Capturing Growth in Adverse Times
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GLOBAL ASSET MANAGEMENT 2012

CAPTURING GROWTH IN ADVERSE TIMES

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**GLOBAL ASSET MANAGEMENT 2012: Capturing Growth in Adverse Times**

Is The Boston Consulting Group’s tenth annual worldwide study of the asset management industry. The decade since our first report has seen steady growth in the breadth of BCG’s market-sizing research and benchmarking studies. The goals of the research, however, have remained steadfast: to provide an unbiased and critical assessment of the industry’s current trends and likely evolutionary path, and of the ways in which institutions might best navigate them.

This year’s findings portray, more starkly than ever, an industry in transition, competing internally and externally for an eroding share of the global pool of investor assets. This is the new normal for investment managers, and for the foreseeable future it will define which business models and providers prosper and which ones fail.

Like its predecessors, this edition of our report reflects a comprehensive market-sizing effort. We covered 42 major markets (representing more than 98 percent of the global asset-management market) and focused exclusively on assets that are professionally managed for a fee. We also conducted a detailed analysis of the forces that are shaping the fortunes of asset management institutions around the globe.

In addition, this report contains conclusions drawn from a detailed benchmarking study of leading industry competitors—representing 48 percent of global assets under management (AuM)—that BCG conducted early in 2012. Our aim was to collect data on fees, products, distribution channels, and costs in order to gain insights into the current state of the industry and its underlying drivers of profitability.
The asset management industry faces growing headwinds, despite a recent rebound in profitability and growth. There are a number of key causes for concern:

- *The industry's growth has stalled.* Managers failed in 2011 to attract substantial flows of net new assets, as they have failed to do every year since the financial crisis began in 2008. With the asset management market remaining at 2007 levels and the global pool of investable assets expanding, managers have lost market share.

- *Asset managers continue to confront a two-speed world.* AuM in developed markets has declined by 1 percent per year since 2007, while AuM in developing markets has experienced a compound annual growth rate (CAGR) of 7 percent.

- *The shift in investor preferences away from traditional offerings continues.* Actively managed core assets are declining as a percentage of total AuM, while passive, alternative, and specialty asset classes, as well as solutions, are growing.

- *The gap between winners and losers continues to grow.* While a few providers have successfully adapted to the shift in investor preferences and are benefiting, most have failed to respond, losing assets as a result.

- *Wealth managers and distributors have flexed their muscles and captured more of the value.* Wealth managers have stepped into the solution developer role, leveraging their direct relationship with investors to capture a larger share of fees. Distributor power is expected to be further bolstered by regulations prohibiting payments by asset managers to distributors.

While the asset management industry remains profitable, its economics are at risk.

- *As a result of these trends, the economics of the industry are at risk.* While the asset management industry remains profitable, having rebounded from its 2009 low point, operating margins were essentially flat in 2011 and have not recovered to pre-2008 levels. Prices in certain segments have declined, adding to longer-term revenue pressures caused by the shift to lower-cost passive and fixed-income products. At the same time, the regulatory environment has eroded the relative attractiveness of asset management businesses within broader financial-services portfolios, especially compared with deposit-gathering businesses.
In short, on top of market and financial turmoil and a slow economic recovery, cyclical turbulence and fundamental structural shifts are buffeting the industry, with potentially long-term consequences. This new-normal environment for investment managers will determine which business models and providers prosper and which ones fail in a winner-take-all world.

To assess the depth of these challenges, and to devise strategies for managers to navigate them, it is essential to better understand the macro trends and other forces that offer potential support for growth.

Industry Growth Has Stalled
Since 2007, the year before the crisis, the growth of the asset management industry, measured in terms of the global value of professionally managed assets, has essentially flatlined, reaching $58.3 trillion at year-end 2011, compared with $58.8 trillion in 2007.1 (See Exhibit 1.) Net new flows have varied from –0.5 to 1.0 percent since the crisis, compared with approximately 3 to 6 percent for many years prior. In 2011, net new flows measured a scant 0.1 percent.

A closer look at the data underscores two particular causes for concern in that poor growth record, both of which warrant a detailed review:

- Emerging markets are capturing a disproportionately large share of the nominal growth, but the impact is relatively small in absolute terms.
- There has been a significant decline in the retail segment across most of the world’s mature markets over the past four years.

**Decline in Developed Markets.** Overall, managed assets in developed markets, representing about 90 percent of global AuM, have declined by 1 percent per year on average since the start of the crisis.2 At the same time, in developing markets, AuM has grown by 7 percent per year on average and now represents roughly 8 percent of global AuM, up from 6 percent in 2007.3 The growth potential in developing markets is partly driven by the increasing penetration of managed assets in relation to total financial assets. (See Exhibit 2.) Apart from a few countries with very strong pension systems, such as Chile and Brazil, most emerging markets show low penetration of managed assets. Still, we can expect that as these countries’ GDP per capita rises, AuM will also grow.

