

GLOBAL ASSET MANAGEMENT 2019

WILL THESE '20s ROAR?



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INTRODUCTION

THE GLOBAL ASSET MANAGEMENT industry has reached a tipping point. In 2018, after roughly a decade of positive momentum, the industry hit a wall—as was sure to happen sooner or later—amid concerns over rising interest rates and a turn in the economic cycle. Major asset markets posted negative returns, and managers saw outflows, leading in some cases to job cuts. Profitability declined and revenue margins contracted. Still, the picture was not entirely gloomy. Operating margins that averaged 35% were nothing to sneeze at; and after a horrible final quarter, markets bounced back in the first half of 2019. For that reason, many firms are not so much viewing the recent past with regret as thinking ahead and considering how to plan for the future.

As we look toward the 2020s, we expect to encounter more market volatility, competition, and economic uncertainty. But we also see opportunities as the asset management industry evolves and as technology moves to center stage. So which trends and dynamics will ultimately prevail? Will these '20s roar for asset managers or not?

Among the key trends that we expect to see dominating the next few years are these:

- Active management will have to continue to make its case against passive solutions and alternatives (especially private assets). Fee erosion is likely to persist in any event.
- Technology will effectively be table stakes in most markets. Getting it right will require a new strategic agenda and, usually, significant investment. We expect most firms to step up their digitization activities, leading to reimagined business models, new technology capabilities, greatly increased efficiency, and transformed client relationships.
- China will become the second-largest region for asset management, ahead of continental Europe, attracting more flows than the US over the next decade. Emerging markets will become more important.
- The winner-takes-all phenomenon we discussed in our [Q1 review](#) will accelerate as brand recognition, distribution dominance, and scale become ever more critical.
- Sustainable investing will rise as firms weave environmental, social, and governance (ESG) factors into their investment decisions, aiming to create positive impact without undermining returns.

The short-term priority for many asset managers will be to restore the positive momentum that lapsed in 2018. The value of assets under management (AuM) fell by 4% globally in 2018, to \$74.3 trillion from \$77.3 trillion. This was the first significant year-over-year decline since the crisis year of 2008, and it reversed some of the benefit of 2017, when AuM increased by 12%. Net new asset flows—the increase that is attributable to new money coming into asset management firms, minus outflows—amounted to \$944 billion. That was sharply below the 2017 figure of \$2.15 trillion in net new asset flows. Nevertheless, the asset flow decline mostly amounted to a reversion to the mean after a record-setting 2017.

The biggest decline in AuM took place in North America, where \$2 trillion in value evaporated over the course of the year, accounting for two-thirds of the global loss in value. North American asset managers saw their 13% AuM gain in 2017 turn into a 5% decline in 2018—an 18-percentage-point swing.

Active products continued to struggle in 2018, as actively managed core assets lost \$1 trillion in AuM. This was not exclusively a function of poor returns in equity and bond markets; it was the result of a secular trend. Over the past 15 years, active core assets have declined significantly in popularity. They now account for just \$1 out of every \$3 of AuM, versus more than \$1 out of every \$2 of AuM in 2003. Although a lot of the money that has flowed out of active has flowed into passive, this has benefited only a handful of asset managers.

Alternatives—a category that includes hedge funds, private equity, real estate, and other holdings—were the strongest asset class in 2018.

A critical consideration going forward is that managers will have a hard time prospering if they don't make step changes in their use of technology. Businesses across the industry view data and analytics as a route to sharper decision making, lower costs, and turbocharged performance. We see particularly strong potential in investment management and distribution—areas where firms are lacking in technological capabilities. The problem is the high degree of uncertainty regarding the way forward.

In this 17th annual BCG report on the global asset management industry, we show that only a few firms are genuinely committed to the data and analytics opportunity. We believe that 20% to 30% of asset managers qualify as pioneers, meaning that they are investing in data and analytics with conviction across a broad range of use cases. Pioneers employ analytics products across the firm and accelerate technology adoption. Many are on their way to building mature data and analytics organizations, though most have not yet reached their destination.

The rest still have some distance to travel. The success of their transition is likely to depend on their ability to identify the data and technology that suits them best, to attract and retain necessary talent, and to ensure that their existing workforce remains on board and can acquire the necessary skills. Among the ingredients that are essential to

achieving these aims are strong leadership, a systematic approach to developing and scaling use cases, and a robust attitude toward technology renewal. Firms that embrace these elements can make significant progress in six to nine months.

Looking ahead, we expect to see an increasingly binary formula for success. The first option comprises boutique alpha shops—small, focused, nimble businesses that can achieve alpha by using capacity-constrained strategies. The second option lies at the opposite end of the scale: distribution powerhouses with more than \$1 trillion in AuM that offer a full spectrum of products. We have doubts about the ability of firms in the middle to reinvent themselves to the degree necessary to create sustainable business models. All of them will have to evolve significantly to be successful, and some will not make it to 2030. There is also a wild card: the role of tech giants. If the likes of Amazon and Google step up, as their peers in China are starting to do, the disruption will be rapid and powerful.

Of course, there are nuances to consider. In an industry comprising thousands of players globally and hundreds of billions of dollars in revenues, some firms will find room to carve out their own niches. Moreover, success factors may differ across geographies and demographics. Nevertheless, the decisions that asset managers make now—and the capabilities that they develop—are likely to play a vital role in driving performance over the coming decade. And the passage of these years will reveal whether “The Roaring ’20s” will take on a new meaning for asset managers.

A SNAPSHOT OF THE INDUSTRY

AFTER A NEARLY UNBROKEN run starting in 2008, the asset management industry experienced the inevitable last year and finally hit a wall. Total assets under management (AuM) declined in almost all regions, largely because of the global market selloff that occurred during the fourth quarter.

The downturn—a consequence of tighter monetary policy, slowing global growth, and investor skittishness—was not confined to any one asset class. Fixed-income assets and alternatives posted negative returns, as did equities. The poor performance of the market overall prompted a response, including layoffs, from some segments of the asset management industry that were already struggling.

Here is what the industry went through in 2018.

AuM Declined by \$3 Trillion

The value of AuM fell by 4% worldwide in 2018, to \$74.3 trillion from \$77.3 trillion. (See Exhibit 1.) This marked the first significant year-over-year decline in global AuM since the crisis year of 2008, and it reversed some of the benefit of a robust 2017, when AuM increased by 12%.

Net new asset flows—the increase that is attributable to new money coming into asset management firms, minus all outflows—

amounted to \$944 billion, sharply below the \$2.15 trillion in net new asset flows in 2017. The asset flow decline, however, was more in the nature of a reversion to the mean than a sign of trouble, after a record-setting 2017.

