with different weights, small-cap, mid-cap, Flexi-cap, trend, or arbitrage strategies.

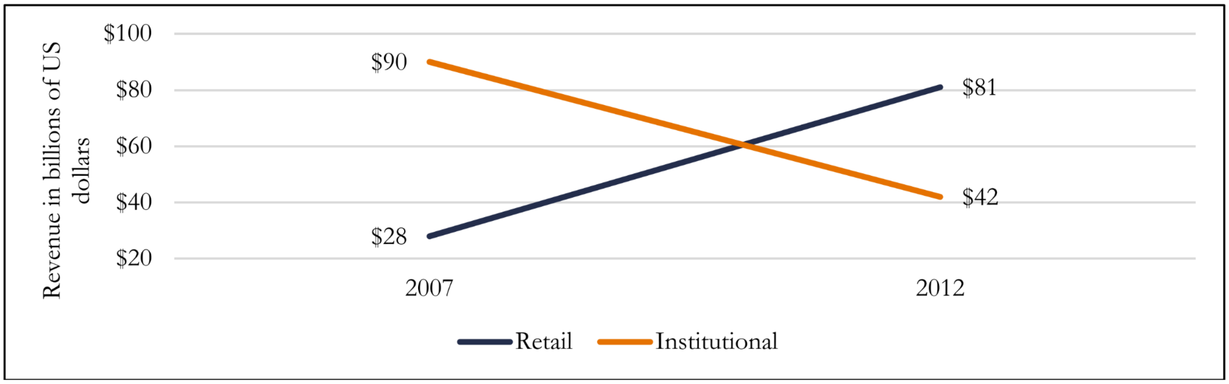
Products

1. Electronically traded funds and Mutual Funds with in-depth performance analysis of fund managers.
2. Private consulting
3. Robo-Advisor

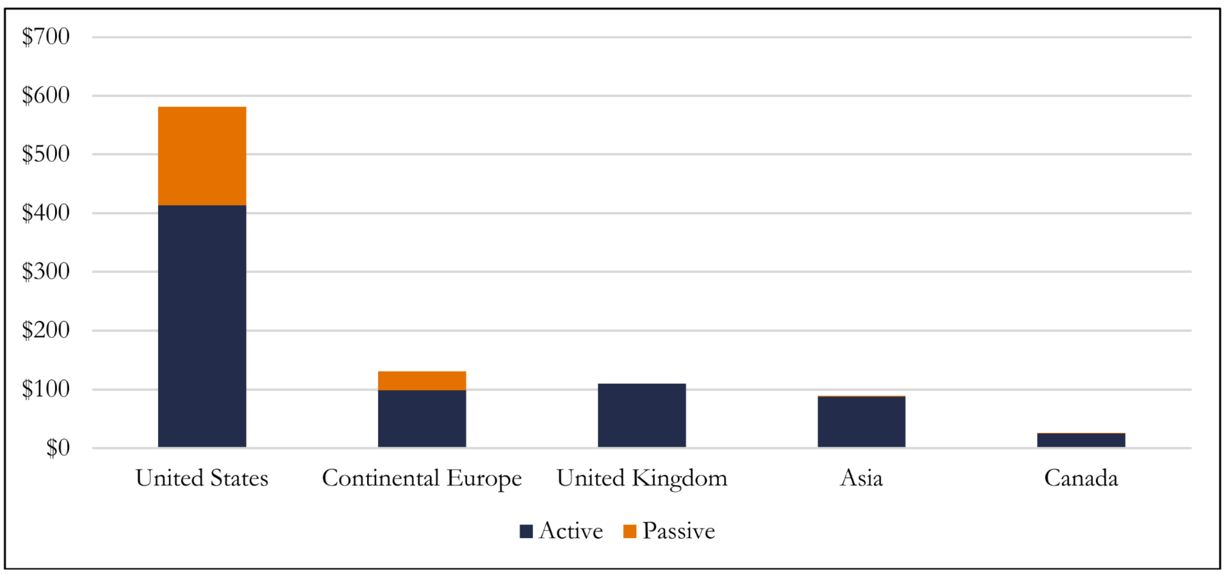
Price

1. Passive Investments should be charged with the least margin over breakeven. These are automated to follow a certain strategy and initially need one-time investment with timely maintenance to have minimum tracking error.
2. Active Investment Managers must earn revenue over performance rather than the revenue earned over net new flows. (e.g., 10% of the profit made or 50% of the percentage over-index made)

The key is to approach profits with these new strategies and shift as the obsolete way of chasing revenue now does not convert into profits. The chart(2017) below is the proof of that. It shows the fall in revenues by institutional investors (about half) and increases by retailers (about thrice). Therefore, it is crucial to concentrate on working on passive strategies and only a few active managers who have consistently beat the market indexes.



It is also worth noting that only developed countries are moving towards cheaper passive investments. Therefore, it is still possible to generate net new flows from developing and underdeveloped countries and get higher margins. The tradeoff should be compared between implementation and gaining the first-mover advantage.



A study from Morgan Stanley showed that 84% of Millennial Retail Investors are interested in sustainable investing as people become more purpose-driven. Invesco Ltd. can be more creative and offer Blockchain-based crypto investments or crowd-sourced investing options for startups.

Lastly, technology should be leveraged, and analytics and quant-driven strategies should be introduced on a scale. These strategies are data-driven, backtested, and include risk management in the model. These strategies should further be channeled through Robo-advisors to clients.

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