Where does the revenues in the mutual fund industry come from?

A qualitative study exploring actively managed mutual funds where a distinction has been made between bank- and nonbank distributed funds

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Abstract

This thesis investigates where the revenues in the mutual fund industry comes from and what determines the large amount of assets under management (AUM) within this industry. A qualitative study has been conducted where eight different interviews were held with interviewees within various seniorities at different institutions. The seniorities included professionals from both banks and nonbanks since these perspectives were considered to differ. The findings reveal that banks, with a large internal distribution channel, tend to recommend their own funds and hence generate higher revenues both from the additional AUM but also from the higher fees charged. We also find that banks use complementary services from its large distribution channel, such as offering lower interest rates to attract additional customers. Further, for funds that are nonbank distributed, third parties such as brokerage houses, are essential to attract capital by being included in the pre-set portfolios that brokers recommend to their customers. The findings also confirm previous research which states that determinants such as the fund manager's reputation, performance, the fee charged, and marketing are all of importance in order to increase the AUM of a fund and hence its revenues.

Key words: AUM, Mutual fund, Fund fee, Distribution channel

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1. Introduction

Within the mutual fund industry, a commonly discussed topic is whether actively managed funds outperform passive funds, as well as whether actively managed funds provide any value added compared to passive funds (Jensen, 1968). The mutual fund industry has for several years been growing and a widely discussed subject within research and media, partly because of the high salaries among fund managers, compared to their performance (Berk & van Binsbergen, 2015). These salaries are driven by high expenses paid by the investors, such as brokerage commissions and management expenses (Jensen, 1969). Thus, some may question how the large amount of assets under management (AUM) in actively managed mutual funds are defensible. Further, if the above-mentioned fees are the only fees that an investor pays when investing in mutual funds and hence the single income for financial advisors and fund managers?

In this thesis, we examine the determinants that drive the mutual funds' AUM and revenues beyond what has already been discovered. Thus, firstly we analyse the different revenue drivers to gain a deeper understanding, in addition to how these may differ between different institutions. Secondly, the investors' choice of funds is examined to further investigate how large of an impact the financial advisors and fund managers have during this process. Lastly, we analyse the effect on the funds' AUM from the different determinants that affect the investors' choice. Hence to gain this perception, this thesis aims to answer the three research questions presented below:

1. *Where does the revenues in the mutual fund industry come from?*
2. *What factors affect the investors' choice of funds and how do the fund managers and financial advisors usually convince an investor to invest?*
3. *How do the answers to the question above affect the asset under management?*

The results from this study is from conducting a qualitative approach involving interviews with fund managers and financial advisors within different ranges of expertise. The sample of interviewees is chosen to include both the perspective from funds distributed by banks and nonbank, in order to examine how the attraction of capital may differ. Further, different interview questions have been designed (presented in Appendix 8.2) depending on the professional role of the interviewee to potentially capture different edges to the chosen research questions. The selected method thus allows for a more in-depth understanding of the field than a quantitative analysis would presumably make and hence answer the research questions more thoroughly.

We find support that the revenues from the mutual funds in Sweden are generated through various fees, and that it is worth noting that these differ between bank distributed funds and nonbank distributed funds. Bank distributed funds tend to generate revenues through internal distribution channels and sale of their internal funds. However, nonbank distributed funds without a large internal distribution channel, are more dependent on attracting additional capital through third-party distribution such as brokerage houses. In such cases, however, the fund revenues are split between the different parties and additional costs such as the annual management charge is added. Moreover, the study indicates that because of this shared income that is split between the different parties and also the use of discounts, the announced amount of invested capital may be misrepresented. Hence, fund managers and financial advisors may earn less income compared to the numbers that are commonly discussed in the media.

Furthermore, we find that managers and financial advisors usually use complementary services and discounts to persuade their clients to invest in funds. In addition, the findings confirm that the fund manager's reputation, fund performance, marketing, and the fee charged play a crucial role in the investment decision-making process. However, non-return factors are often what attract customers and increase the fund' AUM and hence the study suggests that a large distribution network is the most crucial factor.

This thesis aims to contribute to insights on what the investor-level determinants of fund managers and financial advisors' revenues are, in addition to what factors affect the investors' choice of funds. The current literature on mutual funds primarily focuses on the asset pricing field, with a significant emphasis on the ability to outperform the market or related benchmarks, as demonstrated in studies such as Jensen (1968) and Berk & Green (2004). Hence, a gap within this field exists on what other value-added services that are provided beyond return. These value-added services could thus potentially help explain why it is justified that fund managers are still among some of the highest paid in our society (Berk & van Binsbergen, 2015) and hence how to convince an investor to invest based on these services. Some studies, however, analyse for instance the reputation of the fund manager (Chen & Lai, 2010) and how the financial advisor has an impact on the investors' choice of funds (Foerster, Linnainmaa, Melzer & Previtero, 2017). Nonetheless, the value added is likely to differ between different distribution channels and therefore a distinction will be made between bank- and nonbank distributed funds.

Further, by conducting an interview-study, value added services beyond what has already been discovered in previous research, are considered to be more likely to be revealed. For instance, how the increased transparency that has evolved in the industry due to tightened regulations such as MiFIR and MiFID II influences the financial advisors' recommendation, as a result of reduced conflict of interest. In addition, these findings also contribute to previous research by revealing loopholes on how reallocation of fees might be used in order to attract customers with value added services such as discounts, which thus opens up for questions on whether the current regulations should be tightened further.

2. Literature Review

Throughout this chapter, the theoretical framework of the study will be presented. Beginning with previous research where several previous studies have been conducted on for instance fund return, fees, as well as the skill of the fund manager. However, this thesis takes another approach as it aims to contribute with research and deeply assess where the revenues from the mutual fund industry comes from and what determines these, as well as the effect on the AUM. Lastly, the structure of the fee and a regulatory framework will be introduced to present the increased transparency that has evolved throughout the years.

2.1 Previous Research

One of the earliest researches conducted on mutual funds was to determine whether active funds provide any added value compared to passive funds, by Jensen (1968). The paper investigates for the first time, on aggregate compared to an absolute value, if fund managers add any value at all, instead of comparing different fund managers to evaluate if they perform better than others. The findings from the paper are critical towards the value added by fund managers and find both that they as an aggregate underperform compared to the market and that they are not expected to outperform what would have been made by a random chance (Jensen, 1968).

To build upon the findings made by Jensen (1968) the topic has been widely discussed and conclusions similar to Jensen's have been made. Malkiel (1995) adds a new dimension by including survivorship bias which he believes is a vital part to include in the discussion. The findings conclude that active fund managers on aggregate underperform and although data show that positive performance could be observed during the 1970's it was not consistent in the 1980's. Carhart (1997) further argues in his study that when actively managed funds outperform the market, other factors beyond the manager's talent can explain these findings and that persistent underperformance remains an anomaly.

To explain why mutual fund managers are among the highest paid in our society, although research like the presented above claims that actively managed funds on average underperform compared to the market, it is important to understand what drives the revenue and the AUM of these funds. Hence, Dalmácio & Nossa (2004) study the use of marketing of mutual funds to attract AUM from an agency conflict perspective. Actively managed mutual funds tend to have at least one part of the fee structure based on a percentage of the AUM, hence a fund manager would earn more money as AUM increases. As a consequence, an agency conflict can potentially arise since the fund manager would be incentivised to spend time on marketing their fund in order to increase its capital instead of taking the time to actively manage the fund to increase its return. Further, as the fund increases in size a new potential agency conflict can arise since the fund would be harder to manage due to the large number of different holdings which decreases the ability to make an in depth analysis instead of keeping it to a smaller number of companies (Dalmácio & Nossa, 2004).

In addition to the increase in AUM from marketing by the fund managers, Chen & Lai (2010) study reputation stretching and its role among fund managers and fund performance. The authors conclude that reputable fund managers have an advantage in increasing the net fund inflow as well as the returns of a fund. The study also reveals that when an investor aims to invest into a new fund, they tend to increase inflows when the fund is managed by a manager showing good prior returns. Hence, the AUM and the reputation as well as the expectations of the fund manager is linked, as a strong reputation increases the investments and therefore its AUM. Further, Gennaioli, Shleifer & Vishny (2015) present a new model, where investors do not only base their decision on performance but on the trust of the fund manager. They find that managers, referred to as ”money managers” throughout the article, do compete with fees but since trust of the manager is of importance, fees are higher in equilibrium for assets with higher expected return. However, by accounting for fees the average manager underperforms (Gennaioli et al., 2015).

Not only the fund manager has a responsibility, Foerster et al. (2017) also discuss the financial advisors and their impact on a clients' asset allocation. They conclude that the majority of households depend on investment recommendations provided by their financial advisors, and that advisors have a significant impact. One of their findings is that the level of risk that an advisor takes in their own portfolio is the most significant indicator of the risk that their clients will undertake. Hence, the variety in advisors' preferences and beliefs influence the advisor-specific effects (Foerster et al., 2017).

Moreover, Roussanov, Ruan & Wei (2021) investigates the cost of actively managing mutual funds where marketing contributes to approximately one third of the cost. Through a structural model using data from well-diversified U.S. domestic equity mutual funds, Roussanov et al. (2021) finds that to explain the variation in fund size, marketing expenses are almost as important as price and performance. Further, marketing reduces search costs which reduces frictions in the market and by attracting more clients people become more financially educated. In addition, the findings also show that elimination of marketing can improve welfare since the capital would turn towards cheaper funds and the competition would thus decrease fees. In conclusion, they argue that actively managed funds would shrink where capital allocation would become more closely in line with skill and a shift would turn towards passive investments (Roussanov et al., 2021).

Furthermore, Xu (2021) investigates the spillover effect that senior mutual fund managers might have on their more junior colleagues. The study shows that when a junior investment manager has a new senior fund manager in a fund, the capital inflow of the junior mutual fund managers' other funds increases. A model was made to measure the benefits to the junior fund manager which is split into (1) the capital raising ability, and (2) the active investment skill. The capital raising ability is defined as how to increase the funds' AUM instead of its performance from, for instance, receiving clients from senior colleagues or marketing. Active investment skills are defined as how to outperform alternative investments like for instance using investment strategies teached by a senior colleague. The findings show that there do exist some spillover effects related to the capital raising ability of the senior manager while it on the other hand do not exist for the active investment skill. Hence, it helps explain why there exists some underperformance in the market (Xu, 2021).

2.2 The Mutual Fund Fee Structure in Sweden

Proponents of passive funds such as Eugine Fama (Fama, 1970) might make it hard to understand why mutual fund managers are among the highest paid in our society (Berk & van Binsbergen, 2015). It is therefore essential to make sense of how mutual fund companies earn their money through different fund fees, commonly referred to as the expense ratio. These fees are different among countries but in Sweden the most commonly presented is the management fee and the annual fee (Avanza, 2023a).

The management fee is the fee that the fund company charges for managing, storing, administrating and distributing the fund. The fee varies among different funds, depending on for instance what market the fund invests in and how much time that is required to manage the fund and to evaluate the market. The fee is presented in percentage on an annual basis, however on a daily basis 1/365th of the management fee is deducted from the fund before the price of the fund is calculated to ensure that the fund investor only pays fees for the time that it has owned a share in the fund (Avanza, 2023a).

