## The Boston Consulting Group

**Navigating the Maze**

**GLOBAL ASSET MANAGEMENT 2003**

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Navigating the Maze

Global Asset Management 2003:
A Senior Management Perspective

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JUNE 2003
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Preface

Following the publication of *Prospering in Uncertain Times: Global Wealth 2002*, which focused on the private banking market, the asset management practice at BCG decided to undertake a study of the broader asset-management landscape—its current trends and likely evolutionary paths, and the ways in which successful institutions might best navigate them.

This decision led to an extensive research initiative that featured a benchmarking exercise involving more than 40 of the world’s largest asset-management institutions—including 7 of the top 10—with a collective $8 trillion in assets under management (AuM). We asked benchmarking participants, which were evenly divided between Europe and North America—and most of which individually managed a minimum of $100 billion in assets—to complete a quantitative questionnaire that addressed both the institutional and the retail sides of their business during 2002. We requested information about fund inflows and outflows, revenues, and profits, as well as data on client mix, fees, distribution channels, products, and costs. This gathering of data concerned professionally managed assets only—that is, those for which a management fee is paid. The focus of the exercise was to achieve a better understanding of sales and channel issues, operational cost drivers, and overall industry profitability. In addition to the quantitative survey, we conducted in-person interviews with senior managers of many participating companies to discuss their thoughts on the current state of the industry.

The result is this report, *Navigating the Maze: Global Asset Management 2003*. Its goal is to offer an in-depth look at the asset management industry with an emphasis on continental Europe, the United Kingdom, and North America—markets that collectively hold more than 90 percent of global assets under management. We hope the report will prove both informative and thought-provoking in these challenging times for the industry.

We welcome your comments and suggestions either in person or by e-mail at assetmanagement@bcg.com.
Summary of Key Findings

The value of professionally managed assets—those for which a management fee is paid—fell by 8 percent to $31 trillion in 2002, compared with 2001. The decline was mostly attributable to the difficult year endured by global equity markets, as capital inflows in most regions were positive or marginal.

The value of global assets under management was almost evenly split between retail business (45 percent) and institutional business (55 percent), with substantial variation by country.

There are distinct differences in market structure between, on the one hand, North America and the United Kingdom, and, on the other hand, continental Europe. These differences have a direct effect on revenues.

The United States and the United Kingdom are open markets with a significant number of independent players and limited captive distribution. In continental Europe, banking and insurance groups own most players and control distribution. With captive institutional assets commanding far lower revenues than noncaptive assets, European players generally achieve lower revenues than their U.S. and U.K. counterparts.

There is a wide range in profitability among asset managers globally. Roughly 20 percent are unprofitable and a further 20 percent are marginal. The best performers, regardless of retail or institutional focus, achieve higher absolute revenues and lower absolute (and relative) costs than competitors.

Ten percent of the players in our survey, which concentrated on the largest asset managers, reported pretax margins of more than 50 percent, while nearly 30 percent of players reported margins between zero and 19 percent. Seven percent of players were losing money. On average, asset managers that focused on the retail segment had a higher level of operating profit than those that focused on the institutional segment. North America, with its strong retail business and relatively high concentration of noncaptive institutional assets, is the most profitable market, as higher revenues more than compensate for higher costs.

We expect the global asset-management market to expand gradually through 2006 at a compound annual growth rate between 0.7 percent and 6 percent—less than half the 14 percent CAGR achieved between 1995 and 2000.

The anticipated rise will not be driven primarily by equities. The trend in asset allocation has moved away from stocks toward fixed-income instruments and cash, as well as toward alternative investments, in the search for positions that are not correlated with the market. This is especially true for continental European insurers and for defined-benefit programs in the United Kingdom, although U.S.-based defined-benefit programs do not reflect this trend.

Revenues in the asset management industry are likely to remain flat or fall amid a climate of slower growth and thinner margins, and costs will drift upward. Profitability will be increasingly difficult to achieve, resulting in a fierce battle for market share.

If growth in assets under management behaves according to our worst-case scenario through 2006, overall industry profitability may plunge from its 2002 level of about $34 billion to less than $20 billion, or from 11 basis points to 6.

In retail asset management, power continues to shift away from manufacturers toward third-party distributors. Management fees are highly disparate, as are the percentages of those fees that manufacturers pay back to distributors.

Access to third-party distributors will become more competitive as a greater number of manufacturers strive for visibility and market share through the numerous channels. To grant shelf space, distributors are demanding consistent performance ratings, greater clarity on investment style and risk, and firmly established expertise.

In institutional asset management, a far greater number of clients are using investment consultants to help them choose an asset manager. This is increasing margin pressure on institutional asset managers, accentuating the need to rein in costs.
The growing influence of consultants is compelling asset managers to treat them as a specific and highly demanding client segment that must be thoroughly researched and served, with the objective of constructing durable relationships that can bring in new business.

**Actively managed equities, bonds, and money market instruments are being squeezed on all sides—by declining revenues, margins, and allocations.**

Index funds, enhanced index funds, and exchange-traded funds—as well as high-profile alternative investments and private equity—are drawing increasing interest from investors despite struggling equity markets.

**In spite of significant consolidation in the industry over the past ten years, overcapacity and declining profitability should result in continuing consolidation in both North America and Europe.**

Large acquisitions will be increasingly difficult to justify, and the trend toward partial acquisitions, or “lift-outs”—of a division, team, or product group, for example—should gain ground. Some of the least profitable institutions will exit the business altogether. Other institutions may reduce their activities through subadvisory moves or a concentration on certain asset classes. Insurance companies that have diversified into asset management may seek a way out, at least partially.

**To remain competitive, players must realign their organizations toward profits and net revenues, not volumes, and manage distribution rigorously. Further imperatives for improving performance include realizing scale, implementing best-practice cost structures, and optimizing product portfolios.**

Many players do not manage their businesses with the same processes, metrics, and rigor that are commonplace in other areas of financial services or in other industries. There is considerable room for improvement in tracking detailed information on revenues, costs, profitability, products, channels, clients, and personnel.
A Snapshot of the Industry in 2002

The global asset-management industry today is not just one industry but many, each with its own distinct characteristics and nuances. Its size, structure, and profitability vary widely from region to region, product to product, and player to player. It is also still a relatively young industry, one that has experienced many growing pains and is likely to endure more. Its increasingly competitive landscape is making it more difficult than ever for players to attract inflows, gain market share, reduce costs, and remain viable.

How, then, to fully view the industry, comprehend it, and formulate a strategy that offers a chance to achieve true and sustained competitive advantage? The aim of this report, through presenting current industry facts and posing probing questions, is to help asset managers begin to do just that.

A Turbulent Year. Two thousand and two was another stormy year in the asset management industry. The value of professionally managed assets—those for which a management fee is paid—declined by roughly 8 percent from 2001 levels to $31 trillion.\(^1\) The poor performance of global equity markets was chiefly responsible, as capital inflows were relatively healthy in most regions. The steep decrease followed a market decline of 2.5 percent in 2001 to $34 trillion, which was accelerated by the dual blows of the midyear equity-market downturn and the terrorist attacks in the United States on September 11.

In both years, more than 60 percent of global assets under management (AuM) originated in North America. (See Exhibit 1.)

In 2002, as in previous years, there was widespread market variation by region. (See Exhibit 2, page 10.) AuM declined by 17 percent in the United Kingdom, for example, compared with decreases of 10 percent in Germany, 8 percent in North America, and only 0.1 percent in Japan. The precipitous slide in the United Kingdom was largely attributable to high equity exposure, at roughly 70 percent

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\(^1\) This amount would increase to $52 trillion if all investable financial assets of insurance companies, pension funds, corporations, governments, charities, and banks were included.

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**EXHIBIT 1**

**AT THE END OF 2002, PROFESSIONALLY MANAGED ASSETS WERE VALUED AT $31 TRILLION GLOBALLY**

<table>
<thead>
<tr>
<th>Region</th>
<th>Value</th>
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<tbody>
<tr>
<td>North America</td>
<td>$20 trillion</td>
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<tr>
<td>United States</td>
<td>$19.1 trillion</td>
</tr>
<tr>
<td>Canada</td>
<td>$0.7 trillion</td>
</tr>
<tr>
<td>Europe</td>
<td>$8 trillion, with 57% from:</td>
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<tr>
<td>United Kingdom</td>
<td>$2.3 trillion</td>
</tr>
<tr>
<td>France</td>
<td>$1.2 trillion</td>
</tr>
<tr>
<td>Germany</td>
<td>$1.1 trillion</td>
</tr>
<tr>
<td>Japan</td>
<td>$1.9 trillion</td>
</tr>
<tr>
<td>Other</td>
<td>$1 trillion</td>
</tr>
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</table>

**Sources:** Central banks; national insurance and asset management associations; BCG analysis.

**Note:** We included only professionally managed assets—those for which a management fee is paid. If we had included investable financial assets of insurance companies, pension funds, corporations, governments, charities, and banks, the $31 trillion figure would have risen to $52 trillion.
of assets, whereas Japan was characterized by a predominance of fixed-income assets.