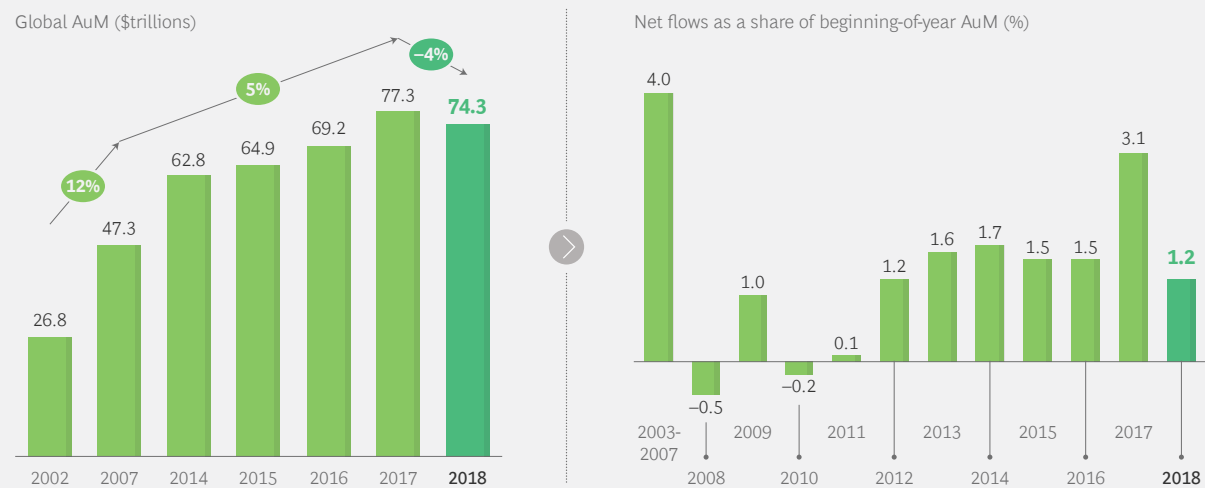
Industry watchers had widely anticipated the market correction after years of steady gains. When growth in the equity market slows, net asset flows tend to decline as well.

North America Was Walloped; Latin America Proved Resilient

The biggest decline in AuM occurred in North America, where \$2 trillion in value disappeared over the course of the year, accounting for two-thirds of the global loss in AuM. North American asset managers saw their stellar 13% AuM gain in 2017 turn into a 5% decline in 2018—an 18-percentage-point swing for the worse. North America's 2018 AuM results, along with the results for the Middle East and Africa (albeit from a much smaller base), were the worst of any region. (See Exhibit 2.)

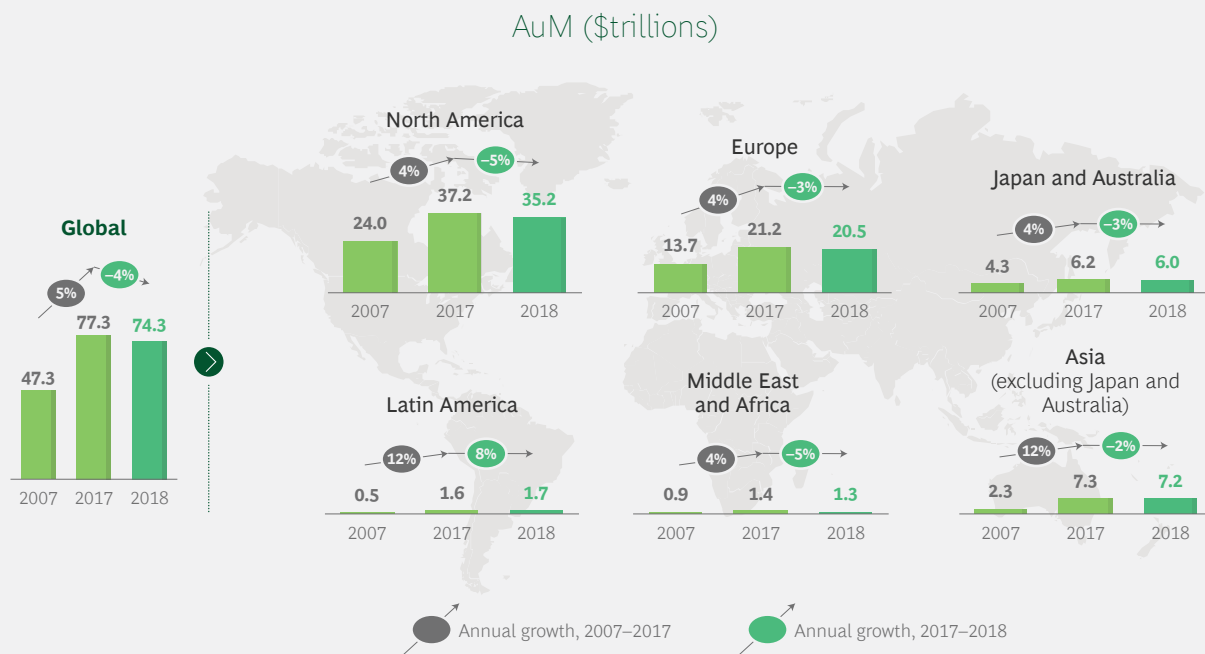
European managers, which have the second-highest level of AuM, saw their holdings decline in value, too, though not as steeply as North American holdings did. Europe has been dealing with a lot of uncertainty in the recent past, including over Brexit, which took a particularly big toll on UK markets.

EXHIBIT 1 | 2018 Saw a Pullback in Asset Levels and Money Flows



Sources: BCG Global Asset Management Market-Sizing Database 2019; BCG Global Asset Management Benchmarking Database 2019.
Note: Market sizing includes assets professionally managed in exchange for management fees; AuM includes captive AuM of insurance groups or pension funds where AuM is delegated to asset management entities with fees paid; 44 markets are covered globally, including offshore AuM. For all countries where the currency is not the US dollar, we applied the end-of-year 2018 exchange rate to all years in order to synchronize current and historic data; values differ from those in prior studies because of fluctuations in exchange rates, revised methodology, and changes in source data.

EXHIBIT 2 | Almost Every Region Felt the Pain in 2018



Sources: BCG Global Asset Management Market-Sizing 2019; The Economist Intelligence Unit, Strategic Insight; Willis Towers Watson; eVestment; local organizations, including regulators; media reports; BCG analysis.
Note: Market sizing corresponds to assets sourced from each region and professionally managed in exchange for management fees; AuM includes captive AuM of insurance groups or pension funds where AuM is delegated to asset management entities with fees paid. Overall, 44 markets are covered globally, including offshore AuM (which is not included in any region). North America = Canada and the United States; Europe = Austria, Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, Netherlands, Norway, Poland, Portugal, Russia, Spain, Sweden, Switzerland, Turkey, and the United Kingdom; Asia = mainland China, Hong Kong, India, Indonesia, Malaysia, Singapore, South Korea, Taiwan, and Thailand; Middle East and Africa = selected sovereign wealth funds and mutual funds of the region, Morocco, and South Africa; Latin America = Argentina, Brazil, Chile, Colombia, and Mexico. For all countries where the currency is not the US dollar, we applied the end-of-year 2018 exchange rate to all years to synchronize current and historic data. Some values differ from those in prior studies because of exchange rate fluctuations, revised methodology, and changes in source data.