In addition to the management fee, the annual fee is usually presented at the fund companies' web pages. The annual fee includes the management fee, but it does also include the costs for distribution, marketing, registration and advice. In Sweden the difference between the management fee and annual fee is generally small. However, for foreign funds there might be a large difference since the management fee does not usually cover as many costs as for the funds in Sweden. Examples of such costs include costs for custody, administration, valuation and audit. In Europe, the annual fee is however standardised so that it is possible to compare costs for funds among them (Avanza, 2023a).

The annual fee does not however wholly cover the total fee since the total fee also includes transaction costs and other fees such as performance-based fees. Transaction costs are the fund's costs for buying and selling holdings in the fund. The performance-based fee is more common for hedge funds or actively managed funds where the fund manager's effort matters more than for other funds. The fee is usually paid out if the fund performs better than its benchmark. The disadvantage of performance-based fees is that it is harder in advance to sense how large the fee will be (Avanza, 2023a).

Lastly, in addition to the above-mentioned fees, when financial institutions such as banks or brokerage houses sell external funds, they are paid a distribution fee by the fund companies, usually referred to as kickbacks. The kickbacks consist of a fixed percentage of the funds management fee which usually amounts to 40-50% of the management fee and is paid out quarterly (Avanza, 2023a).

2.3 MiFID II and MiFIR

The Markets in Financial Instruments Directive (MiFID) and The Markets in Financial Instruments Regulation (MiFIR) control the regulations for how banks and investment companies in Europe should work with investments and investment advisory. The purpose of the directive and regulation created by the European Union is to increase transparency, improve the protection of the investors and increase the trust for the European securities market. MiFID II and MiFIR were first accepted by the European Parliament in May 2014 and came into force on January the 3rd 2018. The regulation was updated from MiFID I to MiFID II and MiFIR, since more financial instruments are available on the market due to fast development in addition to lessons learned after the financial crisis in 2008. The new directive and regulation cover a broader range of financial instruments and more methods of trading with these instruments than the previous. It also includes rules within specific areas such as how to trade with commodity derivatives (Finansinspektionen, 2022).

The specific industries where MiFID II and MiFIR should be adopted in Europe include investment firms, regulated markets, Multilateral Trading Facility (MTF) platforms, Organised Trading Facility (OTF) platforms, providers of data reporting services and third-country companies that provide and/or carry out investment activities in the European Union (Finansinspektionen, 2022).

2.4 Summary of Literature Review

To sum up, the mutual fund industry has been growing for the last few years, where Sweden is the largest market in the Nordics when it comes to managed capital (Möttölä, 2022). Jensen (1968), who was among the first critics towards the added value that fund managers provide, argues that actively managed funds on average underperform and similar findings are supported by Malkiel (1995). Furthermore, Dalmácio & Nossa (2004), emphasises the importance of recognizing factors that drive the AUM and revenues, as the fee charged is typically based on the size of the AUM. This structure of the fee may give rise to agency problems and tensions on whether to focus on properly managing the fund or marketing in order to increase the funds' AUM. Chen & Lai (2010), concludes that a fund manager with a good reputation possesses an advantage in terms of increasing the returns as well as the net inflow in the fund, hence the reputation and the AUM is connected. Moreover, Gennaioli et al. (2015) finds that a trust for the manager is of importance, hence the manager competes with the fees of the fund. However, Carhart (1997) argues that other factors beyond the talent of the manager could help explain why actively managed funds outperform the market. Foerster et al. (2017) on the other hand discusses the impact that a financial advisor has on a client's asset allocation and concludes that they do have a significant impact where preferences and beliefs do influence. Roussanov et al. (2021) analyses the cost of active funds, where they find that marketing counts for approximately one third. Hence, by removing the cost of marketing, the welfare could improve due to the increased competition lowering the fees. Lastly, Xu (2021), discusses the spillover effect which could help explain why there exists some underperformance. Thus, a significant amount of research has been conducted within the field, however this thesis takes another approach by diving deeper into the most important revenue driving determinants to discover if it goes beyond the findings that have already been made.

It is further important to understand the fee structure of the mutual fund industry which is mainly driven by the management fee and annual fee, where the latter partly includes the management fee. In addition, there do exist other fees such as performance-based fees that are more common among hedge funds, or kickbacks which are fees collected when external funds are sold (Avanza, 2023a). Moreover, the MiFID II and MiFIR regulations control how investment companies and banks should manage advisory and investments for customers to increase transparency, trust for the securities market, as well as improve the protection for the investors, which puts pressure on the amount of inflow from the mutual funds (Finansinspektionen, 2022).

3. Methodology

Throughout this chapter, the chosen methodology will be presented. Beginning with the research design where a qualitative approach has been used through semi-structured interviews. Followed by the data collection and presentation of each interviewee and their contribution to the study, as well as the interview design. The chapter ends with a critical reflection of the chosen research design and an ethical reflection of the study.

3.1 Research Design

Due to the descriptive nature of the research questions where the purpose is to get a deeper understanding of the fund revenues as well as finding value-added determinants, rather than answering questions such as "how many" or "how much", a qualitative research method will be used. According to Yin (1994, 2009), a qualitative research method is more suitable when the researcher seeks to focus on questions such as "how" and "why", as well as to understand the role and the origins of the investigated situation. In addition, when the purpose is to get a deeper level of understanding of the phenomenon or event that is being analysed. Therefore, a quantitative research design would not have been the most suitable approach for this thesis. Instead, the qualitative research method effectively addresses the research questions posed by this thesis. Nevertheless, quantitative data is also analysed, but instead with a desire to support the result from the qualitative study.

3.2 Qualitative Data Collection

3.2.1 Interviewee Selection

The selection of the interviewees is from a perspective of receiving as in-depth answers as possible within the field of research. The purpose of this thesis is to investigate what the different determinants of the revenue and AUM in the mutual fund industry are, as well as the factors driving investment choices. Hence, the interviewees were selected because of their field of expertise within the mutual fund industry. In total eight interviews with eight different interviewees were conducted (see Table 1 for the specified list).

The first interview was held with a manager within institutional sales referred to as Employee A at a large bank in Sweden, referred to as Company A throughout this thesis. The interview was held to get an institutional perspective of the mutual fund industry, since it is regarded as an essential part in order to cover the entire customer segment within the industry and hence be able to answer the research questions. The second interview was held with a financial advisor at one of the leading assurance brokers in Sweden, Max Matthiessen. The purpose was to get the customer's perspective, since it is the advisor that has the direct contact with the customer and hence has the best insight on what different customers are valuing the most, as well as how to convince the customers to invest in certain mutual funds. The third interview was held with the Head of Investment Strategy at Max Matthiessen, the aim was thus to sort out which factors he considers to be the most important while setting up a portfolio and thus what determinants that are the most important in order to increase a funds' AUM and revenues. The fourth interview was held with a fund manager at Danske Invest. The purpose of the interview was to get insight on how a fund manager earns money and which factors he believes are the most important for the success of the small-cap company fund that he manages. The fifth interview was held with a fund manager at Naventi which is a fund company in Sweden where we were able to get an additional perspective from a fund manager but at a nonbank on what different determinants that drives their AUM and revenues and thus in what ways it might differ from a bank. The sixth interview was held with the one responsible for the internal Swedish funds referred to as Employee B, at one of Nordic's largest banks, referred to as Company B, in order to discover what s/he believes are the most important factors to attract customers and hence increase its AUM and revenues. The seventh interview was held with a portfolio manager and the CIO at Navigera which is the second fund company that Max Matthiessen owns (in addition to Naventi). It is considered to be an important complement to the Naventi interview since Max Matthiessen do not include Naventi funds in their constructed model-portfolios, but they do include Navigera funds, which is thus a revenue source that Naventi is lacking in comparison. Lastly, an interview was held with a financial advisor at Nordea within Personal Banking, where the main focus was to get an insight on how large flexibility a financial advisor has when it comes to offer lower fees regarding for instance when a package deal is made. This aspect might be essential since banks offer a wide range of services such as mortgage and cards which likely has an impact on the determinants of the mutual fund's revenue and AUM.

The selection of interviewees provides the study with rich answers and contributes to an in-depth understanding of the mutual fund industry. Further, the different levels of seniorities and companies provides a broad picture to discover different dimensions of the industry. However, due to limitation of time and busy schedule of the professionals within the field of study the interviewee selection includes limitations. It would for instance have been of interest to include more interviews to potentially discover more determinants and track additional dimensions.

Table 1

Summary of the constructed interviews

Interviewee	Role	Company	Date
Employee A	Head of Institutional Sales	Company A	2023-03-21
Peter Elfving	Financial Advisor	Max Matthiessen	2023-03-28
Christoffer Johansson	Fund Manager	Naventi	2023-03-29
Jon Arnell	Head of Investment Strategy	Max Matthiessen	2023-03-30
Joel Backesten	Portfolio Manager	Danske Invest	2023-03-30
Employee B	Head of Swedish Branch	Company B	2023-04-03
Per Haldén	CIO and Portfolio Manager	Navigera	2023-04-03
Nils Wikström	Financial Advisor	Nordea Bank	2023-04-04

3.2.2 Initial Contact

The initial contact with the interviewees was made via email where we included a brief introduction to the field of research in addition to a presentation about ourselves. Further, we gave them up to a month in advance before the interview to ensure that their schedule would not be fully booked so that time would not be limited. Both virtual and in-person meetings were also suggested to give the interviewees an option based on preference. Moreover, some were recommended to us as suitable interviewees through contact networks, whereas some were contacted based on research on company pages or LinkedIn where the email to the selected interviewees were available.

3.2.3 Interview Design

The primary data was gathered through individual interviews with various people within the industry, as presented in Chapter 3.2.1. A semi-structured approach was applied, meaning that a frame with prepared questions was used, however, it did not necessarily have to be strictly followed but rather open to get a more fluent interview and conversation (see Chapter 8.2 in Appendix for the interview questions) (Merriam, 1994). Further, a deeper understanding of the respondent attitudes was received by asking follow-up questions. Depending on the interviewee's professional role, different questions were asked beyond the standard questions that were asked in every interview, to get a broader perspective and generate the best results. Additionally, the study is taking an abductive approach, meaning that the framework and interview questions are modified and improved gradually (Dubois & Gadde, 2002), with the purpose of strengthening and improving the interviews.

The interviews were held between the 21st of March and 4th of April, and the duration varied from 20 to 60 minutes based on the amount of pre-formulated questions as well as the professional role of the interviewee. With the interviewees consent, the interviews were recorded to later be transcribed in order to be consistent with the reliability criterion (Yin, 2014). Moreover, some of the interviewees preferred to be anonymous for the written and published thesis, hence, the concerned have been referred to as "Employee X" to protect their identity.

3.3 Secondary Data

Since this thesis follows a qualitative approach, and hence that is what the research is in essence based on, the primary source of data was made through the interview sessions. However, additional information was collected in order to conduct supportive quantitative data in the presented tables and diagrams referred to as "Figure X" below. The gathering of the additional information presented in the different figures were collected from annual reports and complementary public information through the different company's webpages.

3.4 Critical Reflection of the Research Design

According to Bell, Bryman & Harley (2022) some aspects can be considered to be problematic while conducting a qualitative study. The subjective nature of the study opens up for opinions of the researcher in a non-systematic way on whether something is considered to be of importance or not. Thus, subjective interpretations can be present in the findings from the interviews. To avoid these interpretations from happening, all of the interviews were, as above mentioned, recorded and thoroughly reviewed after the interview session. Furthermore, to increase validity all of the interviews were held during a short time frame since answers may vary over time. However, large deviations from the answers are not regarded as likely to change in time due to the chosen research questions. In conclusion, the challenges with the chosen research design increases the importance of clarity throughout this thesis.