In terms of segmentation, the value of global AuM in 2002 was almost evenly split between retail business (45 percent) and institutional business (55 percent).2 Again, there was substantial variation by country. (See Exhibit 3.) Japan, for example, with its small private-banking and mutual-fund industries, was heavily skewed toward the institutional side, as was the Netherlands with its strong, professionally managed pension market. North America was somewhat skewed toward institutional business.

In revenue terms, however, the retail side of the business was the clear leader. In 2002, retail business accounted for 60 percent of the $114 billion in asset-management net revenue globally (gross revenues minus distribution fees), despite increasing pressure on retail margins.

Diversity Reigns. The principal institutions on today’s asset management landscape are a highly disparate group, comprising pure asset-management firms, banking and insurance groups, pure insurance companies, investment banks, and commercial banks. There are also significant differences among regional markets, with those in North America and the United Kingdom having many similar characteristics that are not shared by those in continental Europe. These variations have a direct effect on revenues, and thus performance.

The most fundamental difference concerns ownership structure. In continental Europe, almost all asset managers are owned by banking or insurance groups, whereas the United Kingdom and North America have a high proportion of independent players. As a result, only 1 percent of total AuM in continental Europe is managed by independent players, versus around 30 percent in North America and 23 percent in the United Kingdom. (See Exhibit 4.)

This dynamic is clearly manifested by the respective amounts of AuM in each market consisting of captive assets—those owned or held by an asset manager’s parent or by a group-affiliated company. Such assets made up about 40 percent of total AuM for the asset managers in our survey based in continental Europe, versus 13 percent of total AuM for North American players.

### Exhibit 2

**IN 2002, THE DECLINE IN ASSETS UNDER MANAGEMENT VARIED CONSIDERABLY BY COUNTRY**

<table>
<thead>
<tr>
<th>Country</th>
<th>2002 decrease in AuM (%)</th>
<th>2002 AuM ($trillions)</th>
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<tbody>
<tr>
<td>United Kingdom</td>
<td>–17</td>
<td>2.3</td>
</tr>
<tr>
<td>Netherlands</td>
<td>–12</td>
<td>0.5</td>
</tr>
<tr>
<td>Germany</td>
<td>–10</td>
<td>1.1</td>
</tr>
<tr>
<td>United States</td>
<td>–8</td>
<td>19.1</td>
</tr>
<tr>
<td>Switzerland</td>
<td>–8</td>
<td>0.8</td>
</tr>
<tr>
<td>Canada</td>
<td>–8</td>
<td>0.7</td>
</tr>
<tr>
<td>France</td>
<td>–4</td>
<td>1.2</td>
</tr>
<tr>
<td>Italy</td>
<td>–4</td>
<td>0.8</td>
</tr>
<tr>
<td>Japan</td>
<td>–0.1</td>
<td>1.9</td>
</tr>
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</table>

Sources: National statistics and stock market indexes; BCG analysis.

### Exhibit 3

**THERE ARE STRONG NATIONAL DISTINCTIONS IN THE RETAIL-TO-INSTITUTIONAL RATIO**

2. “Retail” AuM include mutual funds, insurance unit-linked products (such as variable annuities), and assets managed for high-net-worth individuals.

3. “Institutional” AuM include professionally managed assets of banks, insurance companies, pension funds, corporations, and charities. See the methodology section on page 40 for a more detailed description.
The effect of this structural difference on revenue is significant. Average net revenue for North American players in our survey was 30 basis points on every dollar of AuM, compared with 25 basis points in continental Europe. Our analysis showed that this difference was mainly attributable to the North American market’s low concentration of captive institutional assets and to the greater revenues provided by its high concentration of noncaptive institutional assets. North American players earned an average of 29 basis points on noncaptive institutional assets, for instance, versus 6 basis points on captive institutional assets. The corresponding rates for continental Europe were 30 and 10 basis points, respectively. On the retail side of the business, North American players earned an average of 40 basis points, whereas continental European players earned 39.

The asset management business in 2002 was marginally more profitable in North America than in the United Kingdom or continental Europe, with higher revenues more than compensating for higher costs. The North American institutions in our survey had an average cost-to-income ratio of 63 percent, compared with 68 percent for continental European institutions—or pretax profit margins of 37 percent and 32 percent, respectively. What is more, there was widespread variation among individual players on outsourcing costs, which were generally higher in North America. Our survey clearly indicated that the most profitable North American institutional players made relatively heavy use of outsourcing, while the least profitable made relatively light use of it.

Ownership Fundamentally Affects Distribution.

The differences in ownership structure among asset managers have additional and substantial effects on the dynamics of retail distribution, which is most open in the United States and the United Kingdom. Because distribution is so much more fragmented in those two regions, manufacturing is also far less concentrated than in most other markets. (See Exhibit 5.)

For example, since many European asset managers are owned by banking groups, a collective 70 percent of retail mutual funds in France, Germany, Italy, and Spain are distributed “captively” through the branches of the parent or affiliated bank. By
contrast, only about 12 percent of retail funds in
the United Kingdom and a negligible amount in
the United States are sold through bank branches.
In the United Kingdom, the bulk of retail funds are
still sold through independent financial advisers
(IFAs), while in the United States most retail funds
are sold through broker-dealers and financial plan-
ners (the rest being distributed mainly by insurers
and fund supermarkets). While Canada’s distribu-
tion concentration resembles that of continental
Europe, its manufacturing concentration is much
lower, at a level more comparable to that of the
United States. This is because major Canadian
banks own brokerages that operate open architec-
ture models.

These variations are expected to hold relatively
steady over the next few years despite some increas-
ing openness in Europe, especially in Germany, and
a slightly divergent trend in the United Kingdom.
(See Exhibit 6.)

Moreover, the asset management product range in
North America and the United Kingdom is signifi-
cantly broader than in continental Europe, owing
to the freer distribution system and to a
more experienced and sophisticated client base.
Passive management, enhanced indexing, and
quantitative styles are more frequently used; and
vehicles such as exchange-traded funds (ETFs),
hedge funds, and funds of funds (FoF) have devel-
oped more quickly. Niche asset managers have had
a greater opportunity to develop innovative prod-
ucts and to obtain “shelf space” in the market.

Half Empty or Half Full?
Averages aside, the stark
fact is that there is a wide range in performance
and profitability among individual players. Ten per-
cent of the asset managers in our survey—which
focused on the largest institutions (those managing
at least $100 billion in assets)—reported pretax
margins of more than 50 percent, while nearly 30
percent of players reported margins between zero
and 19 percent, and 7 percent reported losses. (See
Exhibit 7.) On a broader, global level, taking much
smaller asset managers into consideration, roughly
20 percent of institutions are losing money and a
further 20 percent are teetering on the brink.
Management fees are highly disparate, as are the
percentages of those fees that manufacturers pay
back to distributors. Such distribution fees—which
include 12B-1 fees, retrocessions, rebates, and shelf-
space payments—are generally higher in Europe
than in North America and run from less than 10
percent for some institutions to nearly 80 percent
for others. This is a remarkable difference and a
good illustration of the enormous variance among institutions in transfer pricing and overall management of distribution costs. (See Exhibit 8.) Even the costs of entry into the industry vary, as it is considerably harder to “get into the game” in continental Europe than in the United Kingdom and the United States, the latter being the most accessible market of all.

Indeed, the current state of the entire asset-management industry might be seen as a case of the glass being both half empty and half full. On the half-empty side, we are witnessing the transformation of a business that was once perceived as almost universally accessible and attractive into one that is increasingly and intensely competitive—and in which only the very strongest will survive. The days of easily attained rapid growth and soaring price-earnings ratios have faded into an era characterized by slow expansion, pressured margins, and declining multiples. The market values of quoted asset managers have substantially decreased, especially in the United States and the United Kingdom. In continental Europe, the price-earnings ratios of asset management activities are falling back to the levels of those in retail and wholesale banking. This process will be exacerbated by the Basle II accord (when it takes effect in 2006), under which asset managers will be required to set aside capital to cover operational risk. Many areas of the industry will be subject to increased regulatory scrutiny following highly publicized scandals in the financial world that have prompted both internal and external examination.