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**EXHIBIT 1 | The Asset Management Industry’s Growth Has Stalled at 2007 Levels**

<table>
<thead>
<tr>
<th>Year</th>
<th>Global AuM ($trillions)</th>
<th>Average net flows (% of AuM at beginning of period)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>34.0</td>
<td>3.1</td>
</tr>
<tr>
<td>2003</td>
<td>48.4</td>
<td>3.2</td>
</tr>
<tr>
<td>2004</td>
<td>54.3</td>
<td>4.5</td>
</tr>
<tr>
<td>2005</td>
<td>58.2</td>
<td>4.0</td>
</tr>
<tr>
<td>2006</td>
<td>58.3</td>
<td>1.0</td>
</tr>
<tr>
<td>2007</td>
<td>58.3</td>
<td>0.1</td>
</tr>
<tr>
<td>2008</td>
<td>54.3</td>
<td>-0.5</td>
</tr>
<tr>
<td>2009</td>
<td>48.4</td>
<td>-0.2</td>
</tr>
<tr>
<td>2010</td>
<td>34.0</td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>58.3</td>
<td></td>
</tr>
</tbody>
</table>

Analysis of global growth makes it clear that asset managers continue to navigate a two-speed world, with slow to no growth in mature markets and more robust growth in many developing markets. 4 (See Exhibit 3.) At the same time, examination by geographic region reveals wide variations, with Asia and Latin America making the largest contributions to global growth in AuM. (See Exhibit 4.)

- North America—which represented 48 percent of global AuM at the end of 2011, with $27.7 trillion—registered essentially
no growth overall in 2011 and has yet to regain its 2007 peak level of $28.8 trillion.

- European AuM fell to $17.4 trillion in 2011, giving up half of the gain it made from 2007 to 2010, when AuM rose to $17.5 trillion from $17.3 trillion. Southern Europe and France, in particular, registered strong declines in 2011 owing to the hard-hit retail segment. Where growth was more robust, it skewed toward the institutional segment. For example, in the U.K. and the Netherlands, that segment grew by 5 percent and 9 percent, respectively.

- Japan and Australia together accounted for 10 percent of global AuM at the end of 2011, a decline of 3 percent and 2 percent, respectively; neither market has regained its precrisis level.

- Asia (excluding Japan and Australia) represented $3.2 trillion of global AuM at the end of 2011—an increase of 5 percent on average, although there were variations across countries. Indonesia, Malaysia, and China showed the strongest growth of more than 8 percent; in contrast, Taiwan, Hong Kong, Singapore, and India showed no growth, while South Korea and Thailand grew modestly.

- Latin America achieved strong growth of 12 percent in 2011, bringing AuM to $1.5 trillion. There were strong variations across countries, however. Chile registered no growth, while Brazil, Mexico, and Argentina all grew by at least 10 percent.

- AuM in the Middle East and South Africa grew by just 1 percent in 2011 (CAGR in both regions was 2 percent from 2007 to 2010.)

Decline in the Retail Segment. Globally, growth since 2007 has been fueled mainly by the institutional segment. Over the same period, the retail market has suffered, with asset managers failing to reconquer the hearts of investors. Instead, many retail investors have turned to investments perceived to be more transparent and less risky, such as bank deposits.

In developed markets, the institutional segment has remained stable since 2007, with the decline in AuM driven mostly by the retail segment. However, in the U.S., Japan, Spain, Portugal, and Greece, both the retail and institutional segments have declined.

In developing markets, both the retail and institutional segments have grown, with the latter expanding more strongly. The persistent strength of the institutional market must be
understood in context. First, this segment has benefited significantly from the positive market impact of declining interest rates over the past few years. But that trend is coming to an end. Second, institutional investors’ growing need for higher performance to offset declining yields has been difficult for asset managers to meet. As a result, managers’ share of the pension fund segment is at risk of eroding.

An Eroding Share of Investable Assets

Key asset pools, including pension funds, insurance companies, and private-household wealth, have collectively achieved a CAGR of 2 percent from year-end 2007 to 2011, when they reached $139 trillion. (See Exhibit 5.) The basic drivers of growth in these assets are similar across regions, but the magnitude of their impact on the asset management industry varies.