AuM in Asia (in both of the regional groupings we use for Asia) also fell, with China accounting for much of the decline. Chinese equity markets plunged by 25%—their biggest drop in a decade. Even so, the fact that AuM in China fell just 4%, to \$3.8 trillion, in a year when share prices plummeted, shows the vast potential of the country’s asset management industry. Mainland China alone is now a larger asset management market than any other country except the US, the UK, and Japan. We continue to expect the country’s AuM to more than triple by 2025. If that happens, China’s AuM will be second only to the US’s.

The US has shifted relatively quickly from active to passive asset management.

Offsetting the AuM decline in China were gains in South Korea and India, two other countries in our Asia-excluding-Japan-and-Australia cohort.

Latin America (with an 8% rise in AuM) was the only region that ended 2018 in better shape than it began the year. This was helped by the surging Brazilian stock market—one of the few exceptions, globally, to the 2018 downturn. The election of a new government in Brazil, Latin America’s largest economy, helped fuel expectations of more business-friendly policies and of a return to economic growth there.

Both Active and Passive AuM Declined

Active assets continued to struggle in 2018, as actively managed core assets lost \$1 trillion in AuM. (See Exhibit 3.) This was not just a function of poor returns in equity and bond markets; it was also a continuation of a long-term trend. Over the past 15 years, the popularity of active core assets has declined significantly. They now account for just \$1 out of every \$3 of AuM, versus more than \$1 out of every \$2 of AuM in 2003. Although a lot of the money that has flowed out of active assets has flowed into passive assets, this has

benefited only a handful of asset managers. The economics of passive assets—specifically, their low revenues—makes them a good bet for firms with the greatest scale and the lowest costs. Smaller asset management firms cannot run passive assets as profitably.

The shift from active to passive management has occurred more quickly in the US than in Europe. [A previous analysis of 2018 that we performed](#) showed that 10 of the top 15 fund types in the US receiving the highest volume of net new asset flows used passive strategies; only 5 used active strategies. In Europe, those ratios were reversed. Still, it is hard to imagine that this differential will remain in place permanently. Passive assets have too many advantages, both from a cost perspective and from a consumer-demand perspective, for them not to eventually grow more popular in Europe.

From an AuM perspective, solutions and passive investments have been the fastest-growing product category over the past 10 years. These assets did not grow appreciably in 2018, but they did retain their market share among asset types. The broad category of solutions comprises liability-driven investments (including those needed to meet pension or insurance obligations) and target-date funds (often part of defined contribution plans), among others.

Alternatives were the strongest asset class in 2018. Although performance within the alternatives category varied from product to product—including negative returns for some (such as hedge funds)—the overall AuM for alternatives increased enough in 2018 to allow them to gain market share. We expect that strong performance to continue, with the result that alternatives will widen their lead as the largest source of the industry’s revenue by 2023. Private equity, already a major and fast-growing product, will be the leading source of revenues among alternatives by that time.

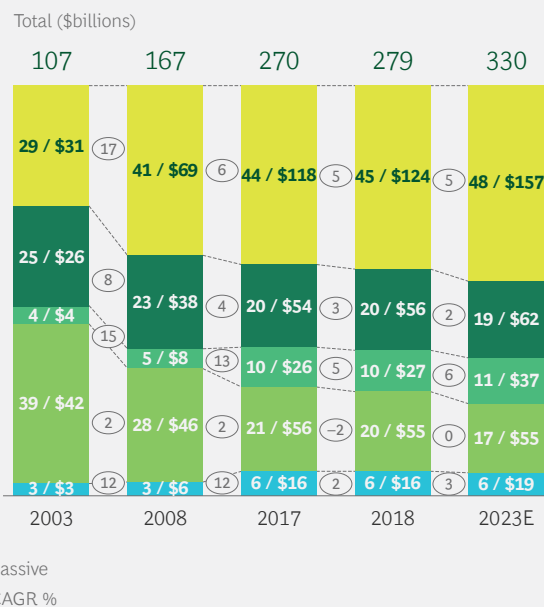
One trend that we see accelerating is *sustainable investing*—a form of investing premised on identifying environmental, social, and governance (ESG) topics by industry and weaving them into investment decisions as a way to

EXHIBIT 3 | Active Products' Popularity Continues to Slip...

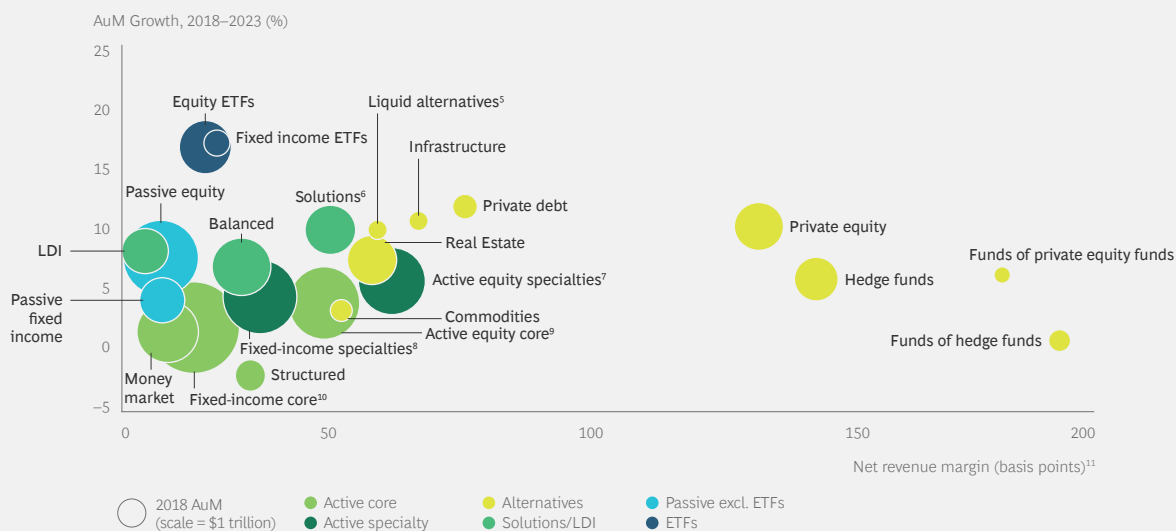
Global AuM split by product (% / \$trillions)



Global revenues split by product (% / \$billions)



... With ETFs and Select Alternatives Likely to Grow Faster Through 2023



Sources: BCG Global Asset Management Market-Sizing Database 2019; BCG Global Asset Management Benchmarking 2019; Strategic Insight; P&I; ICI; Prequin; HFR; BlackRock ETP report; IMA; INREV; BCG analysis.

Note: LDI = liability-driven investments; ETF = exchange-traded fund.