Perhaps most troubling, we are also seeing a sector in which many institutions do not manage their businesses with the same processes, metrics, and rigor that are commonplace in other areas of financial services or in other industries such as pharmaceuticals, retailing, and industrial manufacturing. The ability to motivate sales forces, develop timely products, and control costs is sometimes lacking. For some institutions in our survey, much of the data we requested simply were not readily available, indicating considerable room for improvement in

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**EXHIBIT 8**

**EUROPEAN PLAYERS PAY HIGHER DISTRIBUTION FEES THAN NORTH AMERICAN PLAYERS**

Breakdown of Gross Retail-Management-Related Revenues (%)

<table>
<thead>
<tr>
<th>%</th>
<th>Distribution fees</th>
<th>Net revenues</th>
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</thead>
<tbody>
<tr>
<td>40</td>
<td></td>
<td></td>
</tr>
<tr>
<td>60</td>
<td></td>
<td></td>
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<tr>
<td>80</td>
<td></td>
<td></td>
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<tr>
<td>100</td>
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</tr>
</tbody>
</table>

North American average: 41%

European average: 57%

**Sources:** BCG asset-management database; BCG analysis.

**Note:** Data are from January through June 2002.

1Fees paid back to distributors.
tracking basic information on revenues, costs, profitability, products, channels, clients, and personnel.

That said, on the half-full side, we certainly foresee no doomsday scenario for the industry, even in the present low-growth environment. Historically, capital inflows have remained marginally positive to marginally negative even in extended bear markets such as the current one, now in its fourth year. Most clients, by and large, still feel that asset managers merit their fees. Yet institutions will be increasingly challenged in the future to attract inflows, gain market share, and reduce costs. They must sharpen their value propositions so that both retail and institutional investors will continue to trust them with their money.
Trends in Asset Management

For all asset managers, excellent execution will require a deep knowledge of the overall direction the industry is taking. In our view, current trends can be most effectively categorized into four groups: those concerning market size, the present and potential client base, the product spectrum, and the competitive landscape.

The Market

Barring prolonged international political tensions of the sort that have undermined the global economy in recent months, the asset management market is expected to expand gradually over the next few years. But the strong expansion that was achieved between 1995 and 2000—an average compound annual growth rate of 14 percent across all regions—will likely drop by more than half, to between 0.7 percent and 6 percent through 2006. (See Exhibit 9.) The slight shift in AuM from the institutional to the retail side that we have witnessed in recent years should stabilize near current levels.

The sharp increase in AuM between 1995 and 2000 was not driven just by new inflows but by market impact as well, which accounted on average for roughly half the overall rise. In the United States, for example, market impact drove 68 percent of the expansion, compared with 41 percent in the United Kingdom, 47 percent in France, and 34 percent in Germany. Widespread high exposure to equities by asset managers in both North America and Europe was a particularly strong factor.

But the trend in asset allocation, in general, has moved away from stocks toward less volatile assets such as fixed-income instruments and cash. This is particularly true for insurance companies in continental Europe and for defined-benefit programs in the United Kingdom. (U.S.-based defined-benefit

---

**EXHIBIT 9**

**STRONG HISTORIC GROWTH IN ASSETS UNDER MANAGEMENT IS EXPECTED TO SLOW DOWN**

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Growth projections for 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low</td>
<td>2001: 33.5 trillions</td>
</tr>
<tr>
<td>Medium</td>
<td>2001: 33.5 trillions</td>
</tr>
</tbody>
</table>

**CAGR, 2002–2006 (%)**

- Low: 14%
- Medium: 4%
- High: 6%

**Sources:** National statistics for key countries; national stock markets; BCG estimates; BCG analysis.
programs do not reflect this trend.) Assets have also moved out of equities into alternative investments such as hedge funds. This trend is being driven by the search for increased diversification and for positions that are not correlated to the overall market. In 2002, the proportion of global AuM invested in equities fell below its 1995 level of 45 percent, after having hit 54 percent in 2000. (See Exhibit 10.)

Alas, from a bottom-line standpoint, the outlook for the industry over the next few years can be summed up succinctly: Revenues will decrease or remain level at best, sluggish growth and narrower margins will continue to take their toll, and costs will rise. As profitability becomes more elusive for many institutions, a fierce battle for market share will break out. If growth in AuM behaves according to our worst-case scenario—less than 1 percent through 2006—we could see overall industry profitability plummet from its 2002 level of about $34 billion to less than $20 billion, or from 11 basis points to 6. (See Exhibit 11.)

**Retail distributors are gaining power.** The most telling trend from both a structural and a revenue perspective is the increasing shift in power away from manufacturers toward third-party distributors. This dynamic is in direct alignment with the industry’s heavy swing toward open architecture. The fact is, with thousands of funds to choose from and a growing population of investors, the entity that controls the customer relationship and strongly influences product choice—namely, the distributor, whose advice clients want and are willing to pay for—is today more than ever in a position to dictate which manufacturers get the most shelf space and how much it should cost.

This power shift is not new, especially in the United States, where open distribution has long been evolving. (See Exhibit 12.) But it is becoming more and more pronounced. Revenues from direct channels are steadily declining in the United States and the United Kingdom, and are expected to do so in continental Europe as the branches of open distribution sprout. In Germany, for example, the percentage of funds distributed by bank-owned channels is slowly eroding.

The demand for best-of-breed products is expected to drive open architecture in Europe, with more inflows going into premium funds and well-known global brands. The growth of multimanagement is also expected to play a role, widening opportunities for manufacturers to distribute through third parties, both domestically and across borders. This trend is not expected to evolve quickly, however. Third-party distribution accounts for less than 10 percent of assets under management across Eu-
rope, and that amount is unlikely to change drastically in the near term.

Indeed, up to now, it seems that only players with an established reputation have managed to break into the game on the European continent, and even the most successful have achieved a level of AuM relatively insignificant to their overall size. For example, Fidelity Investments has gained a 2 percent share of the retail market in Germany, representing about $5.5 billion in AuM at the end of 2002, after several years of presence. (Fidelity is now also the top retail brand in the United Kingdom, with a 7 percent share.) Credit Suisse built up nearly $11 billion in AuM in Germany after ten years, starting in the early 1990s. A presence can sometimes be gained with relatively limited investment. For example, Banca Mediolanum of Italy, through a 1999 accord with the multimanagement specialist SEI Investments, achieved $2.5 billion in AuM within only 18 months.

In a global sense, access to third-party distributors will become more competitive as an increasing number of manufacturers vie for exposure and market share through the various channels: broker-dealers, banks, insurers, fund supermarkets, IFAs, and financial planners. What is more, distributors have upped the ante by increasingly selecting manufacturers through tenders. To grant shelf space, they require consistent performance rankings, a high degree of transparency on investment style and risk, a wide range of expertise, a committed wholesaling force to train end brokers, and thorough reporting capability. Being a star fund manager from a small boutique is no longer enough.

Fund supermarkets, a channel dominated by Fidelity Investments and by Charles Schwab—and a phenomenon chiefly in the rapidly changing U.S. market—clearly illustrate just how much choice is available to investors and how competitive the landscape has become. (See the insert “The U.S. Market: Poised for Transformation?” page 18.)

The shift to third parties has already taken place in the United States... and is slowly evolving in continental Europe (Illustration: Germany)

EXHIBIT 12
IN RETAIL ASSET MANAGEMENT, POWER IS SHIFTING INCREASINGLY TOWARD THIRD-PARTY DISTRIBUTORS

The shift to third parties has already taken place in the United States...

<table>
<thead>
<tr>
<th>Share of revenue (%)</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1992</td>
<td>1999</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct</td>
<td>34%</td>
<td>37%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurers</td>
<td>23%</td>
<td>23%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Banks</td>
<td>18%</td>
<td>18%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial planners</td>
<td>10%</td>
<td>10%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Brokers</td>
<td>7%</td>
<td>7%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Supermarkets</td>
<td>3%</td>
<td>3%</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

...and is slowly evolving in continental Europe (Illustration: Germany)

Distribution of mutual funds by channel (%)

<table>
<thead>
<tr>
<th>Distribution of mutual funds by channel (%)</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1997</td>
<td>1999</td>
<td>2003 (estimate)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurers</td>
<td>13%</td>
<td>13%</td>
<td>13%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Direct/discount IFAs</td>
<td>7%</td>
<td>7%</td>
<td>7%</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Bank branches/ bank-owned channels</td>
<td>67%</td>
<td>67%</td>
<td>67%</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Sources: Sanford C. Bernstein & Co.; Investment Company Institute; Morgan Stanley; Deutsche Bundesbank; BVI Bundesverband Investment und Asset Management; BCG analysis.