First, global economic growth, which stagnated following the 2008–2009 financial crisis, appears to be rebounding, if slowly and unevenly. Second, the wave of workers approaching retirement is starting to crest, supporting an expansion of personal savings and investment. Finally, the recent poor performance of equity markets has delayed retirement for many, increasing the proportion of older and higher-income workers in the labor market.

Of the multiple factors contributing to asset managers’ loss of share of investor assets, some are cyclical while others are more systemic and fundamental. These may persist for at least the medium to long term and include the following:

- As investors lose faith in the industry, there has been a flight to quality and to “risk free” assets, including government bonds and bank deposits insured by select governments.
- Banks facing increased pressure to meet balance-sheet and capital-ratio requirements are making aggressive deposit-gathering efforts.
- Institutional and retail investors are searching for higher-yield options that

![EXHIBIT 5 | As Key Investors’ Asset Pools Have Grown, AuM Has Remained Flat](image)

**Key investors’ asset pools ($trillions)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Assets managed professionally for a fee</th>
<th>Assets managed directly by investors</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>49.7</td>
<td>78</td>
</tr>
<tr>
<td>2011</td>
<td>49.7</td>
<td>89.3</td>
</tr>
</tbody>
</table>

**CAGR**

**Sources:** National statistical offices; OECD; Towers Watson; BCG Global Asset Management Market-Sizing Database, 2012; BCG analysis.

**Note:** The total of $49.7 trillion in professionally managed assets shown here for 2011 does not include AuM by banks, corporations, governments, sovereign wealth funds, nonprofit entities, and offshore AuM that is part of the $58.3 trillion total AuM shown in Exhibit 1.
asset managers have not been equipped to provide. On the retail side, an anecdotal but representative development is the rapid expansion of trust products in China, which reached RMB 4.8 trillion (roughly $750 billion) at the end of 2011, compared with RMB 0.6 trillion at the end of 2007. Asset managers participate in only about 10 percent of China’s trust market. On the institutional side, a growing number of large funds are investing directly in nontraditional private assets without asset manager involvement.

Greater scrutiny of costs at large pension and sovereign-wealth funds is driving increased insourcing of core strategies, and sometimes of specialties, by institutions at scale. For example, the California Public Employees Retirement System is in-sourcing wherever possible, managing 91 percent of its portfolio internally in 2011 while outsourcing currency overlay, institutional fixed-income assets, and high-yield assets. Similarly, China’s CIC sovereign-wealth fund has gradually increased internal management in efficient and relatively well-developed markets while relying on external managers for the majority of its overseas investment funds. And Norges Investment Bank, which manages Norway’s Government Pension Fund Global, reduced the share of externally managed assets by 50 percent, to 4.4 percent, in 2011 after ending 18 investment mandates. The bank explained that “external mandates are in segments where we see considerable potential for excess returns.”

**Investors’ Preferences Continue to Shift**

Changes in investor preferences and persistently low interest rates have accelerated the demand for specialization and multiasset capabilities. As a result, passive, alternative, and specialty products such as emerging-market asset classes, as well as solutions, continue to grow. (See Exhibit 6.) Meanwhile, the traditional core—especially fixed-income products—is forecast to weaken further. (See Exhibit 7.)

- **Passive Products.** Overall, growth in exchange-traded funds (ETFs) has been remarkable, rising from $0.8 trillion at the end of 2007 to $1.3 trillion in 2011 despite the crisis—a CAGR of 14 percent.

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**EXHIBIT 6 | Investor Preferences Are Shifting from Traditional Offerings to Passive, Specialty, and Alternative Products**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Active core</strong></td>
<td>$39 trillion</td>
<td>$48 trillion</td>
<td>$58 trillion</td>
</tr>
<tr>
<td>(%)</td>
<td>63</td>
<td>54</td>
<td>49</td>
</tr>
<tr>
<td><strong>Active specialties</strong></td>
<td></td>
<td>22</td>
<td>24</td>
</tr>
<tr>
<td>(%)</td>
<td>21</td>
<td>22</td>
<td>24</td>
</tr>
<tr>
<td><strong>Solutions</strong></td>
<td></td>
<td>26</td>
<td>21.4</td>
</tr>
<tr>
<td>(%)</td>
<td>7</td>
<td>9</td>
<td>12</td>
</tr>
<tr>
<td><strong>Passive/ETFs</strong></td>
<td></td>
<td>9.6</td>
<td>14.2</td>
</tr>
<tr>
<td>(%)</td>
<td>8</td>
<td>13</td>
<td>13</td>
</tr>
<tr>
<td><strong>Alternatives</strong></td>
<td></td>
<td>14.1</td>
<td>8.0</td>
</tr>
<tr>
<td>(%)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

CAGR (%): 63, 54, 49, 22, 24, 21.4, 9, 13, 13

**Sources:** ICI; Preqin; HFR; Strategic Insight; BlackRock ETF report; IMA; Arete; OECD; Towers Watson; P&I; Lippers/Reuters; BCG Global Asset Management Market-Sizing Database, 2012; BCG Global Asset Management Benchmarking Database, 2012.