3.5 Ethical Reflection

In this study the collected information is, as described above, from previous research, available data and the selected interviewees. Certain considerations must however be accounted for when science research is made. The research within social science includes people and therefore a vital part is to consider the implications and applications of its results instead of only the research process itself. Throughout the writing of this thesis an ethical responsibility for the research will thus be applied. Vetenskapsrådet (2023) has published a guideline on ethical principles including criterias and rules that should be followed while writing a thesis. Further, the society demands that an understanding of the research requirement should continue to develop and deepen (Vetenskapsrådet, 2023). In order to succeed to follow these research requirements, the presented information and previous research should be viewed with a critical eye; hence responsibility will be taken throughout this thesis to ensure high quality and moral acceptance (Vetenskapsrådet, 2023).

4. Analysis and Findings

Throughout this chapter the findings from the interviews will be presented. Firstly, a background will be introduced which includes a description to why the various companies were chosen and what perspective it contributes with, as well as why the distinction between bank- and nonbank distributed funds have been made. Moreover, the findings from the interviews will be collected and presented in different sections based on whether the interviewee works at a bank or not, as well as the various themes; additional services, internal sales, pricing schemes and lastly determinants of funds' AUM and revenue.

4.1 Background

As presented in Table 1, eight interviews have been conducted where four of the interviewees were representatives from banks and thus contributes with insights from a banking perspective. To ensure a broader perspective different Nordic banks were selected to gain insights on how they might work differently. In addition, since the mutual fund industry does not only include retail customers but also institutional customers (see Appendix 8.1 for the allocation at the major banks in the Nordics) the perspective from Employee A was of interest to discover. Beyond banks, funds are also distributed from fund companies that are not bank owned in addition to brokerage houses that distribute both bank- and nonbank affiliated funds. Thus, four interviews were held with representatives from nonbank distributed fund companies and a brokerage company. Hence, the attraction of capital to the mutual funds may vary for a bank that provides its internal funds and hence use its large distribution channel and complementary services which likely differ for non-bank affiliated funds. Therefore, a distinction between these two distribution channels has been made throughout this chapter. Below, Table 2 presents a compilation over all of the determinants that were raised during the interviews when asked which determinants they found to be of most importance for their customers when selecting funds.

Table 2

Compilation of the determinants discovered from the interviews

	Company B	Nordea Bank	Danske Invest	Navigera	Naventi	Max Matthiessen
ESG	✓	✓				✓
Performance	✓	✗	✓	✓	✗	
Marketing/Visibility	✗		✗	✓	✓	
Trust for the Financial Advisor	✓			✓	✓	✓
Fees						✓
Reputational Fund Manager		✗			✓	✓

4.2 Bank Distributed Funds

4.2.1 Complementary Services

Banks offer a broad range of services in addition to advising and managing funds, like for instance offering cards and providing customers with mortgages. Hence, in contrast to nonbanks they are able to provide their customers with additional complementary services through its internal banking network. Employee B (2023-04-03), who works at one of Sweden's largest banks, confirms that s/he needs to be humble and admit that without its large banking network a smaller amount of capital would have been attracted. However, s/he also states that although a large distributor is essential it is fundamentally about delivering good returns otherwise the funds would not sell (Employee B, 2023-04-03).

Further, since banks offer mortgages, a way to attract additional customers and hence more capital is to motivate customers to invest in funds by offering for instance lower interest rates (Wikström, 2023-04-04). Wikström (2023-04-04) states that, for retail customers, discounts on fund fees are not available. However, a larger savings amount within Nordea could motivate better interest rate discounts on a customer's mortgage. While asked what is considered a larger savings amount and how the process works, Wikström (2023-04-04) explains a concept referred to as "relationship indicator", which Nordea has increasingly started to work with. It is an internal evaluation measure based on knowledge and experience, since it has been observed that customers with multiple products and services are less likely to switch to another bank solely based on price. Thus, if the customer only has a mortgage within Nordea, s/he is more likely to switch to another bank (Wikström, 2023-04-04). Above 50% of Wikström's (2023-04-04) customers check the criteria for relationship indicator and he further states that they inform their customers about this system in order to provide additional incentives for them to start a savings account or pension with them.

Thus, Nordea is through its relationship indicator system able to offer customers greater deals by including more complementary services. Therefore, one could imagine that the same strategy would be used at Danske Bank. However, Backesten (2023-03-30) explains that other major banks in the Nordic's such as for instance Bank B and Nordea use its banking network in order to attract additional capital which sets Danske Bank in Sweden apart a bit in that it may be more like a smaller firm in that respect. Further, they do not take advantage of their large distribution channel to the same extent and he explains that the majority of the capital comes from third-party distribution. However, he states that for its internal sources the Private Banking segment is what contributes the most to the small-cap fund's AUM and revenue, that he manages. Hence, a way for Danske Invest to attract additional capital would be to work more like other major banks and take advantage of its large distribution channel. However, he adds that it is something that they would want to start working more on in the future and admits that other banks such as Nordea are ahead of time in comparison (Backesten, 2023-03-30).

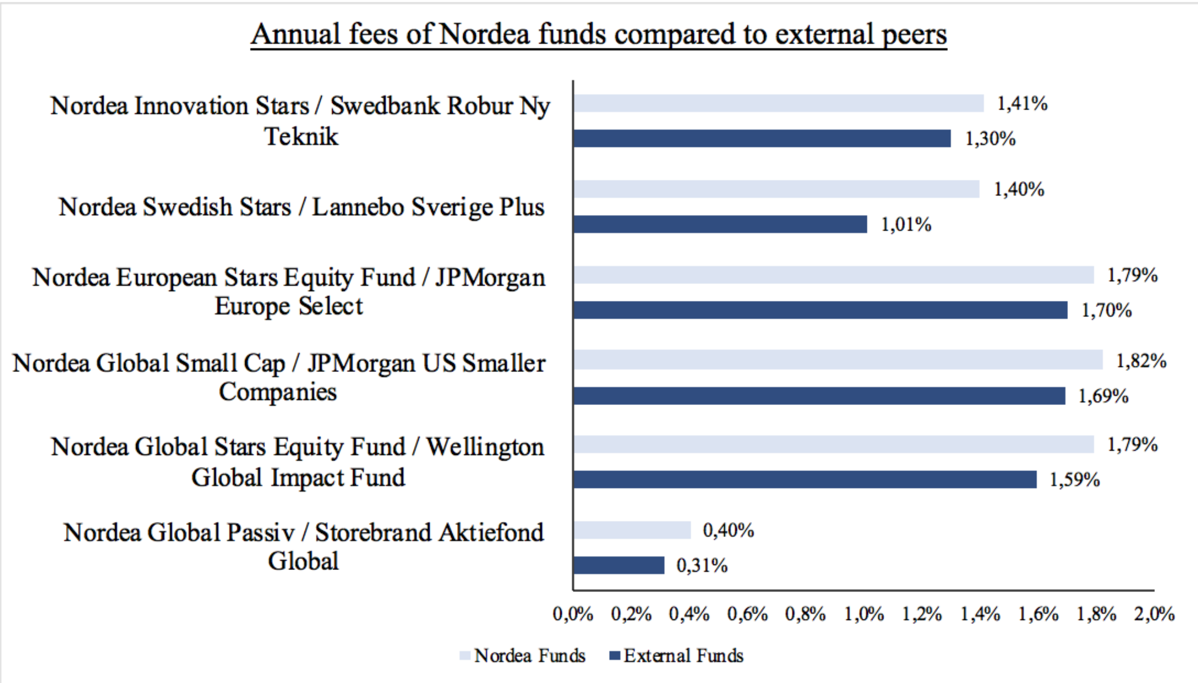
4.2.2 Internal Sales

According to Wikström (2023-04-04) banks tend to mainly offer funds from their own fund selection, hence their internal funds. While asked why that is the case, he explains that it is partly because Nordea's fund company does not earn the entire management fee when external funds are sold. He further states that while meeting a client they are informed beforehand that the advice is not independent and that they mainly provide advice on funds within their own internal range and thus rarely recommend external funds. Wikström (2023-04-04) adds that this applies for the Personal Banking segment which handles the less capital heavy customers at Nordea. For the advisors at the higher levels like for instance wealth advisors or Private Banking the understanding for external products is likely higher. However, for the less capital heavy segments the advisors have not received much training on external funds and only discusses external funds if it is at the customer's own initiative (Wikström, 2023-04-04).

To sum up, Nordea is dependent on selling internal funds where their fund company otherwise would earn less by only receiving a distribution fee (Wikström, 2023-04-04). In addition, as presented in Figure 1, based on a sample of six external funds that Nordea offers in comparison to six Nordea funds with similar niches, the Nordea funds are more expensive. Hence, the advice that is received from a brokerage house such as Max Matthiessen would provide the customer with a broader range of funds, instead of more weight towards expensive internal funds, even though the customer is always allowed to reject the proposed funds offered at Nordea. Moreover, Figure 2 presents the AUM for five bank funds as well five similar nonbank funds. The data shows that bank affiliated funds in general have a larger AUM which could be due to larger internal recommendations and lacking knowledge about external funds among the financial advisors at the banks which is supported by Wikström (2023-04-04).

Figure 1

A comparison between Nordea's internal- and external funds[1]

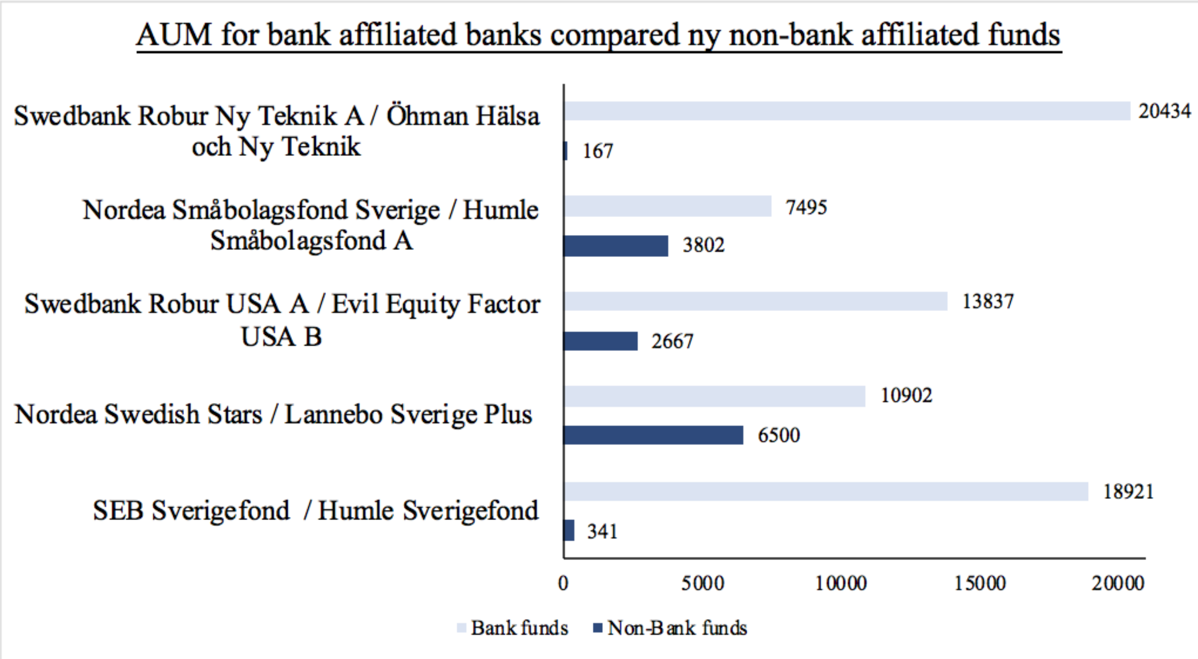


Source: Nordea (2023).