Distributors, particularly in the United States and Australia, have benefited from the popularity of “wrap” and “separately managed” accounts—bundles of managed investments and services for a flat fee. These accounts not only have higher overall margins but also allow the distributor to keep the bulk of the assets managed, often with twice as many basis points as the manufacturer receives. In general, the ratio between the manufacturer’s and the distributor’s margins varies widely from product to product.
A major question thus hanging over the retail asset-management industry is whether the balance of power between manufacturers and distributors will even out over the next few years. Judging from our research and extensive interviews with senior executives, we believe a continuing shift in favor of distributors is more likely. This will not happen without a fight, however, as manufacturers are beginning to speak out. As one senior executive in our survey said: “It’s a tug of war. The broker-dealers are testing how much they can charge for shelf space. It seems as if mutual fund companies are starting to push back from high fees.”

**Institutional consultants have more clout.** On the institutional side of the business, the foremost trend is the increasing use of investment consultants in choosing an asset manager. Consultant-influenced mandates, by number, have risen to nearly half of all U.S. and close to three-fourths of all U.K. institutional mandates. The proportion of pension funds that use consultants is highest in the United Kingdom (over 90 percent) and substantial in many other countries. (See Exhibit 13.) The increasing influence of consultants is forcing asset managers to treat them as a distinct and highly exacting client segment that must be well researched and served, the goal being to build relationships that can bring in new business.

Most of the U.S. institutional players in our survey said they had set up dedicated teams over the past

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**The U.S. Market: Poised for Transformation?**

For years, the asset management industry in the United States was fueled by innovation, multiplying mutual funds, and bull markets. Growth, margins, and compensation were highly attractive. Innovation has recently slowed, however, as the number of players and investment choices have continued to increase, leading to commoditization in the core of the market. How can such a fragmented business regain high growth and high margins?

The U.S. asset-management industry is not just facing depressed markets. We believe it is poised for transformation. This may occur along two paths, which could evolve simultaneously: innovation and commoditization.

**A New Generation of Innovation**

Extensive interviews we have carried out with retail and institutional investors suggest that they have many unmet needs. Addressing those needs will require asset managers and distributors to truly differentiate what they offer, in terms not only of products but also of packaging and advice. This could take the form of one large wave of innovation, as occurred with mutual funds, or many small, incremental innovations.

Players must therefore ask themselves several questions: Where will the next wave of innovation originate? Are we positioned to participate from a manufacturing point of view? Are we aligned with the right distributors? The answers are unclear for many executives. Some are worried that innovation will become the exclusive domain of niche players and that large players will be relegated to distribution roles only.

**Increasing Commoditization**

We believe that, regardless of the pace of innovation, the core market will face continued commoditization, leading to increased pressure on margins, decreases in compensation, consolidation of the back and middle offices, and higher costs to secure shelf space. Leaders will be able to capture high shares and margins in specific segments only by greatly improving their cost structures, managing their product portfolios, and adopting the best-in-class sales and marketing practices of more mature industries.

Some institutions are taking action. One asset-management holding company recently combined analysts, trading, post-trade operations, and support functions across all of its underlying companies, leaving only portfolio management as a separate entity. Another has placed a significant bet on captive distribution, making major investments to transform its distribution model into a more investor-friendly, guidance-oriented mode. Other players are weighing similar moves.
two years whose sole duty was to manage consultant relationships. One U.S. asset manager told us that the percentage of his firm’s new business stemming from consultants had grown from 10 percent to 50 percent over this period. This is not atypical, especially in the U.S. market, and the trend is also gathering steam (albeit at a slower pace) in Europe. As one continental European asset manager said, “More and more institutional clients set up official tenders and use consultants to select asset managers.” We are also witnessing the rise of “manager of managers” products, in which the consultant’s advice is implemented through its own manager selection, keeping the client once removed.

Both the plan-sponsor clients and the asset managers themselves are driving the increasing use of consultants. Many clients perceive a need for more fiduciary oversight in a post-Enron world and are reacting to the impact of increased regulation by “outsourcing” their selection of an asset manager.

The Clients

Obviously, performance remains a sine qua non of the asset management business. Institutional investors in particular have long demanded strong and consistent results against benchmarks, access to a wide and diverse product range, and a straightforward yet creative investment style. Our research suggests that these clients are likely to become even more exacting in the future. Furthermore, relative performance may no longer be enough. Fewer institutional investors are satisfied with a negative 15 percent portfolio return, even if the Standard & Poor’s 500, the FTSE 100, or the CAC 40 have lost twice as much. Insurance companies in particular depend on minimum guaranteed returns regardless of market conditions. There is, therefore, a dawning awareness that asset managers may have to reorient themselves from relative returns toward absolute returns, especially during bear markets. Such a change would imply a redefinition of industry standards, risk management, and performance attribution, but there is a growing demand for it.

We expect institutional asset managers to feel continued pressure on margins over the next few years as clients seek higher levels of service for little or no additional expense. This trend is already being seen through the greater levels of transparency being provided and through the demand of some investors that performance beyond benchmarks be at least three times the fees charged for a product.
Margin pressure is also present on the retail side of the business, and the expectations of retail clients are steadily rising to institutional levels. Amid the barrage of market information available from advisers, broker-dealers, the mass media, newsletters, and investment Web sites, retail investors have moved from domestic equity and bond funds to more sophisticated vehicles, such as balanced funds, guaranteed funds, sector funds, convertible-debt funds, emerging-markets funds, and hedge funds. The percentage of new inflows that goes into top-rated offerings is steadily increasing.

The evolution toward more sophisticated investors holds true across markets, but investors in the United States and the United Kingdom are the most advanced. In the United States, 97 percent of retail inflows go into funds rated in the top third of their peer groups. This indicates either that investors are informed of rankings and have a degree of faith in them or that they at least trust the financial adviser who is using ratings to suggest products. (See Exhibit 14.) Although the European continent is gaining ground—a process that will be nurtured by the growth of open architecture there—it could be many years before Europe reaches a similar level of sophistication. The U.S. model—in which funds are sold virtually like consumer goods, and most investors can fluently discuss the nuances of ratings by companies such as Morningstar and Lipper—is a long way from taking hold in regions where distribution is still carried out largely by banks or by captive distribution, and where performance is not tracked as closely or transparently.

There seems to be a divergence of opinion between European and U.S. asset managers about the economic value of pursuing both retail and institutional clients. In general, European players report that they perceive synergies in production capabilities and products, as well as value from business diversification and from leveraging institutional learning on the retail side. As one executive who participated in our survey said: “The impacts are a higher level of complexity and bureaucracy on the negative side. The positive factors are in market know-how, product development, research, staff-support functions, and back-office scale.”

Other European players say that retail asset managers can profit from the generally higher level of professionalism and transparency on the institutional side. “The skills we have developed over the past years in our institutional business—process quality, reporting skills, performance consistency—are the same as those that retail wholesalers will require from us a few years down the road,” said a top-level European asset manager in our survey.

That viewpoint runs contrary to the opinion of some U.S. players, who say that different products and business needs compromise economies of scale, and that sales force requirements on the institutional side are vastly different from those on the retail side.

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**EXHIBIT 14**

**INVESTORS’ SOPHISTICATION VARIES ACROSS COUNTRIES**

In the United States, 97 percent of retail inflows go to funds rated in the top third of their peer groups . . .

<table>
<thead>
<tr>
<th>Percentage of net inflows to top-third-rated funds (2001)</th>
</tr>
</thead>
<tbody>
<tr>
<td>%</td>
</tr>
<tr>
<td>100</td>
</tr>
<tr>
<td>80</td>
</tr>
<tr>
<td>60</td>
</tr>
<tr>
<td>40</td>
</tr>
<tr>
<td>20</td>
</tr>
</tbody>
</table>

- United States
- United Kingdom
- Germany
- Switzerland
- France
- Italy

. . . following the increased sophistication of customers

<table>
<thead>
<tr>
<th>Percentage of U.S. net inflows to top-third-rated funds</th>
</tr>
</thead>
<tbody>
<tr>
<td>%</td>
</tr>
<tr>
<td>100</td>
</tr>
<tr>
<td>80</td>
</tr>
<tr>
<td>60</td>
</tr>
<tr>
<td>40</td>
</tr>
<tr>
<td>20</td>
</tr>
</tbody>
</table>

- 1995
- 1996
- 1997
- 1998
- 2002

Source: BCG research.
retail side. “The idea is to create scale,” one senior manager in our survey told us. “But in reality, the institutional business is so customized that we have to separate them out.”

Other U.S. players say the notion that competing in both segments provides a larger base for revenue growth—through a similar product and manufacturing base—is a myth. One reason, they argue, is that platforms for products such as separately managed accounts pose different and additional burdens on the back office compared with the requirements of traditional mutual funds.

The potential synergies described by some European players may not remain as valid in the long term, however, as some institutional and retail clients’ needs are becoming more and more specific.

The Products

The universe of asset management products is proliferating. Never before have both institutional and retail investors, and the firms that manage their money, had a wider array of vehicles to choose from. Yet each product group—we think of them as commodities, core products, and alternative investments—will pose a unique set of challenges over the next few years.