1Includes active-domestic, large-cap-equity, active-government fixed-income, money-market, and traditional balanced funds.
2Includes equity specialties (foreign, global, emerging markets, and small- and mid-cap sectors) and fixed-income specialties (credit, emerging markets, global, highyield, and convertibles).
3Includes absolute-return, target-date, global-asset-allocation, flexible, income, and volatility funds.
4Includes structured products, hedge funds, private equity, real estate, infrastructure, liability-driven investments, and commodity funds.
If passive mandates are grouped with ETF assets, the penetration of passive products within the total asset-management market grew from 7 percent in 2003 to 12 percent in 2011.

- **Alternative Asset Classes.** The growth of alternatives has also been strong, especially among institutions seeking greater diversification. For example, hedge funds reached $2.1 trillion in the first quarter of 2012, compared with $2.0 trillion at the end of 2011 and $1.9 trillion in 2010. Net inflows were $55 billion in 2010, $71 billion in 2011, and $16 billion in the first quarter of 2012. Other alternative products also grew robustly. Commodities, for example, rose more than 15 percent yearly from 2007 through 2011.

Demand is also growing for nonlisted alternative assets such as infrastructure and bank loans. Infrastructure assets, which grew more than 30 percent per year from 2007 through 2011, provide diversification, long-term income flows, and inflation protection. Pension funds have become willing investors while banks and insurance companies, especially in Europe, are eager sellers of these assets in order to satisfy higher capital requirements under new Basel III or Solvency II regulations. Bank loans and direct lending through funds are gaining momentum as banks deleverage and companies look for alternative financing. Nonlisted products are challenging for traditional asset managers, which often lack pricing capability and capacity. A few very large global players have invested in these capabilities, setting up large analytics teams, but most have not.

- **Fixed-Income Products.** This traditional stronghold of active managers and a source of recent solid growth is now under attack for several reasons. First, passive fixed-income investing is no longer considered irrelevant, pushing net sales of fixed-income ETFs above $38 billion in 2010 and $50 billion in 2011. This is expected to continue. Second, persistently low rates that are unlikely to fall further are expected to reduce the returns and attractiveness of fixed income as an asset class. Finally, the perceived risk-free, liquid character of government bonds has diminished, driving diversification and a
shift to specialized products like credit, high yield, and emerging-market debt, as well as to new types of private and noncorrelated assets such as infrastructure and bank loans.

A Growing Demand for Solutions and Specialization

In the retail segment, standalone funds are declining, while solution strategies—as well as global and emerging-market funds—grow. Since 2006 in the U.S., there have been three solutions among the top ten product strategies, as measured by mutual-fund net flows. In Europe, there have been three solutions among the top ten strategies since 2006. (See Exhibit 8.) The U.S. solutions were target-date-retirement, world-allocation, and world-bond funds; the Europe, they were target-maturity, mixed-flexible, and absolute-return funds.

By providing strategic asset allocation and diversification across different (and always broader) asset classes, solutions address specific investor needs—such as diversification, capital preservation, and guaranteed income—in highly volatile markets. Two types of solutions, in particular, have emerged:

- **Multiasset/Allocation Funds.** These funds, which include target-date-retirement, global-allocation, income, flexible, and absolute-return funds, have grown dramatically. In 2011, more than $750 billion of assets in the U.S.—3 percent of the total market—were held in these types of solutions, dominated by target-date funds in defined-contribution plans, compared with more than $350 billion at year-end 2008, or 1.8 percent of the total market. In the U.K., assets in multistrategy and asset allocation products increased by 29 percent from 2008 through 2011, to a total of roughly £122 billion, as those products’ total share of market AuM rose from 2.4 percent to 4.0 percent.

- **Managed Programs.** These funds, which include mutual-fund wraps, separately managed accounts, and model portfolios, held nearly $2 trillion in assets in 2011, or 15 to 20 percent of managed retail assets in the U.S. Wealth managers and advisors have established a very strong position in the managed-program market. In the U.S., they package and distribute the majority of these assets, enhancing their own power in the value chain and acting as gatekeepers to asset managers.
In the institutional segment, too, investors’ demand for solutions is growing. At the same time, they are shifting from traditional asset-allocation approaches, driving the evolution of primary investment criteria.

A tough environment is drawing investors away from traditional asset classes.