[1] The two "comparable" funds are diversified within similar niches and weights; the sample further includes Global Innovation funds, Europe funds, Swedish funds, Global Small Cap funds, Global Sustainability funds and Global Index funds. However, the funds are not fully comparable but due to Nordea's rather small offering of funds a comparison was made between the most similar peers.

Figure 2

A comparison between bank affiliated and nonbank affiliated fund's AUM[2]



Source: Avanza (2023b).

4.2.3 Pricing Schemes for Bank Distributed Funds

Employee B is as presented in Chapter 3 responsible for the internal Swedish funds at one of Sweden's largest banks, referred to as Bank B, at their fund company, Company B. For Company B the only fee charged is the annual fee which is further divided into two separate parts: the one for the product and for the distribution where approximately 50% proceeds to the distribution. Bank B is the largest distributor for its respective fund company, but the funds are also available through other platforms like for instance Avanza where the same structure applies. Hence, the management fee is always split between the fund company and the distributor, regardless of whether it is Bank B or any other distributor. Company B has an outsourcing agreement with Company B's Investment Management for the management and administration related to this. The annual fee is a standardised measure developed to compare fund costs across Europe. Further, for funds registered in Sweden, there is no difference, where it is an all-inclusive price (Employee B, 2023-04-03).

[2] The sample includes 10 funds; 5 bank affiliated funds and 5 non bank affiliated funds. The funds have been chosen based on similarities in the sense that they share the same benchmark index, invested industries and geographical spread.

Joel Backesten works together with three other fund managers with five different strategies at Danske Invest with its main focus on the small-cap fund, Sverige Småbolag Class SA. Its main source of money comes from what is referred to as “sticky money” which includes for most part pension savings. Hence, their target group is not retail customers with private savings which are mostly attracted by platforms such as Avanza. Further, in line with the structure at Company B, while selling their funds through for instance Avanza a kickback is received by Danske Invest which is usually around 50% (Backesten, 2023-03-30).

At Danske Invest their customers are divided into three different share classes; a retail class, an institutional class, and a clean share class (Backesten, 2023-03-30). The fund managers earn money on the management fee and their only incentive is to maximise return while Backesten (2023-03-30) claims that the banks focus more on maximising the AUM. However, the fee structure differs for institutional customers compared to retail customers where they are able to offer lower prices to their institutional customers (Backesten, 2023-03-30). Institutional sales contribute to an essential part of the AUM of the Nordic’s largest commercial banks. For Nordea approximately 30% of their total AUM of €360 million in 2022 (see Appendix 1) was from institutional sales (Nordea, 2022) and according to SEB’s factsheet (2022) 41% of their total revenues (see Appendix 2) was generated from this segment. Lastly, approximately 16% of Swedbank’s revenues was generated from Institutions and Large Corporations (see Appendix 3) (Swedbank, 2022).

At the institutional sales division at one of the Nordic’s largest banks’ asset management companies, Company A operates within two different areas; institutional deals as well as distributional deals. For the distributional part of the sale, the revenue and fee structure work as for the sales from retail customers, hence Company A and the distributor splits the revenue. Further, for the institutional part, no separate fee beyond the annual fee is charged. Employee A (2023-03-21) explains that if Company A or any other bank raises other revenues it is not entirely allocated to them. For instance, if a customer buys a Company A fund and holds it in an endowment insurance with another insurance company, then the insurance company would receive any potential fees associated with the endowment insurance. However, Company A would receive a shared revenue from the fund (Employee A, 2023-03-21).

To retain relationships or to stay competitive, different tailored solutions can however be made between the sellers at Company A and the customers. A common solution is to give out certain discounts to the customers, hence the fee paid is below the one presented on the company website. If a discount is offered on a product it is usually an agreement between the institutional customer and the seller where in practice a contract is formed including terms that both parties agree upon. The percentage discount would eventually be sent back to the customer as a cash payment, usually quarterly, where the customer can decide whether to buy additional fund shares or something else. The bottom line is however that economically speaking the customer would pay a lower fee than what is listed on the product (Employee A, 2023-03-21).

Further, Employee A (2023-03-21) describes that it can sometimes be hard to decide on an agreement for the price. There is often a trade-off between attracting new customers to get a “foot in the door” although the initial deal would not generate an essential amount of money, and not giving away a product at a larger discount than what is economically justified. Additionally, Employee A (2023-03-21) clarifies that if a product is considered to be of very high quality it would not be apportioned at any price.

To sum up, the fee structure for the institutional part as well as for the retail part works similar. However, since the institutional part controls larger volumes of money per customer on average, it is of importance to stay competitive and to offer its customers the best possible price. Therefore, different agreements are made for different institutional customers which differs from the findings for retail customers where they work with discounts in the form of for instance lower interest rates. The different types of pricing themes could depend on for instance how important a customer is based on how large of a volume it is investing but also what product it is since some products are regarded as not worth selling at a discount just to close a deal.

4.2.4 Determinants of Funds’ AUM and Revenue

The Personal Banking team at Nordea only advises customers within the capital range of 0-1 MSEK. According to Wikström (2023-04-04), the clients within the Personal Banking segment do not place too much emphasis on historical returns of the funds or the fund manager’s reputation, although the historical return is disclosed when presenting the fund proposal for the customer. Wikström (2023-04-04) adds that a relatively new addition to their advising is that Nordea has started to work substantially on transparency within ESG. Furthermore, based on the customers’ sustainability preference on their savings, funds within the “sustainability choice” are offered and thus a larger focus on passively managed funds can be taken (Wikström, 2023-04-04).

Since ESG has started to play an important part within the mutual fund industry, being a forerunner within this field has increased in importance (Employee B, 2023-04-03). Thus, one of the funds that has performed best during the last couple of years at Company B was, to a large extent, because it was one of the first funds within the ESG profile in the Swedish market which strengthens the above statement (Employee B, 2023-04-03).

Additionally, according to Employee B (2023-04-03) however, it is all about the funds' performance to attract customers. In accordance, Backesten (2023-03-30) agrees that the most important factor will always be performance of the fund. Large emphasis has further not been put on marketing at Danske Invest in order to increase its funds AUM and revenue, and one could imagine that it might be because they have a reputational bank that is well-known to the public behind it, as for Nordea. However, according to Backesten (2023-03-30) that does not apply for Danske Invest where they have rather been struggling due to bad reputation after the money laundry scandal in Estonia. In addition, Employee B also states that they do not work with marketing of their fund, instead it is within the scope of their main distributor and their work. Hence, the advisors are considered to have an important role as they during their meetings with customers can recommend and discuss the funds (Employee B, 2023-04-03).

4.3 Nonbank Distributed Funds

4.3.1 Financial Services

Max Matthiessen as a brokerage house puts a lot of work into negotiating with the different financial institutions that they collaborate with like for instance assurance companies, in order to stay competitive. Elfving (2023-03-28) describes that they often reach out to these assurance companies and explain that they can receive several customers from Max Matthiessen if they offer attractive discounts to their customers in the form of lower fees. These discounts can for instance include a lower management fee or a lower annual fixed fee. Hence, Max Matthiessen possesses a bargaining position where they have been able to push down the prices throughout the years to the extent that it is barely profitable for the assurance companies to continue (Elfving, 2023-03-28). Since Max Matthiessen has been able to push down the prices in order to stay competitive, Elfving (2023-03-28) describes that for a customer at a bank to store all of its savings at the same bank, would probably not make such a difference. However, discounts on for instance mortgages are more likely to occur if a customer decides to put different sources of capital into the same bank (Elfving, 2023-03-28), which Wikström (2023-04-04) confirms.

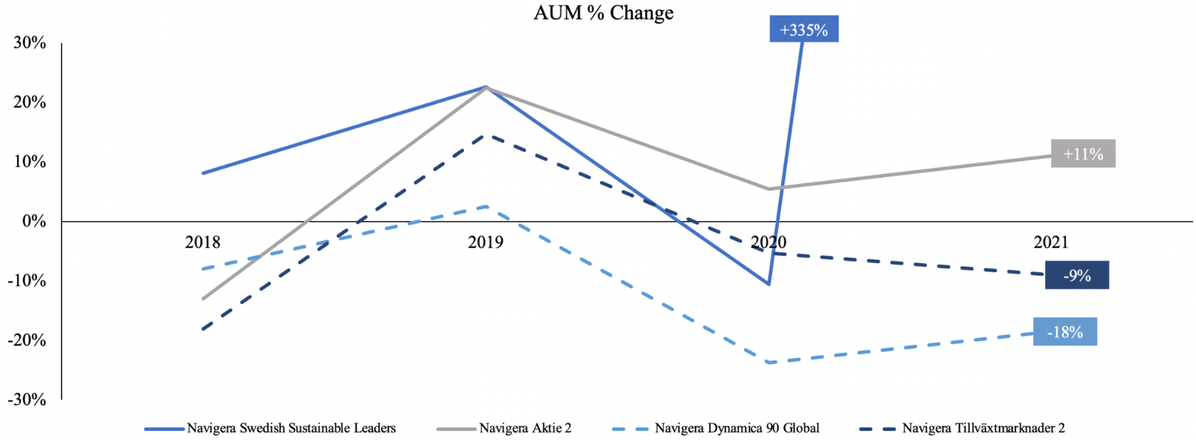
Beyond offering its customers great deals regarding discounts as a result of bargaining with the institutions that Max Matthiessen collaborates with, Elfving (2023-03-28) describes that other factors can also push down the price even more, where the volume of the capital plays an important role. A financially strong customer would thus have more room for negotiation, hence it is in some cases possible to make individual agreement, even though it is rare (Elfving, 2023-03-28). Beyond discounts and individual agreements, Max Matthiessen is also able to offer its customers a great deal of external funds where they for instance are collaborating with Goldman Sachs. The collaboration does, in addition to offering more famous funds, also include exclusive macro and micro analyses which makes these funds more expensive to invest in (Elfving, 2023-03-28).

In 2021 Naventi was acquired by Max Matthiessen, and Johansson (2023-03-29) describes the advantages of the new company structure such that they are "*becoming more like a family that are working closer together*". Hence, they are getting more integrated because of greater communication with the financial advisors. The increased integration could thus increase their sales and AUM as the fund managers receive the customers' perspective through the advisors (Johansson, 2023-03-29). In line with Johansson, Haldén at Navigera also confirms that Max Matthiessen with its financial advisors helps them increase their exposure to customers, and without them they would have had significantly more difficulty attracting capital (Haldén, 2023-04-03). In addition, Johansson (2023-03-29) also describes that the customer service that Naventi provides is significantly more intimate compared to at for instance Nordea, and customers can, regardless of the size of the capital, meet or speak directly with a fund manager which is not as common at a larger bank. Hence, fund managers at Naventi are able to get a better understanding of the characteristics of their investors, and according to Johansson (2023-03-29), the majority of their investors are pension savers and smaller in terms of capital size rather than being dependent on a few larger customers. In the same way as Johansson (2023-03-29) describes, Arnell (2023-03-30) also confirms that pension savings accounts for the larger part of their capital. The revenue streams from pension savings are more continuous compared to private savings where people in general are more restrained as they often do not save on a monthly basis to the same extent (Arnell, 2023-03-30).