Commodities: Costs Are the Key. Consisting primarily of index funds, enhanced index funds, and exchange-traded funds, commodities are drawing increasing interest from investors despite struggling equity markets. The reasons are evident. First, there is recognition that few active managers outperform the market consistently. Second, index funds cost investors less, owing to lower management fees and extensive use of IT systems. Third, passively managed funds give clients a way to isolate market risk.

Currently, passively managed funds account for roughly 20 percent of all equity assets under management in the United States and about 16 percent in the United Kingdom. Broken down, those funds represent 30 percent of institutional AuM and 15 percent of retail AuM in the United States, versus 20 percent of institutional and 5 to 10 percent of retail in the United Kingdom. In France, Germany, and Italy, passively managed funds collectively account for only about 2 percent of total equity AuM.

Exchange-traded funds and enhanced index funds appear poised for the strongest growth in the commodity segment. ETFs track an index and can be traded like a stock, providing greater flexibility and liquidity for investors than traditional index funds because they can be bought and sold at any time during the day. They also offer greater transparency because intraday price fluctuations are visible, and they have tax advantages over traditional funds. In Europe, a downward trend on ETF fees, toward U.S. levels, should give the popularity of such funds an extra lift. (See Exhibit 15, page 22.)

The advantages of enhanced index funds, which also track an index but can stray to take advantage of special market opportunities, include less frequent rebalancing—which in turn reduces churn rates and associated transaction costs—as well as nonpublic rebalancing dates, which prevent front-running by active managers.

Success in traditional index funds, which hold about $2 trillion in AuM globally, will depend increasingly on substantial size and a low cost structure. Currently, the top five players in index funds represent roughly 85 percent of the global market, and competing products (such as ETFs) have put additional pressure on margins. The threat of increased incursions by ETFs has already led to some market consolidation and to the exit of certain players. Deutsche Bank, for example, sold its index-fund business ($110 billion in AuM in 2001) to Northern Trust for $250 million. (See the insert “The Rise of Exchange-Traded Funds,” page 22.)

Core Products: Pressure from All Sides. Actively managed equities, bonds, and money market instruments are being tightly squeezed by falling revenues, narrowing margins, and sparser allocations. This dynamic has evolved amid the overall trends of clients’ greater demand for value, increasing competition, greater transparency, and the shift in influence toward distributors. Activity in core products has also been affected by two divergent trends in allocation: a drive for lower cost through commodities and a push for greater performance through alternative products such as hedge funds and private equity. (See Exhibit 16, page 23.)

Many traditional asset managers have thus been pursuing various options to position themselves better. Potential approaches include increasing scale
Since first appearing on the asset management industry’s radar screen in the early 1990s, exchange-traded funds (ETFs) have grown steadily in terms of both actual number of funds and assets under management. In the United States, ETFs now number well over 100, with AuM of more than $90 billion—up from just a handful of funds in 1993 that contained less than $1 billion in assets. In Europe, ETFs currently number above 90, with roughly $11 billion in AuM. That compares with fewer than 10 as recently as 2000, containing just several hundred million dollars in assets. Combining the advantages of traditional index funds with the trading flexibility of stocks, ETFs are poised for more rapid growth, particularly in Europe. Because they are being used by an increasingly broad spectrum of investors, ETFs are estimated to grow to more than $500 billion in AuM worldwide by 2005. They will likely remain a niche product, however, since traditional mutual funds offer a wider range of investment opportunities and the investor’s general preference for actively managed products is expected to prevail.

**EXHIBIT 15**

**EXCHANGE-TRADED FUNDS ARE LIKELY TO DEVELOP IN EUROPE AS FEES GET LOWER**

<table>
<thead>
<tr>
<th>Region</th>
<th>2002 AuM (Billions)</th>
<th>CAGR</th>
<th>Growth has been strong across the world</th>
<th>Despite a downward trend on fees in Europe, they remain higher than in the United States and Asia</th>
</tr>
</thead>
<tbody>
<tr>
<td>North America</td>
<td>93</td>
<td>55%</td>
<td></td>
<td>Examples of fees for ETFs (in basis points, end 2002)</td>
</tr>
<tr>
<td>Europe</td>
<td>11</td>
<td>265%</td>
<td></td>
<td>Dow Jones Canada 8</td>
</tr>
<tr>
<td>Asia</td>
<td>25</td>
<td>150%</td>
<td></td>
<td>SPDR 12</td>
</tr>
</tbody>
</table>

**Examples of fees for ETFs (in basis points, end 2002)**

- Dow Jones Canada: 8
- SPDR: 12
- Major market ETFs: 16
- TD ETFs: 20
- Style ETFs: 23
- M&G Index (U.K.): 30
- Tracker Halifax FTSE 100 (U.K.): 50
- Merrill Lynch Stoxx 50 (U.K.): 35
- AXA ETF range: 45
- EQQQ: 28
- Mastershare CAC 40 (France): 36
- HVB tracker (Germany): 45
- UBS Fresco: 29
- TraHK: 5
- Nomura Topix: 22
- Nomura Nikkei 225: 22

**Source:** Morningstar; Financial Times; ICI Perspective; business press; BCG analysis.

through consolidation to compete better on price; providing product differentiation on elements such as style, market capitalization, industry sector, and geographic region; and acquiring distributors to gain higher margins and greater access to customers.

One way to branch out is through strategic partnerships, such as the one between the German retail asset manager DekaBank and J.P. Morgan Chase. The U.S. firm now manages all international equity and bond funds sold by DekaBank, which accurately perceived that developing the needed competency in those areas, internally or through acquisitions, would be too time-consuming and costly. It has benefited greatly from JPMC’s reputation as a top-tier asset manager, while JPMC, for its part, has received management fees and expanded to a degree since the deal was forged in 1997.

Other traditional players have eschewed the potential risks of acquisitions and partnerships, choosing instead to battle declining revenues and margins with a laserlike focus on organic performance.

Looking ahead, it is likely that only the best of the breed, or those asset managers with a record of consistently outperforming the market, will be able to make this strategy viable. One such institution is the U.S.-based Capital Group Companies, which has systematically bettered the market in recent years. (See the insert “Capital Group: A Performance Leader,” page 24.)

Alternative Investments: Attractive but Volatile. Vehicles such as hedge funds, private equity, and real estate investment trusts showed appreciable growth in AuM in 2002, and that gradual expansion is expected to continue over the next few years as investors seek ways to find better performance. Globally, AuM in hedge funds gained roughly 11 percent in 2002 to reach approximately $600 billion. Moreover, although the average hedge fund returned precious little in 2002—the Van Global Hedge Fund Index rose by 0.2 percent, a far lower rate than cash instruments—the return was quite attractive next to the 22 percent loss turned in by the Standard & Poor’s 500. Some hedge-fund prod-
products fared better than others. A few short-selling funds returned nearly 30 percent, for example, compared with a loss of more than 12 percent for some aggressive growth funds. We expect growth in private equity to be less than that in other alternative investments in the short term, as portfolios are rebalanced.

The vast majority of hedge fund investment—about 80 percent worldwide—continues to be managed in the United States. The private-equity sector has a similar dynamic, with roughly 70 percent of the market managed in the United States. Hedge funds represent about 2 percent of global assets under management.

Despite a gradual opening of the hedge fund market to investors with lower levels of affluence—illustrated by falling minimum-investment requirements—businesses and high-net-worth individuals are most likely to drive future growth in the sector. Hedge funds will remain a niche, albeit an expanding one.

One persistent problem in the sector is that it is difficult to rate hedge-fund portfolio managers on the basis of their track records. An analysis of 201 hedge funds rated in the top quartile of all such funds in 1998, for example, found that only 2 of those funds remained in the top quartile in 2001. In addition, about 800 hedge funds—around 20 percent of the global total—closed in 2002. Although numerous traditional mutual funds close every year as well, the volatility profile of hedge funds will continue to make them far more likely to fail.

The key to success in alternative products is to put in place structures and processes that allow for strong reactivity and creativity. They can include focused training dedicated to alternative products, the development of highly specialized sales forces, and the use of external growth tools. Heavy attrition in the hedge fund sector is likely to continue, as poor performers will be weeded out.

Meanwhile, the role of the wrap account—not an alternative investment but an innovative product—has evolved rapidly. The U.S. market for wrap accounts reached $700 billion in 2001 and continued to grow in 2002. Wrap accounts have also enjoyed considerable growth in other markets such as Australia, where they represented virtually all retail-fund inflows in 2002—up from 70 percent in 1999. Wrap accounts may be the best vehicle through which individual retail investors can create and manage an optimal level of asset allocation. Asset managers are also reporting a trend toward increased use of other innovative investment vehicles, such as mezzanine debt and collateralized loan obligations.
The Competitors

The asset management industry continued to consolidate in 2002, and M&A activity was surprisingly brisk considering the trying year endured by markets in general. Participants in our survey indicated two overall trends, however: generally smaller deals than in the past, and the tendency of some acquirers to buy just part of a firm’s business, as opposed to the entire institution. This was a substantial shift from M&A activity in previous years, especially the mid to late 1990s, when voracious appetites for smaller firms and sky-high acquisition premiums were more the norm than the exception.