¹Includes hedge funds, private equity, real estate, infrastructure, commodities, private debt, and liquid alternative mutual funds (such as absolute return, long and short, market-neutral, and trading-oriented); private equity and hedge fund revenues do not include performance fees.

²Includes equity specialties (foreign, global, emerging markets, small and mid caps, and sectors) and fixed-income specialties (emerging markets, global, high yield, and convertibles).

³Includes target-dated, global asset allocation, flexible, income, liability-driven, and traditional balanced investments.

⁴Includes actively managed domestic large-cap equity, domestic government and corporate debt, money market, and structured products.

⁵Includes absolute return, long and short, market-neutral, and trading-oriented mutual funds.

⁶Includes target-date, global asset allocation, flexible, and income funds.

⁷Includes foreign, global, and emerging-market equities; small and mid caps; and sectors.

⁸Includes emerging-market and global debt, high-yield bonds, and convertibles.

⁹Includes actively managed domestic large-cap equity.

¹⁰Includes actively managed domestic government and corporate debt.

¹¹Management fees net of distribution costs.

capture alpha. Sustainable investing is a more expansive version of an idea that, in the past, prompted some firms to steer clear of assets with controversial political or societal effects (such as companies that grow tobacco, produce pollution, or benefit from unpopular po-

litical connections). Although sustainability in investing can be difficult to measure, asset managers are going to have to think about it more carefully in the future. (See the sidebar “Sustainable Investing Is Becoming a Must-Have for Asset Management Firms.”)

SUSTAINABLE INVESTING IS BECOMING A MUST-HAVE FOR ASSET MANAGEMENT FIRMS

When making decisions about which assets to invest in, asset managers are increasingly using environmental, social, and governance (ESG) data to better understand risks and to source new opportunities for value.

A philosophy of investing that is designed to support positive societal outcomes and avoid negatives ones (such as harm to human health or the environment), sustainable investing is most prominent in developed parts of the West. Europe (where almost half of all assets are invested sustainably) is near the top, though some smaller asset management markets (such as Canada and Australia/New Zealand) have an even higher proportion of sustainable assets. Asset managers in the US, where regulations are less strict and consumer preferences regarding sustainability are more diverse, have a lower proportional stake in sustainable assets. Other regions are adding such investments quickly. For instance, Japan saw an orders-of-magnitude jump in sustainable investments between 2016 and 2018—a phenomenon attributable in part to Japanese investors’ commitment to the United Nation’s Principals for Responsible Investment.

Driving the focus on sustainability in retail markets is consumers’ increasing desire to have their investments reflect positive values. In the institutional segment, the key driver is the growing body of evidence indicating that investments that incorporate ESG factors outperform investments that do not—especially in the long term, the time horizon that large institutional investors care about the most.

The trick is to translate the thesis that sustainable investing is smarter investing into real results. Asset buyers and owners face multiple challenges, from a lack of standardized data about ESG to “green-washing” (misleading or exaggerated claims by a company about the environmental benefits of its products or services). In addition, getting accurate ESG data for investments other than publicly listed equities is difficult; fixed income, private debt, real estate, and commodities all present challenges. This puts asset managers in a bind because non-equity investments are often a crucial component of their portfolios.

Another obstacle to sustainable investing is a lack of the capabilities needed to assess an asset’s ESG characteristics. Asset management firms typically hire people with financial or quantitative skills; few have made a priority of hiring people who understand sustainability issues. And the pool of people who have expertise in both areas is not large.

Nevertheless, asset management firms can make headway in sustainability by taking a few key steps. To deal with the problem of gaps in standardized data, asset managers should develop proprietary data tools, especially ones that show investors how the managers measure sustainability and how they use that knowledge to drive their investment decisions. To close the talent gap in ESG, hiring managers must reposition their ESG teams as centers of excellence with a mandate to build the necessary buy-in, skills, and capabilities for portfolio managers and analysts alike to use ESG in their day-to-day work.

Profits Dropped and Costs Rose

Asset managers’ profitability declined in 2018. But the declines were modest and for the most part reflected the year-end turmoil.

Overall, the industry still had operating profits of 35%—a level that would be reason for celebration in most other industries. Continuing fee compression did cause the revenue margin (the ratio of revenues to AuM) to decline again, as it has been doing steadily in recent years, from 30.1 basis points in 2013 to 26.2 basis points in 2018. (See Exhibit 4.)

Costs, meanwhile, were flat against average AuM but rose in absolute terms, as asset managers invested in areas such as information technology. Regulatory measures, including the EU’s updated Markets in Financial Instruments Directive (MiFID), also drove up costs. The average firm ended 2018 with costs that were about 5% higher than in 2017, and 34% higher than in 2007, the year we use as a baseline. (See Exhibit 5.)

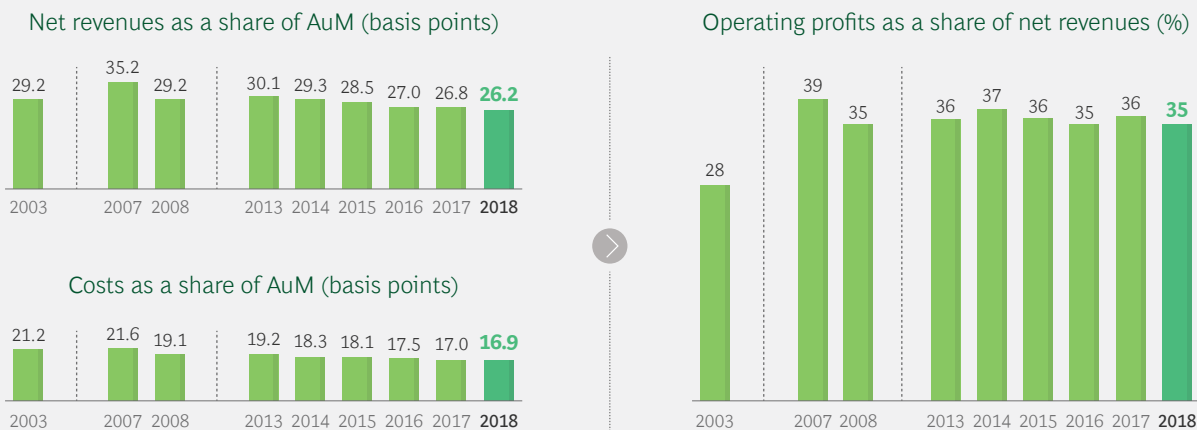
To be sure, the asset management industry has surged back from the financial crisis, rapidly adding assets and building out staff, so the cost increase is not altogether surprising. Nonetheless, cost control is an area where asset managers are forever looking to make headway.

A Look at 2019 and Beyond

The first half of this year brought a welcome turning of the page. In many markets, the selling pressure eased and equity prices rebounded. A palpable sense of relief is evident at some asset management firms.