A tough environment characterized by uncertainty and volatility has altered risk/return assumptions, drawing investors away from traditional models and asset classes such as equity and fixed income. The shift from traditional benchmarks and the implementation of new asset-allocation approaches are now occurring at a deeper, portfolio level. These approaches continue to become more sophisticated and granular in the differentiation between alpha and beta funds in core strategies. Examples of this more nuanced approach include the increased use of risk-based allocation by large pension funds and the adoption of customized global benchmarks with regional mixtures that are not aligned with current market caps. Likewise, liability-driven investments have grown, and liquidity has gained importance as a key investment criterion, in contrast to the historical focus on return targets and risk profiles. At the same time, midsize pension funds have expanded full outsourcing, including fiduciary management.

The Gap Between Winners and Losers Is Widening
A few managers have responded effectively to the shift in investor preferences and have captured a disproportionate share of growth, winning nearly all the net flows into the market in recent years. But the majority of managers have not responded and have lost assets as a result.

The variability in players’ ability to attract net new money continues to increase. The winner-take-all phenomenon was still widespread in 2011, with only about 1 percent of funds capturing about $1 trillion of new money. Excluding players that experienced net outflows, the top ten providers represented 54 percent and 44 percent of net sales of mutual funds domiciled in the U.S. and Europe, respectively. (See Exhibit 9.)

Winners typically have strong product expertise, allowing them to benefit from the specialization trend. Of particular note is the strong success of U.S. and U.K. institutions active in Europe: five of the top ten players in Europe are U.S. companies, representing more than $70 billion in net inflows in a market that recorded $64 billion in net outflows overall. BCG’s benchmarking study revealed that 10 asset managers (all based in the U.S. or the U.K.) managed to increase their European AuM by more than €5 billion in 2011, while 20 managers—mostly continental European providers—suffered reductions in AuM totaling more than €5 billion.

Distributors Are Gaining Power
Distributors of investment products, such as wealth managers, have flexed their muscles and captured a larger share of industry revenue, primarily at the expense of asset managers.

There are two key drivers of this shift in power. The first is a variety of new and proposed regulatory measures in the U.S. and Europe. The rules aim to protect investors by increasing fee transparency and eliminating potential biases in product selection among advisors, sometimes through a ban on third-party commissions. Second, the gatekeeper role played by distributors as providers of managed programs has relegated asset managers to the role of parts provider. Distributors own the investor relationship and typically make the decisions regarding program composition and manager selection. In this capacity, they are able to win a larger share of investment management fees, at the same time demanding lower fees in exchange for access to their programs by a larger number of investors.

Industry Economics Are Attractive but at Risk
The asset management industry remains profitable—having recovered from its 2009
low point—but overall operating margins have remained flat since the crisis and have not rebounded to pre-2008 levels. In 2011, they rose modestly as net revenues grew by 4 percent and costs increased by 3 percent. (See Exhibit 10.)

Industry profits improved by 7 percent overall in 2011, driven mostly by growth in average AuM of 6 percent. At the same time, operating margins rose just slightly from those in 2010. (See Exhibit 11.)

Profitability growth varied widely among providers: 56 percent improved their profits in absolute terms, driven mostly by revenue increases. Globally, 66 percent of players improved their revenues in 2011, while only 38 percent managed to cut their costs in absolute terms.

Declining Prices Add to the Pressures on Revenue
Prices have declined recently in some segments, adding to existing revenue pressures caused by the shift to lower-cost passive and fixed-income products. Revenue margins—or average fees in basis points for AuM—have remained significantly below precrisis levels for the past four years. We believe this trend of lower prices and reduced revenue margins will continue.

Pressures on revenue are strong and are coming from many directions. Historically, these pressures were driven mostly by shifts in product mix—specifically, the larger share of fixed-income and passive products. Pricing of individual asset classes generally remained stable over time, except for some alternative and specialty asset classes that experienced downward pressure. In 2011, however, fee pressures surfaced in some segments, including third-party retail and captive retail. (See Exhibit 12.) An example of this occurred in the U.S., where distributors increased their share of gross revenues or fees at the expense of asset managers. We expect that this pressure will increase and affect third-party-retail asset managers everywhere as wealth managers and distributors become more powerful in the rest of the world.

The expansion of managed programs has also eroded asset manager economics. Wrap fees used in these programs—typically totaling 50 to 100 basis points—raise costs at the distributor level. Because of the need to contain the total fees paid by investors, that has increased pressure on the fees paid to managers of the underlying assets. In the new
EXHIBIT 10 | Increased Profit Margins in 2011 Were Largely Driven by AuM Growth

EXHIBIT 11 | The Asset Management Industry Remains Profitable Despite Flat Operating Margins
normal, investors are more willing to pay for asset-allocation, alpha-beta mix, or manager-selection services provided by managed-program providers than for actively managed assets of certain asset classes. Passive funds and ETFs also provide attractive, lower-fee alternatives to actively managed assets.