The difference between then and now is that the risks of major acquisitions in our highly uncertain, low-growth environment are far greater. Any substantial amount of goodwill is that much harder to carry on the balance sheet for any length of time, and there are always tall integration hurdles to clear, such as those concerning corporate cultures, IT systems, and investment processes. Now, more than ever, acquiring firms must be able to convince their staffs, the market, and their clients that the proposed merger will bring clear, tangible value—and sooner rather than later.

Those firms that did take the M&A plunge in 2002 were continuing the consolidation trend of most of the past decade. For example, in 1994, the top ten global asset managers collectively held about 11 percent of AuM worldwide. By 2001, the new top ten—whose identities had changed considerably—had captured more than 30 percent of the market.

Judging from activity involving the 15 largest asset managers on each side of the Atlantic between 1994 and 2001, there were 53 mergers or acquisitions in continental Europe and the United Kingdom, involving $3.5 trillion in AuM; and there were 17 deals in the United States, involving $1.3 trillion in AuM. Two basic types of deals were characteristic: those aimed at expansion (which includes the extension of product ranges and the development of new clients and regions) and those aimed at efficiency (typically struck between two companies with similar product and client bases). On average, expansion deals accounted for nearly 80 percent of the global activity during those years.

The top European players were more active in initiating deals than their U.S. counterparts between 1994 and 2001, accounting for more than three-fourths of M&A activity worldwide. (See Exhibit 17.) Expansion, with a strong regional-development

<table>
<thead>
<tr>
<th>Exhibit 17</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>THE TOP EUROPEAN PLAYERS HAVE BEEN MORE ACTIVE IN M&amp;A THAN THE TOP U.S. PLAYERS</strong></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>X = number of deals</th>
<th>Size of circle = AuM related to deals ($1,000 billion)</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>Within the U.S.</th>
<th>Europe to U.S.</th>
<th>Europe to Asia-Pacific</th>
<th>U.S. to U.K.</th>
<th>Within Europe</th>
</tr>
</thead>
<tbody>
<tr>
<td>13</td>
<td>23</td>
<td>30</td>
<td>4</td>
<td>32</td>
</tr>
</tbody>
</table>

Source: BCG analysis.

Note: Our analysis is based on a review of deals struck by the top 15 U.S. players and the top 15 European players between 1994 and 2001.
A SENIOR MANAGEMENT PERSPECTIVE

Over the past five to ten years, many insurance companies—particularly in Europe—diversified into the asset management business. This strategic move had a compelling logic based on the belief that since investment decisions are a core competency of insurance companies, bringing in new volumes of assets through acquisitions could help achieve scale throughout the value chain and across a variety of products. Other elements of the argument were that insurers already had “push” distribution channels, through which they could sell investment funds, and that such funds would be a good way to keep assets in-house once a life insurance contract had expired. In essence, it was thought that insurers could use their financial power to participate in a high-growth business.

However, now that markets have fallen and asset management has become a low-growth business, insurance companies are starting to review this strategic logic. Many have found that diversification substantially increased their overall exposure to equity market risk—especially companies that were geared primarily toward stocks—in management of both their captive and noncaptive assets. Some acquisitions of asset management firms have weighed heavily on overall profitability because of high costs and high amounts of goodwill being carried on the insurer’s balance sheet. And many insurers have had the same difficulties as banks in integrating asset management firms with different cultures, sales force skills, market backgrounds, and investment styles.

The question at present is the degree to which consolidation will continue and in what regions it will occur. Our view is that overcapacity and declining profitability will result in the trend continuing in 2003 at roughly the 2002 level, although the geographic slant is uncertain. That said, with large acquisitions increasingly difficult to justify, the trend of partial acquisitions, or “lift-outs” of specific products or product groups, will expand. Some of the least profitable institutions will get out of the business. Other players may reduce their activities through subadvisory moves or a concentration on certain asset classes. Insurance companies that have diversified into asset management may seek a way out. (See the insert “Will Insurance Companies Stay in the Game?”)

WILL INSURANCE COMPANIES STAY IN THE GAME?

Over the past five to ten years, many insurance companies—particularly in Europe—diversified into the asset management business. This strategic move had a compelling logic based on the belief that since investment decisions are a core competency of insurance companies, bringing in new volumes of assets through acquisitions could help achieve scale throughout the value chain and across a variety of products. Other elements of the argument were that insurers already had “push” distribution channels, through which they could sell investment funds, and that such funds would be a good way to keep assets in-house once a life insurance contract had expired. In essence, it was thought that insurers could use their financial power to participate in a high-growth business.

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The overall consequence of these dynamics, in our view, is that we are likely to see some insurance companies, especially midsize ones, selling off their asset-management divisions and outsourcing management of some or all of their captive assets. Although some larger insurance groups with sufficient financial muscle will choose to stay in the asset management business, many may adopt a different view of how to run it. One probability for these companies is that the demarcation line between captive assets and assets in the separate asset-management division will be drawn more sharply. This means that asset-liability analysis, as well as strategic and tactical asset allocation, will be the responsibility of the insurance division, while the in-house asset manager will execute more clearly defined investment strategies.

The asset management division will then face the same challenges as its independent competitors: competing on product, performance, and brand in an open-architecture world. These larger insurance groups may find that their asset-management divisions continue to add more risk to their portfolio and absorb more financial resources than originally hoped for—especially if stock markets do not recover soon.
The Challenges Ahead

Why be in the asset management business at all? A blunt question, to be sure, but one that many companies—especially large financial-services institutions with asset management divisions—are grappling with. The reasons for posing the query are clear enough: deep resources are required to withstand market downturns; it is getting harder for conglomerates to align asset management strategy with the strategy of the company at large; and the Basle II accord will add another hurdle. Indeed, the business has become one in which, quite simply, it is not all that easy to make money—or not as much as asset managers were once accustomed to making.

That said, long-term growth and opportunity are still available—now and in the future—to well-run players. Our survey revealed that the best institutional and retail asset managers continue to have pretax margins well above 50 percent, and some as high as 70 percent. Not surprisingly, the most profitable players exhibit much higher revenue realization and better cost management than their competitors. But smarter strategy and sharper execution will be required for leading players to enjoy continued success, and for struggling ones to maintain their current position or to improve. All players will face critical challenges in their battles to develop optimal business models, enhance their brands, and gain competitive advantage.

In our view, the most fundamental of these challenges will concern the following areas:

- Sharpening segment focus and investment style
- Managing distribution channels
- Achieving operational effectiveness through scale and cost control
- Focusing the product portfolio
- Pricing to maximize revenue

Sharpening Segment Focus and Investment Style. There is wide variation in how players view the advisability of a homogeneous model—targeting solely retail or solely institutional investors—in contrast to a broader strategy of pursuing both segments. There are similarly diverse views on active versus passive management and on the potential of outsourcing assets in areas where in-house expertise is weak. Also, some institutional players now focused on captive funds are pondering whether to test the noncaptive waters. Ultimately, choices on such issues must be made through a stringent assessment of internal capabilities, regional and global market conditions, and the prowess of competitors.

According to our survey, players that focus primarily on the retail segment have a higher average level of operating profit than those that focus principally on the institutional segment. (See Exhibit 18.) In North America, for example, the best per-

![Exhibit 18: Players Focusing on the Retail Segment Achieve Higher Operating Profits](image-url)
formers have a strong concentration of retail business and rely mostly on noncaptive assets in their institutional activities. In Europe, some leading players are increasing their share of noncaptive institutional assets while maintaining a strong retail presence.

However, our research also shows that strong execution can overcome disadvantages stemming from any segmentation bias. Some players achieve better margins than others despite their lower share of both retail business and noncaptive institutional assets.

**Managing Distribution Channels.** Many players are struggling with channel management. The challenge stems from the fact that direct channels (such as proprietary bank and insurance outlets, and captive agents) and indirect channels (such as broker-dealers, third-party fund supermarkets, nonproprietary bank and insurance outlets, and independent financial advisers) each have their own set of economics for determining profit and loss. Our survey suggests that while some players have a firm grasp on client profitability, precious few understand channel profitability to the extent they might. Management information systems that track revenues and costs by channel are still underdeveloped, making channel-specific data hard to come by. The costs of acquiring and maintaining various channels are widely diverse. The tug of war over fees is raging between manufacturers and distributors.