All of which makes this a very good time for companies to take a fresh look at their strategies, their capabilities, and their operating models. The coming decade seems to have a greater-than-usual degree of unpredictability associated with it. For instance, the nature and the identity of the likeliest competitors are impossible to pinpoint with any certainty. Nonetheless, a few things are clear. One is that volatility and economic uncertainty will continue to be the rule rather than the exception. Another is that firms will not win without holding a leading position in technology. How to navigate this environment is the subject of the rest of this report.

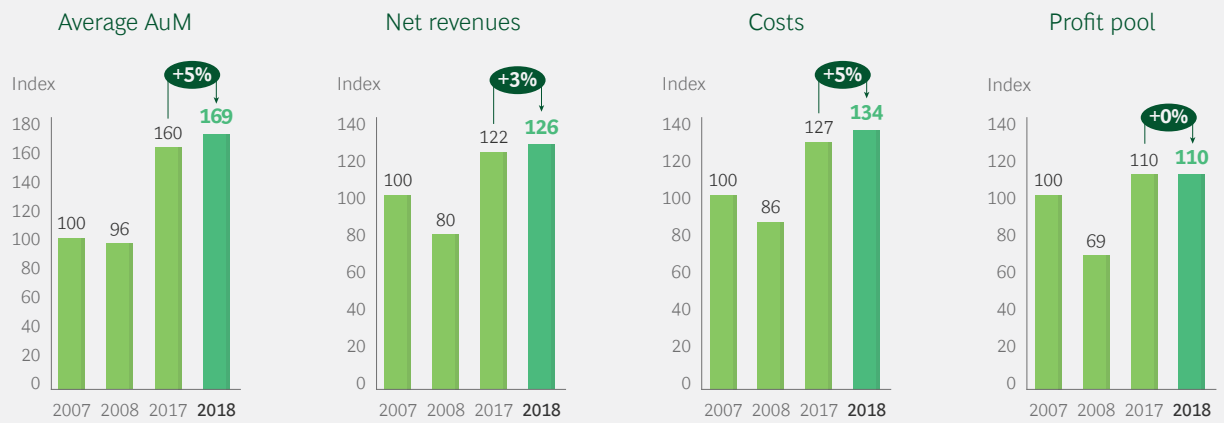
EXHIBIT 4 | Profits Fell as Cost Controls Failed to Offset Fee Pressure



Sources: BCG Global Asset Management Market-Sizing Database 2019; BCG Global Asset Management Benchmarking Database 2019.

Note: Analysis based on our global benchmarking, which includes 154 leading asset managers, representing \$53 trillion AuM, or more than 69% of global AuM. This sample is weighted toward more traditional players and does not include pure alternative players, so those economics are not comparable with total asset management revenues based on our global product trend analysis. Values with fixed exchange rates: the year-end 2018 US dollar exchange rate has been applied to all past years to synchronize current and historic data. Also, historic data has been restated to maintain consistency of samples over time. Net revenues are management fees minus distribution costs.

EXHIBIT 5 | Changes from the Pre-Crisis Baseline of 2007



Sources: BCG Global Asset Management Market-Sizing Database 2019; BCG Global Asset Management Benchmarking Database 2019.

Note: Analysis based on our global benchmarking, which includes 154 leading asset managers, representing \$53 trillion AuM. This sample is weighted toward more traditional players and does not include pure alternative players, so those economics are not comparable with total asset management revenues based on our global product trend analysis. Values with fixed exchange rates: the year-end 2018 US dollar exchange rate has been applied to all past years to synchronize current and historic data. Also, historic data has been restated to maintain consistency of samples over time. Net revenues are management fees minus distribution costs. Average AuM is based on quarterly or monthly measures throughout the year; it is not a year-end snapshot, which explains why this figure rose while total year-end AuM fell.

ON THE CUSP OF A NEW DECADE

EVEN AFTER A YEAR as challenging as 2018, asset management is on a fundamentally solid footing. It is hard to feel gloomy about an industry that generated almost \$100 billion in operating profits in a down year. Still, to keep the profits coming, asset managers must adapt to major changes during the 2020s.

The coming decade will be about meeting evolving customer expectations related to technology, preparing for the possibility of asymmetric competition, and adjusting to the emergence of China (and probably others) as a major asset management market. The 2020s will be a new world, and strategies that set asset managers up for success in the past may not suffice in the future.

One basic path to success for asset managers is to operate as a boutique alpha shop.

Looking at the coming changes, we see two basic paths to success for asset managers. The first path will be to operate as a boutique alpha shop—as a small, focused company that concentrates on investment performance. The second path will be to operate as a distribution powerhouse, amassing scale and maintaining advantaged access to customers.

These two paths to success are already visible today, but in a winner-takes-all industry like asset management, we think their outlines will come into even sharper focus in the next few years. As for the many asset managers that are unable to define themselves as offering either superior investment performance or superior scale, we suspect that they will struggle to avoid drifting toward irrelevance. The change-or-perish imperative that they face will first be evident in the US, but soon afterward it will also appear in Europe and other smaller markets.

The wild card with regard to these developments is possible disruption from digital giants—companies whose level of digital expertise and direct-to-consumer marketing prowess goes well beyond what even the biggest and best-resourced asset managers can marshal. In some ways, the giants' capabilities would translate well to asset management. For instance, it is easy to imagine Google using consumer sentiment data captured by its various services to predict market or individual stock performance with a heightened level of insight. Similarly, consumers might readily trust a “mutual funds sold by Amazon” offering, complete with reviews and other data that enable them to choose quickly among providers.

In China, Alibaba has made a successful move into the industry through its subsidiary

Ant Financial, which has been offering the well-known Yu’e Bao money market fund for several years. More recently, Alibaba has been forming distribution partnerships with local and foreign asset managers.

It is probably less a question of whether other digital giants will try to grab a piece of the asset management industry than when they will—and exactly which parts of the value chain they will try to disrupt. (See Exhibit 6.)

How Fast Will the Changes Come?

To be sure, one might argue that asset management will continue to develop as it has in the past, without step changes or anything amounting to real disruption. This perspective is understandable, given the gradual innovations and strategy adaptations that characterized the industry’s development during previous decades. This slow unfolding has allowed asset managers to keep pushing their sources of advantage and holding on to their share of the industry’s profits.

It is not out of the question that things will develop in a similar way during the 2020s. But another scenario involves more disruptive change, with tech giants or leading asset managers crowding out those that are not strategically differentiated and positioning themselves to capture most of the new money flows. In our view, the smart move for managers to make is to assume that this more disruptive end state will become the reality and to prepare for it.

The two possible strategies we see for surviving disruption—one emphasizing nimbleness and the other great scale—have a number of distinctive characteristics.




Boutique Alpha Shops. Consistent, superior performance is a rare feat in money management, and asset managers that can provide it will always have a place in the industry. But such exceptional success is possible only at asset managers that have the requisite levels of specialization and focus; otherwise, they would not be able to attract (and reward) the best portfolio managers and researchers.