Moreover, a difference between Naventi and Navigera is that Navigera is included in Max Matthiessen's so-called model-portfolios, which are the pre-set portfolios that the financial advisors recommend to their customers. By being a part of these portfolios, Navigera generates additional sales and Max Matthiessen can offer their customers internal funds. However, the Naventi funds are not part of these portfolios due to their small size (Arnell, 2023-03-30). Hence, Navigera are able to benefit more from Max Matthiessen's ownership than Naventi by generating additional sales. In the below figure, four Navigera funds and their AUM are presented, where Navigera Swedish Sustainable Leaders and Navigera Aktie 2 have been part of the model-portfolio since 2018. The two other funds (dashed) are however not part of the model-portfolios and one can clearly observe that these have decreased in AUM whereas the two that are included in the portfolios have increased, which strengthens the above statement. Navigera Swedish Sustainable Leaders is included in all of the eight model-portfolios that Max Matthiessen provides whereas Navigera Aktie 2 is only included in one of them and has thus been able to recover remarkable since the Covid-19 negative effect of 2020 with an increase in AUM of 335% in 2021. However, according to Haldén (2023-04-03) the extreme increase is mostly explained by some Navigera funds that are funds-in-funds (Navigera Aktie 1, Navigera Balans 1 and Navigera Tillväxt 1) which was re-allocated and started to invest in Navigera Swedish Sustainable Leaders in September 2021. He further stresses that for their fund-of-funds that invests in their internal funds, the management fee is discounted in order to not pay high management fees to themselves (Haldén, 2023-04-03).

Figure 3

Percentage change in the AUM of four Navigera funds[3]



Source: Navigera (2023).

4.3.2 Pricing Schemes for Nonbank Distributed Funds

Peter Elfving (2023-03-28) describes Max Matthiessen's fee and income structure as varying depending on different business cases. However, the vast majority, around 90%, of the cases are transactions where their income is generated from provision. In other words, Max Matthiessen are brokers to financial institutions' products (funds), which in turn rewards Max Matthiessen with compensation for it. It could also be the case that Max Matthiessen charges the end customer directly, however, it is not as common. In the most common cases, the customer is charged between 2-6% on every monthly premium contribution from the employer, depending on what service the employer wants from Max Matthiessen. Further, an annual management charge of approximately 0.25% is allocated to the financial advisors which is what the customer is charged for the financial advice. As a result of the implementation of the MiFID II and MiFIR regulations this fee however stays constant among the fund selection and financial institutions in order to reduce conflict of interest between the advisor and the customer (Elfving, 2023-03-28). In addition to the previously mentioned fees, one-time fees are also in some instances charged if the customer for instance switches to another financial institution but still wants financial advice from them. In other

[3] The sample of the selected Navigera funds were limited due to the fact that the majority of the Navigera funds were founded in 2021 and therefore a % change could not be calculated since the 2022 AUM numbers had at the time not been published for these funds.

words, the financial advisors at brokerage houses charge monthly premium contributions, advisory fees as well as one-time fees.

The financial advisors at Max Matthiessen present a proposal for a set of funds that a client potentially invests in, referred to as model-portfolios as described above, which includes both internal (Navigera funds) and external funds. The compensation works differently for external funds where Max Matthiessen then receives third-party compensation which differs from the model that is followed based on their internal funds. However, because of a potential conflict of interest, the financial advisor does not get paid extra when selling internal funds to a client, but instead, the additional income that is generated from the fund fees ends up centrally within Max Matthiessen, which however increases the income of the company (Elfving, 2023-03-28).

For Max Matthiessen's fund companies Naventi and Navigera, the revenue model looks similar as for the fund companies at banks, thus they do not generate income from any other source beyond the annual fund fee, however they do not provide any institutional funds. The pricing of the funds thus affects their revenue model and is partly determined based on the expected return, where fixed income funds are almost always cheaper because of low historical return. In addition, the pricing also depends on how much it costs to manage the fund, where the large Swedish companies are cheaper since these funds are neither encouraging nor personnel heavy in contrast to the more expensive funds allocated in emerging markets like for instance China (Johansson, 2023-03-29). In addition, Naventi primarily generates sales through third-party channels. However, if Naventi were to utilise platforms such as Avanza to expand its target audience and include more free saving by retail customers, its fee structure may be subject to change due to the substantial portion of fees taken by these platforms which he believes would not be more profitable (Johansson, 2023-03-29).

Haldén (2023-04-03) states that the pricing is also highly dependent on competitors and what they believe is a suitable fee in order to achieve a sustainable margin and thus optimise its business. However, it can look different in parts of the fund industry, where discounts and kickbacks are paid to for instance assurance companies in order to be included on their platforms which is taken from the management fee and the entire fee is not allocated to the fund manager. Moreover, the difference between the annual fee and the management fee is provided to the companies that Navigera buys the management service from. For instance, they have a fund-of-funds strategy that pays for the largest funds to navigate, such as Navigera Aktie 1, as mentioned above. The management fee is then charged to manage that strategy, and the underlying funds are paid to manage their own portfolios, which is the difference between the annual fee and the management fee (Haldén, 2023-04-03).

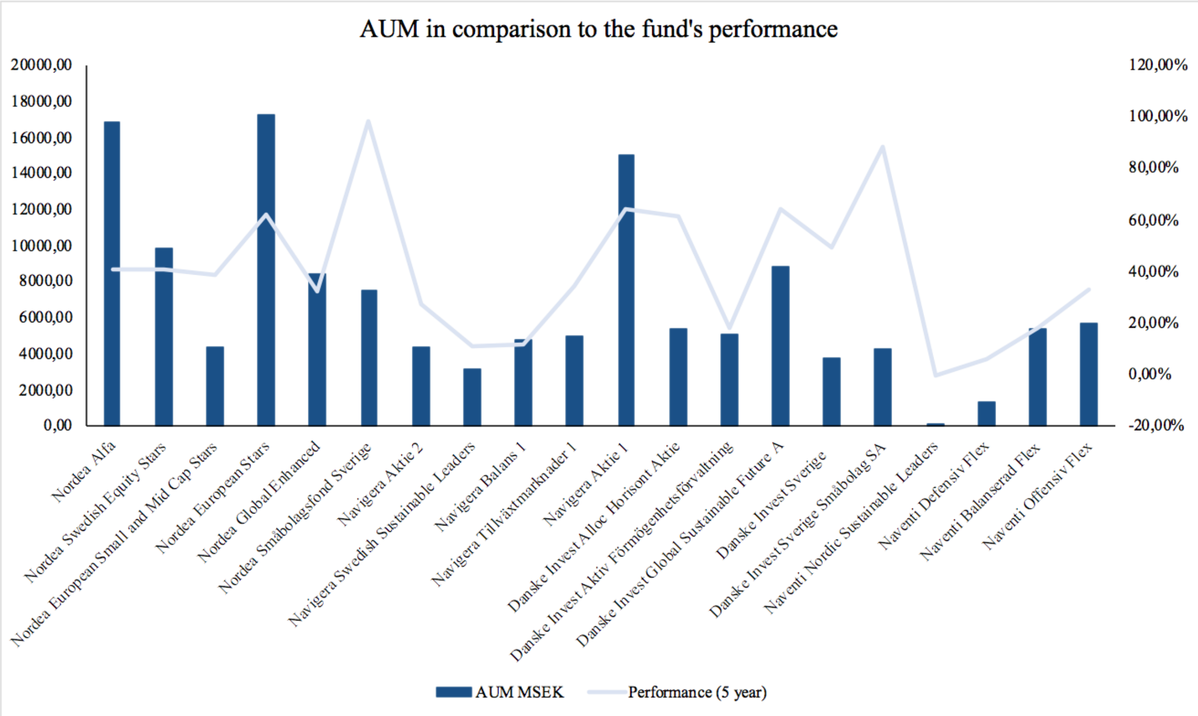
Jon Arnell, as the head of Investment Strategy at Max Matthiessen, can be seen as a larger customer to the fund companies of Max Matthiessen, since he is purchasing their funds into his model-portfolios. He explains that in regard to the fees, the market for the fund prices are pressured, and that they will most likely continue to be that. Additionally, he believes that the transparency regarding fees will increase as customers seek clarity on what they are actually paying for which includes; what they are charged for, the cost of the underlying portfolios, what in their portfolio incurs costs, and whether it is transactions in the funds or the fund fees themselves (Arnell, 2023-03-30).

4.3.3 Determinants of Funds' AUM and Revenue

When customers at Max Matthiessen are about to invest in funds, there are several different determinants that they tend to take into consideration. ESG is an area that has increased in importance throughout the years, and additionally as for Nordea new policies at Max Matthiessen requires financial advisors to investigate the customers' sustainability preferences (Elfving, 2023-03-28). However, although sustainable options are important in order to not exclude customers, Elfving (2023-03-28) believes that the most important factor beyond his own advice, is the cost of the fee since people are becoming more aware of what things cost which applies not least to funds. Therefore, selling funds that are expensive can work if there is some good performance, but it is tougher to sell than something cheaper (Elfving, 2023-03-28). In line with Elfving, Arnell believes that the fee of the fund is of importance, similarly, he explains that one can tolerate a higher fee if the performance is good but that it is harder to justify buying a fund with a higher fee (Arnell, 2023-03-30). In Figure 4 and 5 the performance and price of 20 funds are compared to its respective AUM. However, no clear trend is observed where for instance Danske Invest Småbolag SA which Joel Backesten manages has one of the strongest performances whereas its AUM is relatively low. Further, Navigera Aktie 1 has one of the highest AUM in the sample with a somewhat average performance but at the highest price. Hence, other determinants beyond performance and the cost of the fund are confirmed to be of importance for the funds' AUM.

Figure 4

Sample of 20 funds comparing funds' performance to its AUM[4]

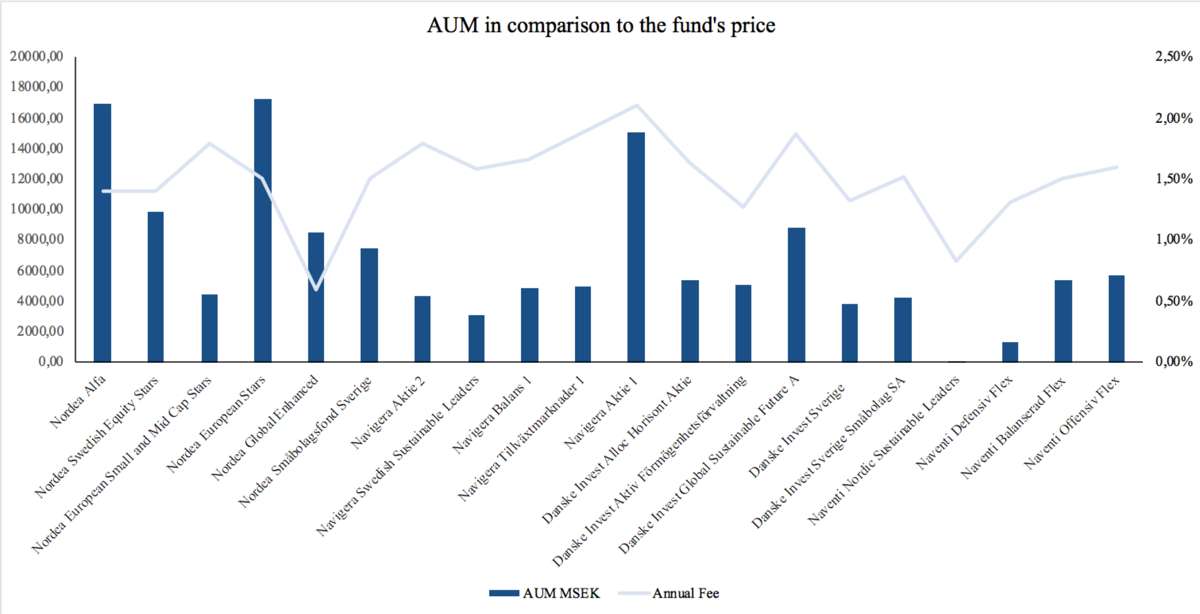


Source: Nordea (2023), Navigera (2023), Danske Invest (2023) and Naventi (2023).