This state of affairs presents a sizable opportunity for first movers that make a full assessment of their profitability by channel and that analyze channel-specific investment and potential new business in strict net-present-value terms. Such an initiative would likely lead to better-informed choices regarding which channels are most important for their businesses. This process, in turn, could give players a stronger negotiating position and heavier clout in determining how many basis points of revenue actually reach the bottom line.

Indeed, our survey and research show that having a sophisticated distribution strategy leads to better performance. (See Exhibit 19.) Indicators of a high sophistication level are dedicated sales and marketing teams for each client segment and channel; a different product mix across channels; segment- and channel-specific metrics; and the existence of a focused team to deal with investment consultants. Having such elements in place is an integral part of superior sales-force effectiveness.

Our survey also reveals much variation among asset managers in the ability of their sales forces to generate capital inflows in both the retail and institutional segments. (See Exhibit 20.) There are also widespread differences in average inflows per client and in average salary per sales-and-marketing employee. That said, it is apparent that relatively small players and those whose institutional AuM are mostly noncaptive tend to perform best in attracting new business relative to their size. Some of these players show a higher level of capital inflow per dollar spent on sales and marketing, and invest proportionally more in this area than do larger players. Regarding organization, we have witnessed

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**EXHIBIT 19**

**PLAYERS WITH A SOPHISTICATED DISTRIBUTION STRATEGY TEND TO PERFORM BETTER**

<table>
<thead>
<tr>
<th>Players focusing on the institutional segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profitability (basis points)</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>% institutional</td>
</tr>
<tr>
<td>-------------------</td>
</tr>
<tr>
<td>93</td>
</tr>
</tbody>
</table>

**Distribution sophistication level**

<table>
<thead>
<tr>
<th>Players focusing on the retail segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profitability (basis points)</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>% institutional</td>
</tr>
<tr>
<td>-------------------</td>
</tr>
<tr>
<td>8</td>
</tr>
</tbody>
</table>

**Distribution sophistication level**

Sources: BCG asset-management database; interviews; BCG analysis.

Note: Data are from January through June 2002.
Navigating the Maze

Strong results by companies that lean toward letting their sales forces behave like a partnership of entrepreneurs—for example, allowing sellers a high degree of independence and some limited price discretion in pursuing new inflows.

A key for asset managers in the future will be to provide effective support for sellers by identifying untapped market opportunities. Currently, for example, large potential exists in assets that are managed in-house by insurance companies—an amount currently estimated at about $6 trillion globally. If insurers worldwide were to delegate just 20 percent of their AuM to third parties, that would represent an opportunity of more than $1 trillion in AuM for asset managers to pursue. Of course, winning this business will not happen on its own. Insurers have specialized needs regarding risk exposure and liquidity. Regulators impose quite different parameters on their investment processes than are common to typical institutional investors. Asset managers will need to develop expertise, systems, and distribution strategies tailored to insurers’ special needs in order to convince them that they can add value.

On another front, the dawning trend in Europe of less reliance on national and corporate pension schemes offers asset managers a promising opportunity. The market may be somewhat modest—an estimated $400 billion in new inflows by 2006—but it is clearly worth pursuing. Doing so will also require a dedicated commitment by asset managers and their sales forces.

Achieving Operational Effectiveness Through Scale and Cost Control. Every asset manager has to think about scale and costs. In today’s hypercompetitive, low-growth environment, finding a way forward means addressing these concerns head-on. Our survey revealed that many scale-minded players are asking themselves, To buy or not to buy?

There are many reasons why the acquisition route may not be the best choice for any given player. In addition to high amounts of goodwill and numerous integration hurdles, top-level salespeople have been known to flee such situations, taking preferred clients and sizable AuM along with them. There is also the simple fact that bigger and more diversified does not necessarily mean better for serving all types of clients. In the United States, for example, the demand for pure, focused styles is on the rise.

Yet it is also clear that acquisitions add significant value if executed and implemented crisply. A critical element of this process is realizing that the interests of both shareholders and employees are closely aligned, and that the support of these two groups is essential for the acquiring company. We have also witnessed characteristics that are common to well-executed postmerger-integration processes in the asset management industry. Successfully merging companies tend to

- retain a high degree of premerger assets

Sources: BCG asset-management database; BCG analysis.
Note: Data are from January through June 2002.
• rationalize cost overlaps quickly
• have a clear view of each other’s investment philosophies and processes
• understand how highly valuable (and highly mobile) human assets fit into their plans, and make it a priority to retain them
• set strict dates for the completion of each stage of integration

One notable example of a successful integration (albeit involving a high acquisition premium) is the Italian bank UniCredito’s buyout of Pioneer Group, which occurred in 2000. (See the insert “UniCredito-Pioneer: A Successful Integration,” page 34.)

Any potential acquisition, of course, especially one aimed at expanding the product range, involves a tradeoff between the benefits of a wider offering and the complexity that comes with it. Different cultures and structures across products can hinder uniform and consistent performance. Having many products means having to recruit staff with different profiles and manage diverse compensation schemes. Moreover, our survey and research show that a broad range of products does not necessarily enhance profitability.

As consolidation in asset management continues, all institutions will need a focused scale strategy to move forward. And, as challenging as acquisitions may be, the decision to stay away from them completely comes with the risk of being left out in the cold as competitors pair off.

Operational effectiveness, of course, also involves controlling costs. Yet our survey strongly suggests that although asset managers have launched many initiatives to enhance revenues, few have devoted equal energy to cutting costs, which are likely to drift upward by between 1 and 3 percent across the entire value chain over the next few years. Our research shows that current cost structures vary noticeably across markets and regions. (See Exhibit 21.)

In production, the cost increase will be driven partly by the demand for a broader range of investment vehicles and by growth in the number of portfolio managers. The ability to control the costs of portfolio management will be increasingly important, and there are significant scale advantages to be had in both equity and fixed-income management. (See Exhibit 22.) Potential sources for scale advantage are large mandates in which no extra portfolio management is required, and instances in which large numbers of funds have shared resources. Our research indicates a wide range in productivity among players worldwide, as measured by their amount of AuM per every dollar that they spend on portfolio management. (See Exhibit 23.) The trend among many firms toward further developing their own buy-side research will be a con-

**EXHIBIT 21**

**COST STRUCTURES DIFFER IN NORTH AMERICA AND EUROPE**

<table>
<thead>
<tr>
<th>Breakdown of costs by type (%)</th>
<th>North America</th>
<th>Europe</th>
</tr>
</thead>
<tbody>
<tr>
<td>20 basis points</td>
<td>35</td>
<td>44</td>
</tr>
<tr>
<td>17 basis points</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>19</td>
<td>50</td>
<td>52</td>
</tr>
<tr>
<td>Outsourcing</td>
<td>44</td>
<td>4</td>
</tr>
<tr>
<td>Personnel</td>
<td>22</td>
<td>27</td>
</tr>
<tr>
<td>Overhead and support functions</td>
<td>21</td>
<td>21</td>
</tr>
<tr>
<td>Post-trade operations</td>
<td>43</td>
<td>31</td>
</tr>
<tr>
<td>Portfolio management and trading</td>
<td>22</td>
<td>27</td>
</tr>
<tr>
<td>Sales and marketing</td>
<td>22</td>
<td>27</td>
</tr>
</tbody>
</table>

*Sources: BCG asset-management database; BCG analysis.*

*Note: Data are from January through June 2002.*
EXHIBIT 22
SIGNIFICANT SCALE EFFECTS ARE OBSERVED IN BOTH EQUITY AND FIXED-INCOME MANAGEMENT

Scale in equity portfolio management is realized at roughly $80 billion. There are strong scale effects in fixed income.

EXHIBIT 23
PORTFOLIO MANAGEMENT PRODUCTIVITY DIFFERS ACROSS COMPANIES

$AuM per Dollar Spent on Portfolio Management

Sources: BCG asset-management database; BCG analysis.

NOTE: Head count is used as a measure of scale to remove regional bias owing to differences in employee remuneration.
tributing factor to rising costs. Moreover, trade execution costs are likely to increase in line with growing market volatility, despite the trend toward reduced commissions.

In IT, the development of platforms for third-party distribution and for customers' online access is adding to costs, which will likely be further inflated by large investments to support industry moves toward real-time settlement, straight-through processing, and other back-office efficiency initiatives. In marketing and sales, compliance costs to get products to market are increasing, partly because of tighter government regulation in some regions aimed at ensuring that tax incentives are passed on to customers. Even advertising costs are rising, and not by small steps. Since 1995, advertising expenditures by U.S. asset managers, for example, have risen by an average of 18 percent per year amid intensifying competition and efforts to strengthen brand identity. Personnel costs will continue to rise as well, although at a lower rate than during the bull markets of the 1990s.