Another hallmark of these alpha shops is their use of leading-edge tools. Almost by necessity, asset managers that can do all of these things well are small—generally with AuM of less than \$100 billion.

The boutique alpha shop model has three key success factors:

- Access to the best investment and research talent
- Tailored sales and marketing engines to ensure that the manager’s value proposition is well understood and communicated
- A pioneering use of data and analytics for investment purposes, which necessarily entails finding ways to access and prioritize the emerging sources of data and new technology

EXHIBIT 6 | Where Asset Managers Are Vulnerable to Digital Giants

Value chain component	Source of the vulnerability	Digital giants’ advantage
 Products and performance	Consumer expectation of personalized engagement and advice—as well as strong performance	Digital giants already have superior quantitative data, tools, and technologies. They may be able to use these advantages to generate investment performance above benchmark and personalized service in ways not previously possible
 Distribution	Direct access to consumers, and consumer expectations of a 24/7 multichannel integrated experience	These companies have an unmatched amount of proprietary data and information on consumers, and huge numbers of customers with whom they interact daily
 IT and operations	An era in which instant fulfillment and error-free service are the norm	Digital giants are automated and have highly flexible systems, reducing the barriers they face in adding new businesses; the older infrastructure of many asset managers acts as a built-in obstacle to expansion

Source: BCG analysis.

To enable this last success factor, asset managers may want to build dedicated teams that scour the field for promising new fintechs and other partners. They may also focus on upgrading the investment organization to include data scientists and technologists, so that the firm can test new ideas and rapidly integrate them into the investment process.

Distribution Powerhouses. Asset managers that succeed through scale will have more than \$1 trillion in AuM. By offering a full

spectrum of products—including products in faster-growing areas such as passive funds, solutions, and alternatives—these managers can gain an advantage in distribution and can take a disproportionate share of the industry’s money flows. These companies will also have the scale needed to lead the charge in technology investment, the brand needed to attract clients, and the broad capabilities needed to win in the fast-expanding Chinese market. (See the sidebar “China Beckons as an Opportunity for Foreign Firms.”)

CHINA BECKONS AS AN OPPORTUNITY FOR FOREIGN FIRMS

Regulatory changes are starting to open up the previously restricted Chinese market to foreign asset managers. Chinese AuM is poised to more than triple, to \$14 trillion in 2025 from \$4 trillion at the end of 2018, so there is every reason for foreign asset managers to attempt to participate in this immensely promising market.

Already, China allows foreign asset managers to set up private fund management companies in the form of wholly foreign-owned enterprises (WFOEs). In 2018, the government raised the cap on foreign shareholding in domestic mutual funds from 49% to 51%, and it will remove the cap in 2020. Foreign firms’ strengths in the areas of investment practices, technology, and internal governance should help them take advantage of this opportunity.

In their investment practices, international companies have a higher level of expertise in asset allocation and risk management than Chinese companies have. Chinese asset managers typically run their equity and fixed-income desks in separate silos, with no overarching department to manage tactical asset allocation or to offer tailored asset allocation advice to clients. In addition, the idea of a risk-adjusted return remains somewhat foreign in China; risk management is still a back-office function. Their investment and risk management experience may give foreign asset managers an advantage in winning the institu-

tional business of Chinese pension funds, banks, and insurers, which must satisfy very specific mandates with regard to the assets they can hold.

Non-Chinese asset managers may also be able to pick up share by selling passive investments, which represent only about 13% of China’s total mutual fund industry, including exchange-traded funds (ETFs) and excluding money market funds. In contrast, passive funds account for approximately 35% of mutual fund holdings in the US. As more and more institutions realize that the returns of alpha strategies net of fees resemble those of beta strategies, the demand for beta products such as ETFs will skyrocket in China. Foreign asset managers with experience in ETF marketing and with a strong position in ETF ecosystems will be well positioned to prosper.

Of course, the advantages that foreign asset managers have over their Chinese counterparts do not guarantee them success in China. Western asset managers will still need to partner with experienced Chinese players that understand the market and the regulatory environment. In pursuing the high-net-worth and mass retail segments, outsiders will find it invaluable to obtain distribution through a local partner, whether that partner is a bank or one of China’s gigantic internet providers.

The distribution powerhouse model has four success factors:

- Superior branding, sales, and marketing
- Advantaged and personalized access to intermediaries (and where possible, to end customers)
- A complete and dynamic product lineup
- A scalable and efficient technology and operating model

The second factor noted above calls for leveraging big data and technology to create individualized offers.

The third factor involves developing new products, and shortening the time to market, by following the agile development approach of digital companies such as Spotify. Not every investment product that distribution powerhouses offer has to be a performance leader; some of them may simply offer “good enough” performance, including by partnering with third parties.

To develop the fourth factor—a scalable and efficient technology and operating model—distribution powerhouses must automate their operations and information technology;

replace their legacy systems with modern, cloud-enabled platforms; and tap the services of utility players for the most commoditized functions, such as investment operations and transactional tasks.

Decision Time

This is a binary view of the industry’s future, and it cannot completely capture the nuances of an industry that has thousands of players globally and hundreds of billions of dollars in revenues. Something that might be an imperative and an established trend in a highly developed market may be less of an imperative and less of a foregone conclusion somewhere else. In short, the success factors may differ.

But it is hard to imagine anything coming along to supplant the fundamental promise of outside money management—namely, that someone, somewhere, can provide a superior return or can largely free clients from the hassle and complexity of being an investor. Some asset managers will not need to make a decision about which path to take and which kind of value to provide, because they long ago committed to one of the two paths. For asset managers whose strategies are less firmly fixed, the next decade will be a time to identify a unique service they can provide that might allow them to stay in the game.

THE TECHNOLOGY-LED ASSET MANAGER

HOW DATA AND ANALYTICS CHANGE THE GAME

DATA AND ANALYTICS ARE the center of attention in the asset management industry today because firms see them as a potentially significant driver of performance. Stories abound of hedge funds using credit card and satellite data and of algorithmically driven investors hoovering up mispriced securities. Behind the headlines, however, few firms have leveraged the technology at scale or used it to significantly boost their bottom line.

Pioneering asset managers use analytics-based products across the entire firm.

Most industry leaders recognize that data and analytics can serve as tools to sharpen their decision making and upgrade their operational efficiency. They understand that having access to more and better information can help improve numerous tasks and processes across the business, supporting clients' complex needs. (See sidebar "The Era of Insurance Asset Management.") But many of them lack the IT resources, data architecture, talent, and cultural readiness to implement changes at the required scale.

As a result, many in the industry feel a rising sense of urgency. Technology enablement is

becoming table stakes in many markets, and management teams know that failing to act could seriously undermine the business on a five-year horizon. Still, they are stuck, with little idea of how and where to invest.