[4] The sample includes 20 funds for the different fund companies that the selected interviewees works for, hence; Nordea, Navigera, Danske Invest and Naventi. Further, different funds were chosen to include funds with an AUM between 0-20 000 MSEK.

Figure 5

Sample of 20 funds comparing funds' price to its AUM[5]



Source: Nordea (2023), Navigera (2023), Danske Bank (2023) and Naventi (2023).

However, according to Johansson (2023-03-29) the most important dimension for the customer goes beyond the fee, ESG and performance of the fund. Instead he stresses that the reputation of the fund manager is the most crucial factor. He describes that historical returns do not sell well and if one would analyse statistics on the inflow of funds, it is almost never the best performers that have the largest inflow, but rather well-known companies and fund managers. Similarly, Arnell (2023-03-30) also believes that the trust and reputation of the fund manager is of greatest importance. He explains that everything revolves around trust, especially when dealing with private money. Hence, reputation is of utmost importance as good reputation and knowledge can take you a long way. An investor can tolerate poor performance for a while if the fund manager/the company has a good reputation as well as skilled professionals. On the other hand, if the fund manager/the company has a poor reputation, it would not take long for money to move away (Arnell, 2023-03-30). Elfving (2023-03-28) also discusses that different investors take the fund manager's reputation into account. Further, he explains that it is more common among clients working within the financial sector, and that a typical customer at Max Matthiessen does not take the fund manager's reputation into consideration. It is rather more about the trust for the financial advisor that is an important determinant for the client to consider when choosing what to

[5] The same sample is chosen as for Figure 4.

invest in (Elfving, 2023-03-28). However, one example of what could strengthen the statement that some investors do take the fund managers into consideration is related to the Goldman Sachs collaboration. Elfving (2023-03-28) describes that among clients with more capital, like for instance Private Banking customers, it has been of more interest to invest in Goldman Sachs funds with prominent fund managers, although they are more expensive.

Moreover, for a smaller fund company as Naventi, which could not be compared to for instance a large bank with its own asset management, different determinants are considered. It is of high importance for them to increase their visibility, in order to grow its AUM and revenues, by for instance publicity in Dagens Industri. Further, they have also built an app in order for its customers to more easily and succinctly follow what the management does through video clips (Johansson, 2023-03-29). In line with Johansson, Haldén (2023-04-03) also believes that marketing is of high significance in order to increase their AUM. However, since Navigera is owned by Max Matthiessen, they have not dedicated much money on marketing in terms of direct marketing, but rather more towards indirect marketing through their financial advisors. However, a difference between Naventi and Navigera is, as mentioned above, that Navigera is included in the model-portfolio offered by Max Matthiessen, hence, the indirect marketing to their clients is more significant. Moreover, Haldén believes that Navigera has had an advantage by being owned by Max Matthiessen, as they have obtained a distribution network which has made it easier for them to attract capital (Haldén, 2023-04-03). Moreover, Haldén (2023-04-03) also states that performance is an important determinant and the factor that drives investment choices. Without performance in the long run, he believes that it is difficult to generate capital. Nevertheless, performance in turn depends on other factors such as fees (Haldén, 2023-04-03).

5. Discussion

In the following section, the various findings from the semi-structured interviews will be presented. To begin with the first research question will be answered, thus the sources of the revenues will be discussed, followed by the factors that affect investors' investment choice to answer the second question, and lastly how these answers affect the funds' AUM. The answers to the three research questions will be discussed based on the literature presented earlier in Chapter 2 and the findings made from the analysis in Chapter 4.

The study was conducted in order to answer where the revenues in the mutual fund industry come from and what factors that affect the investors choice of fund, as well as its effect on the AUM. Eight interviews were held with various professionals within the mutual fund industry, from those who are selling the fund, to the ones that are managing the funds and in charge of the funds, to get an in-depth and broad understanding. Further, half of the interviews were held with bank employees and the other half with non-bank employees in order to evaluate how the answers may vary. Hence, with the information that has been collected from the interviews, the following research questions will be answered:

1. *Where does the revenues in the mutual fund industry come from?*
2. *What factors affect the investors' choice of funds and how do the fund managers and financial advisors usually convince an investor to invest?*
3. *How do the answers to the question above affect the asset under management?*

Previous research argues that fund managers on aggregate underperform compared to the market and thus investors would benefit from investing in low-cost passive funds (Jensen, 1968). Nevertheless, fund managers are among the highest paid in our society which opens up for a discussion on where these revenues come from (Berk & van Binsbergen, 2015). Hence, to answer the first research question, our findings reveal that the majority of the revenues in the mutual fund industry in Sweden comes from the annual fee as well as separate one-time fees, however, the sources vary depending on the characteristics of the institution. The annual fee was raised as the main income stream during all of the interviews, in other words both at banks and nonbanks. However, it could be seen that there exist differences between these two. For the bank distributed funds, the revenues are mainly generated through their internal banking network and internal funds which is confirmed by the findings made in Figure 2 which shows that bank affiliated funds in general have higher AUM compared to similar nonbank funds.

Nonbank distributed funds on the other hand, may use third-party distributors such as brokerage houses to attract additional customers, where the financial advisors however charge other fees beyond the annual fee. The annual management charge, which is charged for the financial advice provided by the financial advisor, stays constant among the fund selection as a result of the implementation of the MiFIR and MiFID II regulations in order to minimise conflict of interest while advising different funds. Before the implementation of the regulations, advisors could thus receive additional compensation while selling certain funds. However, they also charge other fees such as one-time fees and annual fixed fees, and it is on these that they can potentially offer discounts (Elfving, 2023-03-28). Since it is the financial institutions that Max Matthiessen collaborates with that provides discounts on their products, Max Matthiessen increases their revenues substantially compared to if it was their own funds that were discounted, which also contrasts them from banks. However, if a discount is offered on the annual fee by the financial institutions, it could potentially be that they instead charge a one-time fee. Hence, one could argue that there exist loopholes in the allocation of the different fees where the customer can be given a discount on a certain fee, but instead other fees are charged. Foerster et al. (2017) states that customers depend on their financial advisor, and thus even though regulations have increased transparency one might be blindsided by the proposed discounts by the financial advisor which might not be as reduced as firstly perceived since other fees are instead charged. Hence, it might be questioned whether the MiFIR and MiFID II regulations are enough or if it should be tightened further where Arnell (2023-03-30) states that he believes that the transparency regarding fees will increase additionally in the future. Nevertheless, the conflict of interest has been highly reduced compared to before the implementation, since the financial advisors are not personally rewarded when suggesting one fund over the other because the annual management charge stays constant.

To get further understanding of where the revenues come from, different income generating divisions have been analysed. While accounting for larger banks in Sweden such as SEB, Swedbank and Nordea; 16-41% of their revenues or AUM was generated through institutional sales, 11-30% from Private Banking and 8-20% from Life and Pension (see Appendix 8.1). Hence, one could argue that institutional sales contribute to an essential part of the bank's revenues, and fund companies could thus increase its managed capital and revenues by attracting institutional customers. Nevertheless, smaller fund companies such as

Navigera and Naventi, that currently exclude the institutional segment, would then be able to attract additional revenues by including institutional investors in addition to their current customer segment, which has been discussed to be the next step for them (Johansson, 2023-03-29 & Haldén, 2023-04-03). However, since 16-41% of the bank's revenues are generated through institutional sales, the remaining 59-84% is still from retail investors where the largest revenue/AUM generating customer segment varies between the different Nordic banks (see Appendix 8.1). However, attracting various customer segments, where Max Matthiessen for instance has to the greatest extent focused on pension saving, is a way to increase the revenues generated from the mutual funds which also explains why the bank affiliated funds have higher AUM.

Additionally, the findings from this study indicate that the apparent inflow of invested capital may be higher than the actual amount, and that financial advisors and fund managers might earn lower income compared to the astonishing amount of revenues that are debated to stream from the mutual fund industry. For instance, as Employee A (2023-03-21) explains, the customer pays the whole annual fee for the fund, but the potential discounts are later given as a quarterly cash payment to the customer. Hence the inflow is larger than what it "should be" because of individual agreements with various customers. What further supports the latter is the large kickbacks that exist within the industry. In general kickbacks account for around 40-50% of the management fee (Avanza, 2023a), which are deducted from the management fee and consequently reducing the revenues delivered to the individual company. Thus, the large amount of AUM that is observed within the mutual fund industry is not completely correlated with the revenues generated, which one might first believe since the fee is usually paid as a percentage of the AUM, due to discounts and kickbacks. In addition, funds with higher fees might not always be those that the fund managers earn the most from since these may give rise to higher personnel costs like for instance emerging market funds (Johansson, 2023-03-29).

Now that we know where the revenues come from one might wonder what factors affect the investors' choice of funds and how investors are convinced to invest in these high-fee funds. Hence, to answer the second and third research questions the different interviewees were asked what determinants that they have discovered to be the most important in order to attract customers. The answers between the interviewees varied, where Elfving (2023-03-28) claims that the cost of the fee is the most crucial part, apart from a trust for the financial advisor's judgement which the findings by Foerster et al. (2017) also confirms. While Backesten (2023-03-30) agree that the cost of the fund is important, he, from a fund manager's perspective, claims in line with the findings made by Carhart (1997) that performance is always the most important factor which Haldén (2023-04-03) also agrees upon. However, Johansson (2023-03-29) argues, in accordance with the findings made by Chen & Lai (2010) and Gennaioli et al. (2015), that the reputation of the fund manager is the most important factor in order to attract new capital, which the investment manager at Max Matthiessen, Arnell (2023-03-30) also confirms. Elfving (2023-03-28) claims that it is important to make a distinction between different customers where the fund manager's reputation might be important for a customer that works within finance but that it does not hold for a typical retail customer. The statements by Johansson (2023-03-29) and Arnell (2023-03-30) are thus contradictory to the findings made by Jensen (1968) where he argues that fund managers do not add value which should then not be a crucial determinant in a rational world. Xu (2021) concludes in his article that a more senior fund manager, in other words a more experienced and competent manager, can attract additional customers and hence increase the funds' AUM. The findings by Xu (2021) are in line with what Johansson (2023-03-29), Arnell (2023-03-30), and Employee A (2023-03-21) describes when they stress the importance of the reputation of the fund manager. According to Employee A (2023-03-21), the length of the period that the fund manager has managed the fund is of significance, as well as if s/he has done it before. However, there are some contradictions, where Wikström (2023-04-04) states that his clients do not usually consider the fund manager in their evaluation whereas Elfving (2023-03-28) describes that some does. Malkiel (1995) argues that an active fund manager on average underperforms while data show positive returns, hence supported by Arnell's (2023-03-30) statement that a good reputation and a professional fund manager can take them a long way, and therefore tolerate poor performance for a while, and still keep customers.