Regulatory changes and the scarcity of funding have also diminished the industry’s attractiveness within the broader portfolio. In continental Europe, financial institutions prefer deposits that can funnel cash to bank balance sheets over managed and structured products.

NOTES
1. Asset values for all currencies in all years are based on 2011 average U.S. dollar exchange rates to prevent currency swing distortions. The figures here do not directly correspond to those in our past annual reports owing to currency rate adjustments as well as to updated historical source data, methodology changes (in Australia, in particular), and the larger base of countries surveyed in 2011.
2. Developed markets include Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, Luxembourg, the Netherlands, Norway, Portugal, Singapore, South Korea, Spain, Sweden, Switzerland, Taiwan, the United Kingdom, and the United States.
3. Developing markets include Argentina, Brazil, Chile, China, the Czech Republic, Hungary, India, Indonesia, Malaysia, Mexico, the Middle East, Morocco, Poland, Russia, South Africa, Thailand, and Turkey.
4. AuM figures represent assets sourced from each region or country, not AuM managed or invested in each. Total AuM for developed and developing markets is less than 100 percent of global AuM because $1.5 trillion in offshore assets is counted separately.
5. See *Global Wealth 2012: The Battle to Regain Strength*, BCG report, May 2012. Private-household wealth includes cash and deposits, money market funds, and listed securities held directly or indirectly through managed investments; it excludes investors' own businesses, residences, and luxury goods.

<table>
<thead>
<tr>
<th>Exhibit 12</th>
<th>Pricing Pressures Are Growing, Especially in Third-Party Retail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Economics vary by segment</td>
<td>Pricing pressures are on the rise</td>
</tr>
<tr>
<td>Third-party retail</td>
<td>Third-party retail</td>
</tr>
<tr>
<td>Captive retail</td>
<td>Captive retail</td>
</tr>
<tr>
<td>Third-party institutional</td>
<td>Third-party institutional</td>
</tr>
<tr>
<td>Captive institutional</td>
<td>Captive institutional</td>
</tr>
</tbody>
</table>

WINNING IN THE NEW NORMAL

Turbulence across the asset management environment is driving profound and abrupt shifts in the structure of the industry. While a number of positive macro trends support growth, the countervailing pressures on the industry are many, strong, and diverse. These include stalled growth, shifting investor demands, a growing divergence between winners and losers, increasing distribution power, and changing regulations, in addition to market volatility, persistent economic and rate uncertainty, and demographic changes—all striking unevenly and with effects that are often difficult to forecast.

Asset managers must rethink their value proposition and all their offerings.

The net result is an industry in transition, competing internally and externally for an eroding share of the global pool of investor assets. For the foreseeable future, this is the environment that will define which business models and providers prosper and which ones fail.

Opportunities for growth in the new-normal environment vary widely by market and segment. To craft a winning strategy, it is crucial to differentiate accordingly. To be sure, asset managers face a common set of overarching challenges and at least one competitive mandate for success: they must focus relentlessly on understanding and addressing the real needs of investors, and they must be equipped to do so by constantly innovating, building capabilities, and bringing adapted solutions to the market.

Given their declining share of investable assets, managers must challenge themselves to rethink their value proposition and their complete set of offerings. They will have to address specific investor needs, including capital preservation, guaranteed-income features, and broader asset-class diversification. Flexibility is imperative for providers that hope to stay abreast of market shifts. (See the sidebar, “The Flexibility Premium.”)

Capturing Growth Begins with Self-Assessment

In short, to reverse their eroding share of investor assets and capture new flows, managers will need to make clear-cut strategic choices informed by an honest assessment of their own starting point. Through our research and client work, we have identified some ways in which providers can position themselves to exploit growth opportunities on the basis of their target markets and existing capabilities.
As a first step, managers should conduct an unbiased and comprehensive assessment of their capabilities in the context of the evolving market and investor needs. At the same time, they should analyze and rank the relative attractiveness of specific market opportunities.

As part of the self-assessment, managers should de-average their business by segment, product, and geography and evaluate their capabilities and market opportunities in each segment-product-geography combination. Larger asset managers typically fail to recognize their lack of scale and advantage in specific segment-product-geography combinations. Company-level scale generally provides limited benefits in the quest for growth.