A Few Committed Firms

A global BCG survey of asset managers suggests that only a few firms are genuinely committed to the data and analytics opportunity. We believe that 20% to 30% of asset managers can be classified as what we call *pioneers*—companies that are investing with conviction across a broad range of use cases. Pioneers employ analytics-based products across the entire firm and accelerate technology adoption. Many are on their way to building mature data and analytics organizations, though most have not yet reached their destination.

The impact of data and analytics innovations can be dramatic. (See Exhibit 7.) On the investment side, pioneers supplement decision making with alternative data, more precise simulation, and sharper analysis. The changes boost performance and efficiency in sharing and using research. In trading, they deliver better execution and lower costs. Distribution and marketing functions, meanwhile, benefit from deeper analysis, which permits more-personalized offerings and improved resource deployment, and leads to revenue uplifts of 5% to 10%. New modeling approaches inform

THE ERA OF INSURANCE ASSET MANAGEMENT

Regulations require asset managers to provide attractive investment returns for their insurer clients, but managers also need a good understanding of insurers' capital needs, including those mandated under regulatory frameworks such as the EU's Solvency II Directive and new IFRS standards, which will have significant impacts on insurer portfolios.

In the past 18 years, insurers and pensions have represented on average 80% of total institutional business—more than \$35 trillion overall. But in coming years, asset managers' insurance fiduciary mandates are likely to evolve to include optimizing returns on capital. The new mandates will give insurers confidence that asset managers are aligned with their interests. Indeed, as the insurance business industrializes capital management, asset managers will likely have to adopt a capital lens through the investment value chain.

Asset managers will need to compare risk-adjusted returns, profitability, and capital absorption across investment options and over multiple time frames and scenarios. They will also need to ensure appropriate remuneration of capital held against investments, which entails defining a specific segment cost of capital and a target return on risk capital. Firms must also factor in lifetime views of asset classes and correlations—a challenge in areas such as private assets, where correlations are low and returns may be realizable only over the longer term.

In addition, firms looking to provide capital management services should make sure that the business is compatible with their strategy (cost leadership, for example, or full service) and that they can commercialize their services effectively.

Some asset managers have established the structures, tools (including data and analytics), and capabilities to make this happen. Those that have not yet made the

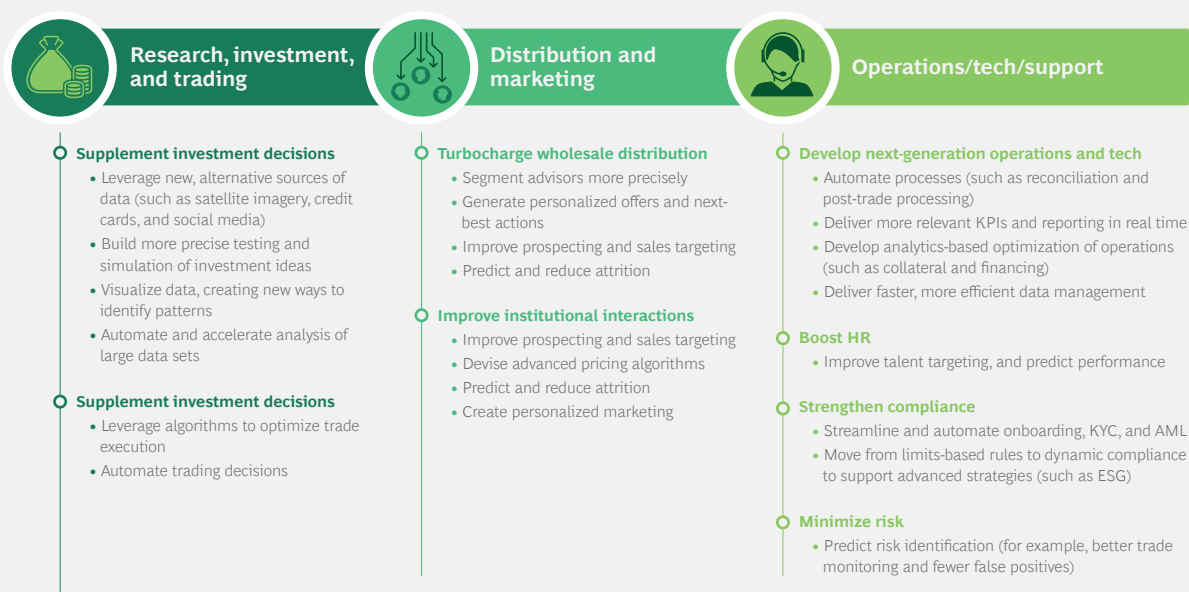
transition but are looking to do so must ensure that they are up to speed in areas including the following:

- Capital absorbed by each asset class under multiple scenarios on a stand-alone basis
- Roles for each asset class from the perspective of profitability versus capital
- Potential risk-adjusted return on capital, capturing both lifetime return on assets and lifetime capital, using metrics such as lifetime return on risk capital
- Key insurance asset and liability management (ALM) constraints
- Diversification benefits across geographies and asset classes, moving from a standalone view to a view of the actual impact on insurers' portfolios
- End-to-end investment solutions to optimize capital consumption in live or runoff books

Strong partnerships between asset managers and insurers can significantly enhance risk-adjusted returns on capital. They can also reduce insurers' balance sheet volatility, lower their capital requirements, and open value creation opportunities on both sides.

But to transition to this brave new world, managers must enhance their traditional return-versus-volatility frameworks, develop new scenarios, and build insurance-relevant capabilities. They need specialized sales teams, supported by financial engineers, to engage with insurers on ALM and investment. They should also design IT infrastructure, tools, and data management to reflect insurers' needs and data structures. These tasks are nuanced and potentially complex, but the prize for successful implementation is likely to be a material boost to the bottom line.

EXHIBIT 7 | Managers Can Deploy Data and Analytics Throughout the Asset Management Value Chain



Source: BCG analysis.

Note: AML = anti-money laundering; ESG = environmental, social, and governance; KYC = know your customer.

prospecting, retention, and marketing. Finally, technology helps firms identify and manage bottlenecks and facilitate automation in operations, which can generate efficiency gains of 15% to 30%.

One level below pioneers on the development ladder is a group that we call *investigators and experimenters*. These firms—which account for about a third of all managers—are making coordinated efforts to build data and analytics capabilities, and are beginning to run proofs of concept and put products into production. Most of them, however, have yet to roll out initiatives at scale and are stuck in legacy ways of working. Strategically, they tend to lack a clear sense of direction.

We call the final and probably largest group of asset managers *passive adopters*. These firms are still in the scoping stage and have not yet committed significant resources or investment to data and analytics. Many are waiting for the technology to mature, for use cases to become clearer, and for ROI to be established.

In terms of raw impact, the most important business areas for data and analytics are investment management and distribution.

Effective application of data and analytics in these two core activities can have a significant impact on the bottom line. For that reason, data and analytics are most likely to merit investment in technology, talent, and change management.