In addition, the findings made by Roussanov et al. (2021) who claims that marketing expenses are almost as important as the price and performance of the funds, are confirmed by the interviewees where the view on its importance however differs. At Naventi which is a small fund company, marketing in the form of for instance publicity in Dagens Industri and visibility among its customers, has been crucial to attract customers to invest in their funds (Johansson, 2023-03-29). Whereas at for instance Navigera they are not working as much with direct marketing since they are achieving that indirectly from Max Matthiessen through its financial advisors by being included in their model-portfolios (Haldén, 2023-04-03). Hence, the agency conflict that Dalmácio & Nossa (2004) argues to arise through fund managers focusing too much on marketing and less on actually managing the fund, is reduced through the outsourcing of marketing to its financial advisors. Company A and Danske Invest are also less dependent on marketing due to their larger size and are hence not as reliant on visibility. However, on the contrary in terms of bad publicity, pressure from the public and constantly being overlooked might be a disadvantage where the Estonia scandal is an example of what has become an obstacle in order to retain trust for Danske Invest. Furthermore, apart from performance, the reputation of the fund manager, the price and great exposure to marketing, ESG was unsurprisingly brought up as an important factor that has increased in interest among fund investors throughout the years. Hence, an important dimension to include in the fund selection in order to not exclude investors.

Another finding from the interviews is that banks and brokerage companies offer other financial services in addition to providing suitable portfolios for their customers, in order to attract additional capital to the fund. Hence, since the fees are based on a percentage of the AUM it further increases its revenues. These services include for instance offering lower interest rates on mortgage by for instance meeting the “relationship indicator” criteria which mean that other sources of capital are allocated at one place. Nevertheless, the lowered interest rate would not reduce the revenue generated from the fund, since the fund fee is not lowered based on this criterion, but rather on special instances such as when astonishing volumes of capital is invested in a fund by an institutional investor.

During the interview with the financial advisor at Nordea it was also unsurprisingly discovered that they, in most of the instances, only suggest their own internal funds (Wikström, 2023-04-04). While not fully to the same extent as for a bank, recommending internal funds also holds for Max Matthiessen which offer funds in their model-portfolio from their own fund company, Navigera. However, the portfolio also includes external funds and it also excludes funds from their other fund company Naventi and some Navigera funds. Nonetheless, it would be more profitable for Max Matthiessen to include all of the funds from Navigera and Naventi in their model-portfolios, but it would most likely not be appreciated by its customers since these funds have not yet fully built up a reputation among the public. For a larger bank like Nordea, worrying about customers who might not fully recognize its funds is however not an issue due to its size. Hence, they do not have to educate their financial advisors on external funds and thus only invest in these if a customer specifically seeks investments in them (Wikström, 2023-04-04). Further, by suggesting a portfolio with solely internal funds, in addition to not only receiving distribution fees when selling external funds, would increase Nordea’s revenues since the external funds are often more cheaply accessible (see Figure 1) and selling these would thus decrease Nordea’s revenues. Moreover, offering financial services to attract customers is a way to increase a fund's AUM and revenues which is also observed in Figure 3 where the Navigera funds that are included in the model-portfolio have an increasing AUM in contrast to the funds that are not included.

Although various determinants such as performance, ESG, the manager's reputation, marketing and the price of the funds are all important aspects to consider in order to attract customers, the most important factor that has been discovered to increase the funds AUM and hence its revenues is a large distribution network. Banks and brokerage houses have pre-set portfolios that are presented to customers and convince them to invest in these by offering lower fees or interest rates. According to Figure 4 & 5 one can observe that the fund with the highest AUM does not necessarily have the strongest performance or lowest price. For instance, Navigera Aktie 1 has the highest price of the funds but also within the highest range in terms of AUM in the sample. Thus, to sum up, the observations speak in favour of leaning towards a large bank such as Nordea, or a brokerage house to attract capital through financial advisors that offer custom-made "model-portfolios" in order to increase a fund's AUM and further its revenues.

6. Conclusion

6.1 Concluding Remarks

Through a qualitative method this thesis aims to analyse the revenues in the mutual fund industry in Sweden. The industry has for several years been growing, and there has been an increasing interest among retail investors to invest in equity funds (SCB, 2021). While the existing literature on mutual funds has predominantly focused on asset pricing and particularly on the ability to outperform related benchmarks or the market (e.g. Jensen (1968) and Berk & Green (2004)), this study aims to contribute with a broader understanding as well as valuable insights into the factors that determine the revenues and hence the AUM. These insights will be discovered by answering the three research questions below:

1) *Where does the revenues in the mutual fund industry come from?*
2) *What factors affect the investors' choice of funds and how do the fund managers and financial advisors usually convince an investor to invest?*
3) *How do the answers to the question above affect the asset under management?*

Eight different interviews were conducted with various professionals within the industry. The selection of interviewees was based on their professional role in order to receive a broad perspective, as well as to include various companies. The findings from the first research question are that revenues in the mutual fund industry are generated from different fund related fees. It is further important to consider that there are differences in the revenues generated from bank distributed funds and non-bank distributed funds. Banks tend to generate revenue through various customer segments and attract these through an internal distribution channel. Non-bank distributed funds on the other hand, rather use third-party distribution such as brokerage houses to generate revenue where additional fees beyond the annual fund fee is usually charged, such as the annual management charge for the financial advice. Furthermore, for the larger banks in Sweden institutional sales accounts for 16-41% of the revenues and hence by including this segment additional revenues can be attracted by smaller fund companies that are not offering institutional funds. Moreover, findings suggest that the reported inflow of invested capital may be overstated, and that financial advisors and fund managers may be earning lower revenues compared to the numbers which are commonly discussed in the mutual fund industry. Hence the fees, which are the main revenue source for the funds, are not entirely set as a percentage of the AUM due to the use of discounts and other complementary services that are being offered to investors.

Additionally, to answer the second research question, it has been found that the use of the above-mentioned discounts and complementary services are used by financial advisors and fund managers to convince their investors to invest in funds. The money is then often allocated to the pre-set portfolios proposed by the financial advisors which are constructed by the fund managers and investment chiefs, which at banks are predominantly consisting of their own internal funds. However, these funds tend to be within the higher range considering fees but are thus chosen due to these additional value-added services such as lower interest rates.

Further, the study confirms that the performance of the fund, the fund manager's reputation, the fee charged, as well as marketing have a significant role in the investment choice. Where for instance the reputation of the fund manager is often considered to be more important for a customer working within finance than for a regular Personal Banking customer due to recognition. In addition, marketing also tends to be of higher importance for a smaller fund company than for larger banks in order to gain customer recognition, which can be reached by indirect marketing through financial advisors selling funds through for instance brokerage houses to increase a funds' AUM. Thus, it is concluded that there are other factors beyond return that attract customers and therefore increase a fund's AUM and further its revenues. Hence, it was found that the most important factor in order to attract customers and thus increase a funds AUM is in fact a large distribution network to attract capital through offering complimentary services, which as mentioned above, tends to make a customer choose funds within the internal selection provided by the financial advisor.

6.2 Further Research

Writing this thesis included some limitations where a less limited time frame could for instance have opened up for a larger sample of interviewees to potentially discover additional findings. We would therefore encourage future researchers to include a larger number of interviewees. In addition, this thesis only focused on funds that are available for investors in the Nordics. Thus, different pricing schemes might differ between the countries outside of Europe where the annual fee might not be standardised and the MiFID II and MiFIR regulation does not hold. Hence, a suggestion for further research would be to investigate other markets such as for instance the US, to elaborate more on the already existing findings and how it might differ based on for instance different regulation and transparency requirements.

In addition, even though a qualitative approach seemed suitable for the chosen research questions a quantitative approach could suggest additional support or distinctions to this thesis. Even though some figures have been presented to support the findings made by the interviews, a small sample has only been included to cover the funds handled by the different institutions that the interviewees are employees at and thus includes limitations. A more thoughtful quantitative addition to this topic could therefore contribute to additional findings.

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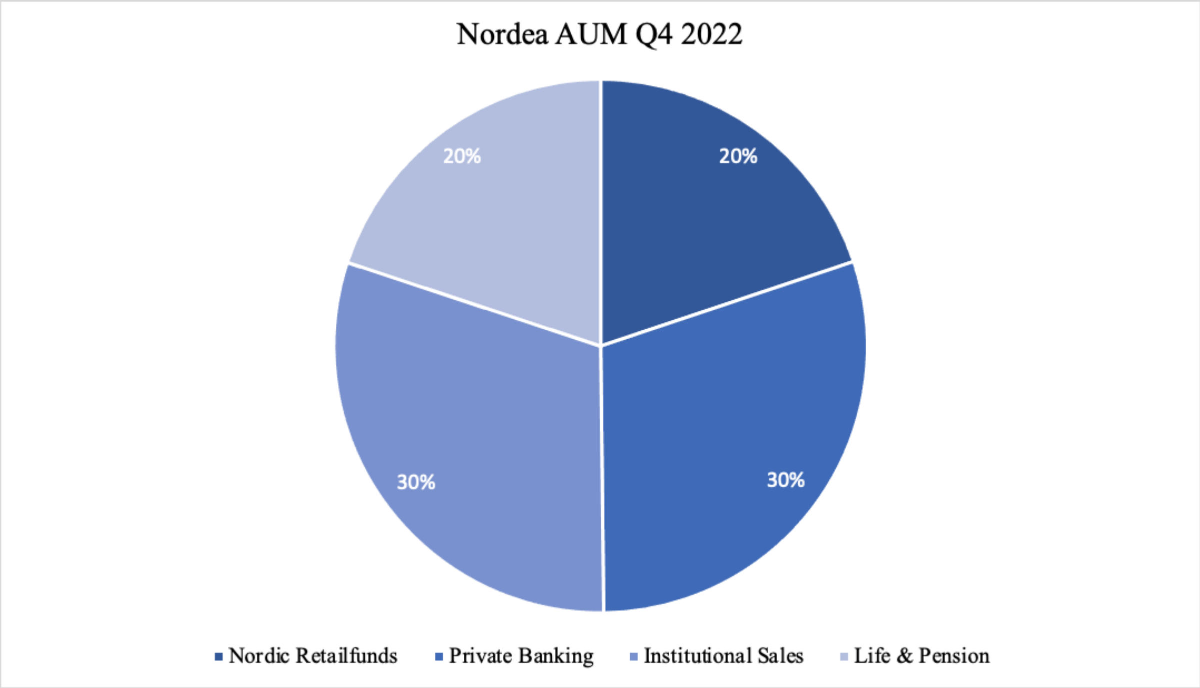
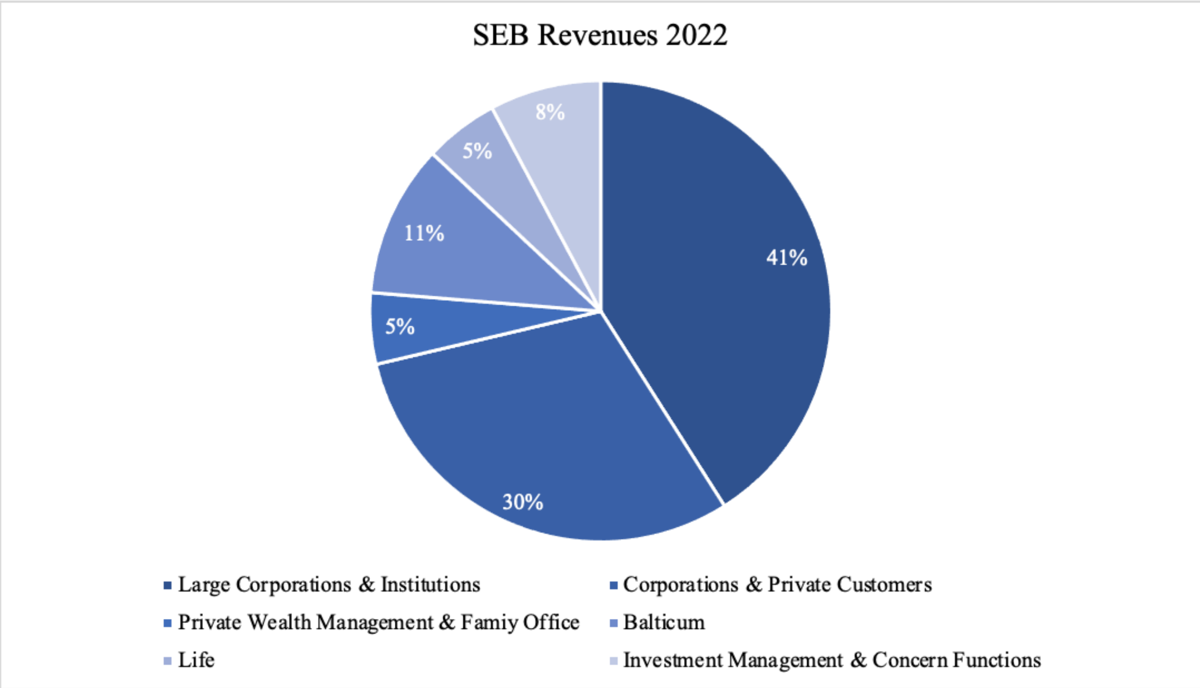
8. Appendix