Market opportunity is highly dependent on product choice—in particular, on whether the offering is active or passive. Currently in developed markets, active products in core asset classes are not attracting flows, except in the case of the strongest-performing funds and alternative and specialized asset classes—such as specialty fixed-income, global allocation, and global equities. Developing markets offer more promising growth prospects for active products. In developed markets, passive products—typically long-only—are capturing more than 50 percent of all flows into domestic-equity and other core asset classes. Passive flows are also experiencing accelerating growth and penetration in emerging-equity and core fixed-income asset classes.

**Emerging Winners**

In the new normal, emerging winners are often larger managers that develop a broad spectrum of products that capture accumulated benefits and capabilities from across multiple segment-product-geography combinations at scale. Benefits such as brand awareness and distribution enable these providers to ride out
market challenges to specific parts of their business or the entire enterprise. Emerging winners also include smaller managers with strong capabilities and offerings focused on just a few segment-product-geography combinations. There will always be space in the market for such providers, known for investment management excellence.

Specialized products are particularly needed in the institutional segment.

Many asset managers fall into a third category of typically midsize providers. They are neither big enough to realize accumulated benefits nor focused enough to achieve excellence in any one segment-product-geography combination. These providers, particularly those in actively managed core-asset classes, need to rethink their source of comparative differentiation and redefine their strategic path.

Strategic Choices
It is critical for asset managers to understand the implications of their strategic choices on a company’s business model and capabilities. Investment—perhaps even an acquisition—may be necessary to build those capabilities, whether they support a strategy based on product differentiation, specialized capabilities, or distribution expertise.

Differentiated Product Offerings. This strategic path can be supported in several ways, most notably through a strong performance record or rating. A strong record is critical in standalone active funds, in third-party retail, and in institutional channels. Managers must present clear, transparent, well-documented investment processes and a track record of consistent performance over time. Performance glitches are not necessarily an issue if they are explained and if countermeasures are taken.

Compelling product suites, including a robust pipeline with frequent new-product releases, also provide a means to successful product differentiation—one that requires the ability to identify changing investor needs and create solutions accordingly. In both the retail and institutional segments, identifying those needs is no less critical for passive providers—if they want to avoid displacement by third-party managers—than for active providers. Compelling products are increasingly important for captive-retail providers as captive markets—primarily located in continental Europe—move to more guided architecture. This is true even if the performance threshold is lower, as is the case at European retail banks, which are generally satisfied with their mostly affiliated offerings. Captive providers should take advantage of preferred access to distribution networks and proximity to investors in order to better understand investor needs.

Solutions, particularly those that meet retail investors’ needs in highly volatile markets, are another way of providing a differentiated product offering. Solutions must be compelling in order to succeed in the retail segment. They might deliver strategic asset allocation, capital preservation, guaranteed-income features, or diversification—the latter across different and always broader asset classes. In retail markets, distribution of solutions can pose particular challenges to asset managers because wealth managers and investment advisors are often better positioned than asset managers to deliver solutions to investors. As a result, and as discussed in detail above, standalone fund providers are increasingly relegated to the role of parts provider. Asset managers with affiliated networks, however, have a potential advantage in this situation. They can more readily and rapidly identify investor needs and create adapted solutions by tapping the distribution network’s proximity to the investor.

New and More Specialized Product Strategies. These offer a second potentially successful strategic path in the new-normal environment. Specialized products are particularly needed in the institutional segment, where the uncertain and volatile environment has altered risk/return assumptions. As a result, investors have pulled back from traditional asset-allocation models and asset classes, such as equities, instead adopting new
models and noncorrelated asset classes like infrastructure and bank loans.

Capabilities that support specialized product strategies include strategic asset allocation, multiasset allocation, and pricing and other analytical expertise. These are just table stakes in many markets, but they still require familiarity and acumen with respect to multiple asset classes, even when these are externally sourced. In addition, the winning asset classes tend to change yearly. (See Exhibit 13.)

Pricing and other analytical capabilities are now required in order to support new and nontraditional asset classes that are noncorrelated, such as infrastructure and bank loans. Such assets are often privately traded and therefore require deep skills in pricing and due diligence. Value-added analytics also include new portfolio-management models and metrics such as liquidity that go beyond traditional measurements of performance and risk tolerance.

**Distribution Expertise.** This set of capabilities offers a third potentially successful path to growth. By providing best-practice, value-added services to advisors—enhancing their productivity—managers can deliver a differentiated and compelling value proposition. This is a critical capability for active and passive providers, and it is increasingly important even in captive-retail markets with more open architecture, such as Germany and Italy. Distribution expertise typically requires a very well-coordinated interface between investment management and distribution teams.