Opportunities Along the Investment Value Chain

Internal and third-party information have always driven investment decisions. Now, however, much more data is available, from a wider array of sources. In addition, advanced analytics can interrogate larger data sets, bringing existing data resources that were previously too large or complex into play.

Together, more data and better analytics can powerfully boost decision making. For example, they can help analysts investigate a new sector or company by scouring news content to spot macro trends, or predict companies that may be considering an IPO. They can improve modeling and simulations associated with investment opportunities. Applications such as web scraping can identify frequently used search terms and popular products, leading to more-accurate revenue estimates on specific companies. They can assess credit

card data to estimate customer churn at a specific company. Natural-language processing and sentiment analysis can enable firms to dissect investor call transcripts, seeking out verbal signals that point to changing conditions. At the portfolio level, analytics can monitor risk exposure or screen for criteria such as ESG factors.

Over time, the firms holding the best information will create the most alpha.

These are among a panoply of potential use cases limited only by the firm's collective imagination and its ability to implement change. Over time, the impact of data and analytics will be profound, and firms holding the best information will create the most alpha, though their advantage will dissipate as the technology becomes more widely implemented and markets become more efficient. To stay ahead of the curve, pioneers must continuously invest. It's easy to imagine the emergence of an information arms race in the coming years. If that happens, capital costs will of course rise. But those costs will be more than offset by returns in the form of better investment performance and operational efficiency.

A New Paradigm in Distribution

Distribution is another area ripe for modernization, and the retail segment represents the low-hanging fruit. Here firms can accumulate valuable insights to build up a dynamic picture of investor DNA to support decision making. The data set should bring together various types of data, including profile (location, number of end clients, type of mandates, investment style), value (average revenue, average holding period), and transaction history (flows, diversification, share of wallet). Another source of valuable information is third-party data—for example, data related to demographics or pricing.

The investor DNA database should become an anchor for multiple applications. Among

these are better segmentation and, therefore, optimized resource allocation (for example, sales focused on advisors that are the most likely to purchase products). Strategic use of the data can help managers predict churn and attrition, and thus increase the holding period of assets under management.

Firms can provide more personalized content, informed by client's actions, decisions, and behaviors, and ensure that they are engaged via the right channel at the right time. The database can help sales teams prioritize leads and ensure that messaging focuses on value-creating opportunities. Finally, the database can support a highly targeted and personalized marketing proposition, based on content tailored to the situation. Effectively managed, such data use can have a transformative impact, leading to a 5% to 10% uplift in revenues and gains of 10% to 30% in efficiency.

Three Levers to Make Data and Analytics Pay

Over the next five years, mastering data and analytics will become a prerequisite for participation in the investment management industry. Right now, however, only 20% to 30% of firms are fully engaged—primarily because such mastery involves more than just buying technology. Making the move requires a strategic leap that embraces data and analytics, talent, and the change management process.

As executives consider their options, they should focus on three core areas:

- **Data and Analytics.** One challenge that faces the industry involves the excess of technological riches: there are simply too many data sources and too many startups claiming to offer game-changing technology. Against this backdrop, the key for firms is to develop informed relationships with the ecosystem of third-party providers. That means having superior ability to distinguish between what is valuable and what is not. At the implementation stage, firms must have solid data architecture and technologists who can integrate solutions into daily workflows and decision tools. The task is complicated by

the need to modernize legacy platforms—but it can be done, and multiple leading players are proceeding on that basis.

- **Talent.** Data and analytics talent is crucial to successful implementation and build-out, which explains why demand for data science expertise is soaring across the financial industry. Yet most tech-savvy people would rather work for tech firms or startups than for asset managers. Critical issues include how to acquire and retain the people needed, and how to create career paths that will help them deliver. Many firms are wrestling with these challenges, and some are taking action—for example, by opening new centers close to large pools of expertise (such as New York City, Austin, or Silicon Valley), developing career paths, and pooling resources to create a sense of community. Similarly, a growing number of firms are deploying agile methodologies and new ways of working to foster collaboration and a culture of innovation.
- **Managing Change.** For many years, asset managers have run successful businesses without using advanced data and analytics, relying instead on portfolio managers and sales team intuition to drive the business. Firms must now rethink how these successful professionals should work, offering retraining on new tools and metrics. This is a tough challenge. Although some sales teams and portfolio managers readily embrace new ways of working, others are more skeptical; and at the margins, a few will never make the transition, creating dilemmas for senior management.

These three areas require profound change, and there is no single recipe for success. However, a few basic principles apply. First, the CEO, with the full backing of the leadership team, should lead the change effort. In terms of process, one successful approach is to start with a few high-impact, narrowly focused use cases (typically three to five for each domain), perhaps leveraging temporary architecture and external resources. High-impact use cases help create momentum and secure investment for the next step.

After the initial phase of experimentation, firms can move on to hardening data architecture and IT infrastructure and rapidly assembling teams of data scientists and technologists to build a new, more powerful cohort of use cases. At that same time, they should drive cultural change by empowering some of the savviest investment professionals and sales teams. Six to nine months down the line, firms should have established a sufficiently robust framework to enable them to process more ideas and drive scale. At that point, data and analytics should start to become more of a business-as-usual capability. Over the following months and years, firms can continue to roll out new applications as they convert the rest of the organization.

Data and analytics are moving to center stage in asset management as critical sources of competitive differentiation. For those not on board, however, the clock is ticking. Leaders need to plan, invest, and execute. Even more importantly, they need to change their firm's mindset. Data and analytics transformation is not a one-off process. Rather, it is the route to a new operating model that will continue to evolve as the pace of innovation accelerates. It is difficult to anticipate all of the roles that data and analytics will play in asset management in the coming years. However, companies that take a wait-and-see approach are likely to be left behind.

FOR FURTHER READING

Boston Consulting Group has published other reports and articles that may be of interest to senior financial executives. Recent examples include those listed here.

Global Wealth 2019: Reigniting Radical Growth

A report by Boston Consulting Group, June 2019

How Asset Managers Can Win in a Winner-Takes-All World

A Focus by Boston Consulting Group, May 2019

Global Risk 2019: Creating a More Digital, Resilient Bank

A report by Boston Consulting Group, March 2019

What Does Personalization in Banking Really Mean?

An article by Boston Consulting Group, March 2019

How CIB Markets Divisions Can Boost Revenue Growth

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Trimming the Sails: Insights from BCG's Treasury Benchmarking Survey 2018

A Focus by Boston Consulting Group, December 2018

What Do Corporate Banking Customers Really Want?

An article by Boston Consulting Group, November 2018

Global Payments 2018: Reimagining the Customer Experience

A report by Boston Consulting Group, October 2018

Retail Banks Must Embrace Open Banking or Be Sidelined

An article by Boston Consulting Group, October 2018

Banking's Cybersecurity Blind Spot—and How to Fix It

An article by Boston Consulting Group, August 2018

Global Capital Markets 2018: Embracing the Digital Migration

A report by Boston Consulting Group, May 2018

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