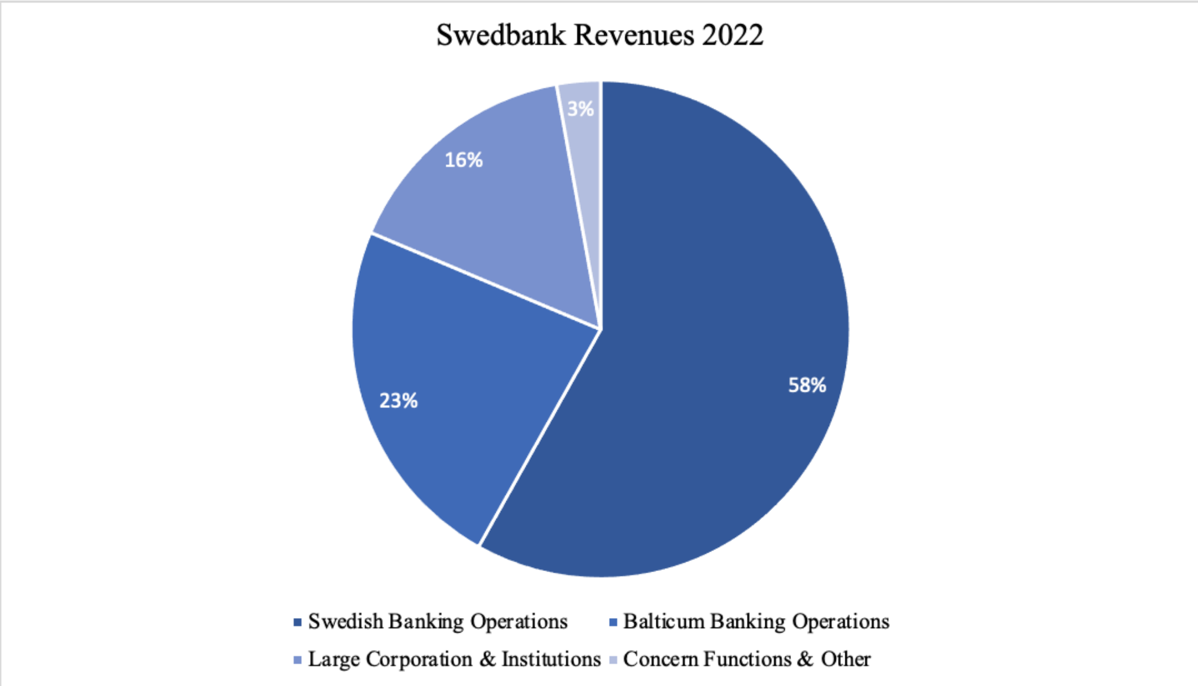
8.1 Allocation of Revenues/AUM 2022



Appendix 1: Allocation of Nordea's AUM 2022, Source: (Nordea, 2022).



Appendix 2: Allocation of SEB's revenues 2022, Source: (SEB, 2022).



Appendix 3: Allocation of Swedbank's revenues 2022, Source: (Swedbank, 2022).

8.2 Interview Questions

8.2.1 Standard Questions

1. Can you briefly tell us about your profession and role?
2. What does your revenue model look like?
3. How do you think you/company X can increase the funds' AUM?

8.2.2 Employee A - Head of Institutional Sales

1. Are you making money from anything other than the annual fee and management fee? Do you also receive a share of the revenue from the products that the capital is invested in, such as investment accounts or securities accounts?
2. Do your salespeople receive any commission or fee when they sell an institutional fund to your institutional clients?
3. What do you believe is the most important factor while selling your funds - the fee, performance, fund manager, etc.?
4. Do your customers receive any better overall solution through the bank if they choose your institutional funds?

5. What is the average investment horizon of your institutional clients?
6. Why should institutions invest in your institutional funds instead of the other non-institutional funds on the fund list?
7. Why should institutional clients invest in institutional funds when other similar non-institutional funds have lower fees and perform better over a longer time horizon (3-10 years)?
8. What are your weaknesses compared to your competitors? What do you see as your threats/opportunities in the market?

8.2.3 Peter Elfving - Financial Advisor

1. Do you know the percentage breakdowns regarding for instance commission or kickbacks?
2. Do you receive any one-time income, capital taxation, recurring income for premiums, one-time premiums etc.?
3. What could a one-time income be received for?
4. What types of customers do you earn the most revenues from?
5. Do you earn more if you sell internal funds compared to external funds? Does Max Matthiessen earn additional revenues from it?
6. What have you noticed is most important to your customers when it comes to saving? It could for instance be factors like for instance ESG, return and fees.
7. If a customer wants a comprehensive solution like for instance a mortgage via Skandia, what is the difference in fund fees and compensation that you can offer at Skandia compared to if the customer did not need a mortgage and could choose another pension company?
8. Do you feel that the reputation/previous performance of fund managers is important for your customers when choosing funds?
9. How do you act if the customer is not satisfied with your advice of funds to invest in? Do you provide advice beyond your model-portfolios?
10. How much room do you have to negotiate discounts on for instance funds, scale costs, etc.? Is it Max Matthiessen that is providing the discount?

8.2.4 Christoffer Johansson - Fund Manager

1. What factors do you consider when setting fees for your funds?

2. What factors were crucial to your success story before being acquired by Max Matthiessen, and what factors do you think will be crucial in the future? Fees, performance, reputation of fund managers, marketing, niche etc.?
3. Has your AUM/Revenue increased since being acquired by Max Matthiessen?
4. Which business area has contributed the most to your funds since the acquisition?
5. Do you work on institutional sales?
6. What is the next step for you in your success story?

8.2.5 Jon Arnell - Head of Investment Strategy

1. What factors do you consider when putting together a model-portfolio? Performance, fund managers, fees etc.?
2. Do you have to include Navigera funds in your model-portfolios?
3. Why are there no Naventi funds included in your model-portfolios?
4. How crucial do you think marketing and the fund manager's reputation is for a fund's AUM? Is it more important than performance?
5. How important do you think it is to have a strong company behind you, such as Max Matthiessen, as they sell Navigera funds through Private Banking and Life & Pension, compared to for instance Cliens Capital Management, which does not have that capability?
6. What changes do you think need to happen in the fund market?
7. Do you think fees need to be regulated, or should companies be able to charge whatever fees they want as long as the costs can be justified?
8. What do you think about the market for actively managed funds and all the criticism from critics such as Eugene Fama? Do you think actively managed funds will have lower fees in the future?

8.2.6 Joel Backesten - Portfolio Manager

1. Do you have different prices for private customers vs. institutional customers?
2. What do you think have been the crucial factors for the success of your fund?
3. Do you believe that Danske Invest is less dependent on marketing in comparison to smaller fund companies since you have a larger bank behind you?
4. How important do you think your reputation and the bank's reputation have been to the success story of the small-cap fund?

5. Do you transfer customers between the divisions within the bank?
6. If yes, which customer segment transfers the most customers; PeB, Private Banking, Life & Pension or Institutional Sales?
7. How do you choose what companies to include in the fund?
8. When you sell your fund through platforms such as Avanza, do they take a part of the revenues? If yes, how much?

8.2.7 Employee B - Head of Swedish Branch

1. Do you think you would have been equally successful if you didn't have a big bank behind you?
2. What do you think have been the decisive factors for your successful fund? E.g. Marketing? Performance? Diversification? Niche?
3. How big of a role do you think the fund manager's and the bank's reputation has played for the AUM/revenue in your funds?
4. Which business area contributes the most to the AUM of your funds?
5. How much is from third-party sales?

8.2.8 Per Haldén - CIO and Portfolio Manager

1. Does Navigera receive the entire annual fee, or does the difference between the annual fee and management fee go to Max Matthiessen?
2. Do you earn money in any other way?
3. What factors determine the fees you set for your funds?
4. Do you think you would have had the same AUM/revenues if you were not part of the Max Matthiessen-umbrella and included in their model-portfolios? Do you think it is a major contributing factor to your success?
5. Which business area do you think has contributed the most to the inflow of revenue into your funds?
6. Do you work on institutional sales?
7. What factors have been crucial and what do you think will be crucial for you in the future?
8. Is marketing important for you?
9. What is the next step for you?

8.2.9 Nils Wikström - Financial Advisor

1. Do you charge any one-time fees, capital compensation, ongoing compensation or premiums? Do you receive compensation for mortgage loans and other services?
2. What types of customers generate the most revenues for Nordea?
3. Do you receive any additional income if you sell Nordea funds compared to external funds?
4. Can you offer the same discount on mortgage loans if the customer chooses external funds or does it have to be Nordea funds?
5. If a customer chooses to open a savings account through you/move their pension to Nordea to get better terms on their mortgage, will they receive the most expensive setup for their pension/savings?
6. How much room do you have to negotiate discounts on funds, administrative costs, etc.?
7. What have you noticed to be most important to customers when it comes to saving (ESG, return, fees, overall solutions etc.)?
8. Do you believe that the reputation/previous performance of fund managers is important for your customers?