**Capturing Unrealized Growth Potential**

All asset managers—whether or not they need to shift strategic direction—should identify and pursue unrealized potential for growth and profit improvement. They must look inside their existing business as well as outside of it to identify fresh opportunities.

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**EXHIBIT 13 | Annual Top-Returning Assets: No Single Class Prevails**

| Year | S&P 500 | Commodity Bonds | Non-U.S. Equity | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds |
|------|---------|----------------|----------------|------|-------------|--------------------------|----------------|---------------------|----------|---------|----------------|----------------|---------------------|----------|--------|-------------|--------------------------|----------------|---------------------|----------|--------|-------------|----------------|---------------------|----------|--------|-------------|--------------------------|----------------|---------------------|----------|--------|-------------|----------------|---------------------|----------|
| 1998 | S&P 500 | Commodity Bonds | Non-U.S. Equity | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds |
| 1999 | S&P 500 | Commodity Bonds | Non-U.S. Equity | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds |
| 2000 | S&P 500 | Commodity Bonds | Non-U.S. Equity | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds |
| 2001 | S&P 500 | Commodity Bonds | Non-U.S. Equity | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds |
| 2002 | S&P 500 | Commodity Bonds | Non-U.S. Equity | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds |
| 2003 | S&P 500 | Commodity Bonds | Non-U.S. Equity | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds |
| 2004 | S&P 500 | Commodity Bonds | Non-U.S. Equity | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds |
| 2005 | S&P 500 | Commodity Bonds | Non-U.S. Equity | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds |
| 2006 | S&P 500 | Commodity Bonds | Non-U.S. Equity | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds |
| 2007 | S&P 500 | Commodity Bonds | Non-U.S. Equity | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds |
| 2008 | S&P 500 | Commodity Bonds | Non-U.S. Equity | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds |
| 2009 | S&P 500 | Commodity Bonds | Non-U.S. Equity | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds |
| 2010 | S&P 500 | Commodity Bonds | Non-U.S. Equity | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds |
| 2011 | S&P 500 | Commodity Bonds | Non-U.S. Equity | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | S&P 500 | Commodity Bonds | Non-U.S. Equity | Small-Cap Equity | High Yield | REITs | Hedge Funds | Investment-Grade Bonds |

Source: Datastream.

Note: Asset classes above the red line in a given year achieved positive returns; those below the line had negative returns.
One lever is to realize the full pricing potential of the current business. This can be achieved by deploying more robust governance of pricing decisions throughout the organization and by upgrading consultative selling capabilities in the field. Expansion into faster-growing markets is another potential lever for growth—depending on a careful review of the relative attractiveness of different markets and the probability of success given the available entry options.

Enhancing the business’s operating model to achieve the optimal balance between efficiency and effectiveness provides a third lever. Managers should consider improving their flexibility in order to support new-product introductions, new-market-entry efforts, or both. Outsourcing back-office and middle-office functions offers potential benefits in terms of efficiency and effectiveness, although most managers currently limit outsourcing to traditional custody and fund administration.

There is no safe haven in the new normal—no “right” to a fair share of asset flows into the market. Strong performance is important to attract new money, along with the ability to understand investors and maintain a robust set of offerings relevant to their changing needs. Institutions lacking these table stakes will face increasing difficulty simply defending their existing assets, clients, and business.

Difficult and turbulent times demand strategic reinvention. Yet they also offer fresh opportunities, as our research has revealed and as we have outlined above. The opportunities, however, are not available to everyone—only to those asset managers willing to challenge themselves, to rethink their value in the marketplace, and to innovate. Managers can begin by undertaking a fact-based reassessment of their strategic priorities, current models, and capability sets. That is the first step on the path to succeeding in a winner-take-all world.
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**How Banks Can Take the Lead in Mobile Payments**  
An article by The Boston Consulting Group, June 2012

**The Battle to Regain Strength: Global Wealth 2012**  
A report by The Boston Consulting Group, May 2012

**Back to the Future: The BCG 2012 Investor Survey**  
An article by The Boston Consulting Group, April 2012

**Tough Decisions and New Directions: Global Capital Markets 2012**  
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**Customer-Centricity in Retail Banking**  
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**Global Aging: How Companies Can Adapt to the New Reality**  
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**Wealth Markets in China: Seeking the Opportunity to Lead—China Wealth 2011**  
A report by The Boston Consulting Group and China Construction Bank, December 2011

**Building on Success: Global Asset Management 2011**  
A report by The Boston Consulting Group, July 2011

**Shaping a New Tomorrow: Global Wealth 2011**  
A report by The Boston Consulting Group, May 2011
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