Where do these developments leave asset managers? Unfortunately, in the always difficult position of finding “fat” in their organizations. In our view, there is a considerable amount in the industry. To trim it, each player will need to carefully analyze its products, systems, and human resources from a cost standpoint. Our survey revealed that regardless of retail or institutional segmentation, the top performers in the industry are able to achieve both higher absolute revenues and lower absolute (and relative) costs than their peers. (See Exhibit 24.)

**Focusing the Product Portfolio.** Of the many insights our survey provided, among the clearest was that many asset managers do not have a well-honed process for product development and maintenance. This can result in poor decision making when one evaluates potential new products, and can foster a reluctance to prune mature offerings that are adding less value than they could. Also, driven by the demand of some clients for a consistently wide product range, relatively few players are saying to themselves, “Here’s a product line we won’t go into,” even if the profitability of the offering seems questionable. Too many players, both retail and institutional, are trying to be everything to everybody.

To be sure, a balanced portfolio can bring significant benefits. It can help institutions that are currently active in all product categories maintain revenues and leverage existing scale in their cost structure. Margins can be enhanced through cross-selling (if executed well), and risk can be diversified since different products have varying growth patterns and volatility profiles.
From a more circumspect angle, however, players with a balanced portfolio can find it very hard to be recognized in every product segment as an expert and to reach sufficient scale. Management time can be spread too thinly to ensure sufficient drive. Simply having many offerings only adds cost if you don’t have the expertise both to sell them effectively and to drive them to sufficient performance levels. On the other side of the spectrum, specialists must consistently prove that their narrow focus adds value.

Over the next few years, players that take the time to develop a clear portfolio strategy—one that is focused as well as flexible—will be best positioned to respond to increasingly volatile markets. This initiative will by necessity entail a careful stocktaking of internal capabilities and external market forces. For example, many players are currently trying to position themselves for an eventual upturn in equity markets and a consequent exodus from money market offerings.

Pricing to Maximize Revenue. Pricing is an underutilized lever for revenue and profit in many areas of financial services, and the asset management industry is no exception. Moreover, the sophistication of many investors—including their scrutiny of fees, commissions, and loads—makes optimal pricing a major challenge.

Our research shows a large variation in pricing optimization across institutions, with strong past performance, brand leadership, and distribution power emerging as key factors in the ability to realize relatively high prices. (See Exhibit 25.) According to our survey, most players could clearly benefit from rigorously evaluating their pricing models. The challenge is to find areas where

- the market might accept increases in loads and management fees
- some form of bundling or unbundling of products or services might better extract the full value that investors are willing to pay
- price leakage, or excessive discounting by salespeople—sometimes used to help bring in new business—can be sealed up
- the price-volume tradeoff can be more optimally set

### Exhibit 25

SOME PLAYERS ARE ABLE TO COMMAND HIGHER PRICES EVEN AFTER ADJUSTMENT FOR CLIENT AND ASSET MIX

In retail ...

<table>
<thead>
<tr>
<th>Gross revenues, adjusted for client and asset mix</th>
<th>Basis points</th>
</tr>
</thead>
<tbody>
<tr>
<td>[Diagram showing data for retail]</td>
<td></td>
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</tbody>
</table>

... and for institutional noncaptive assets

<table>
<thead>
<tr>
<th>Net revenues, adjusted for client and asset mix</th>
<th>Basis points</th>
</tr>
</thead>
<tbody>
<tr>
<td>[Diagram showing data for institutional noncaptive assets]</td>
<td></td>
</tr>
</tbody>
</table>
UniCredito Italiano’s acquisition of Pioneer Group in May 2000 was based on the idea of combining complementary strengths. UniCredito sought to gain sufficient size to be among the top five European asset managers, to complement its product range, and to acquire expertise in both portfolio management and research. The Italian company also hoped to leverage the Pioneer brand name—which was strong in Germany, Poland, and the United States—and to develop strong cross-selling capabilities. UniCredito believed it had the best practices to turn around the struggling U.S. institution and to create value by maximizing production and distribution synergies, optimizing operations, and exiting unprofitable units.

The implementation was quick and thorough. UniCredito used a hands-on approach and close cooperation to quickly integrate research teams, align investment processes, and set up global IT systems. It adopted a common branding strategy through which all mutual funds were sold under the Pioneer name. After reviewing options for distribution strategy in the United States, UniCredito used links between Merrill Lynch and itself to promote Pioneer funds.

Since the merger took place, the results have been very positive. Pioneer’s net inflows rose by $6 billion (15 percent) in 2002, compared with $1 billion in net outflows (out of $25 billion in total AuM) during the first quarter of 2000; and Pioneer funds increased their penetration among U.S. brokers. Pioneer is now on the Prudential list of recommended asset managers. UniCredito is well on the way toward achieving the goals of the acquisition.
The Road to Improvement

Roughly 40 percent of global asset managers are either losing money or showing marginal profitability (a pretax margin of less than 20 percent). For most of the remainder, the comfortable margins of the late 1990s have shrunk dramatically. With asset growth likely to languish between 1 and 6 percent annually in the short and near terms, players will clearly need to undertake concrete initiatives to raise revenues, streamline costs, and improve performance.

There is, of course, no universal panacea. For each asset manager, bettering the bottom line needs to begin with a thoughtful assessment of external markets, competitors, and internal capabilities, and lead to a thorough analysis of possible strategic choices for all aspects of the business model.

As you contemplate ways to improve your company’s profitability, we urge you to consider how your institution might approach the following broad initiatives. While each is ambitious in its own right—requiring time, commitment, and considerable resources—it is also an opportunity for action that, if pursued, could lead to a measurable boost in performance. Our research, benchmarking, and case work with leading asset managers make it clear that virtually all players can meet the challenges we have identified in this report by

- realigning the organization toward profits and net revenues, not volumes
- managing distribution rigorously
- realizing scale and best-in-class cost structure
- optimizing the product portfolio

Realigning Organization Toward Profits and Net Revenues, Not Volumes. One of the biggest failings of the asset management industry in recent years is that the rising tide of the 1980s and 1990s led to a fixation on volumes, sometimes at the expense of profitability. Now that the tide has gone out, the industry needs to reorient itself. As one CEO said to us, “Wal-Mart has data about product profitability by the hour that we see only at the end of the year.”

This reorientation can begin by fully understanding which customers, products, and channels generate profit at a point in time, and can continue with the building of management information systems that give executives a consistent and timely view of pertinent data.

It is clear from our benchmarking study that the best performers actively monitor and manage revenues and costs both by segment and by channel. They have a highly accurate view of the present value of new business they generate. This allows them to continually realign their resources to maximize profits. One player we know, by focusing its sales effort on a relatively high-performing fund, was able to triple the fund’s profits. (See Exhibit 26, page 37.)

Managing Distribution Rigorously. The most effective third-party distribution we witnessed in our survey was an annual inflow of $400 million in AuM per salesperson. Since this is more than three times the industry average of $125 million, we investigated the underlying reasons. We found

- a small number (40) of carefully selected accounts
- deep business-to-business relationships on multiple levels, from the CEO on down
- an explicit desire to “fit” the distributors’ product range
- superior “on the ground” service

Dynamics such as these result in a high share of voice and an ability to promote offerings aggressively early in the performance window—which is helped by limiting the number of products per salesperson and by team-based selling. Asset managers can learn from best practices in other industries, such as pharmaceuticals, in this regard. (See the insert “Can Asset Managers Learn from Pharmaceutical Companies?” page 36.)

The opposite end of the spectrum is characterized by hundreds of small relationships in which the salesperson knows only one or two people in the
As a relatively young industry, asset management has the opportunity to learn from best-in-class management practices of other sectors. The pharmaceutical industry, in particular, offers a number of parallels:

- Complex products that are judged by performance over time
- Long product-development cycles
- Powerful intermediaries between product manufacturers and end users
- A fierce battle for shelf space, as products have become commoditized
- A need for sophisticated pricing, targeting, coordination, and product differentiation

In BCG’s intensive work with leading pharmaceutical sales and marketing organizations, we have observed several dynamics that are applicable to asset management.

**Share of Voice.** Above-average share of voice leads to disproportionately higher market share. This demonstrates the value of identifying where you have lead products and doubling sales efforts for those offerings. BCG recently worked with an asset manager to identify its share of voice—which is not typically measured in the industry—and subsequent restructuring of sales initiatives doubled sales force productivity.

**Early Share Gain.** Aggressive promotion of products early in the performance window can bring a significant increase in revenues. In asset management, many investors exhibit LIFO behavior—“last in” before product performance declines, and “first out” after it does. Conversely, investors who get in early tend to stay longer after a downturn in product performance. In institutional asset management, successful early promotion can double or triple the net present value of a product. (See the exhibit “Aggressive Promotion Early in the Performance Window Leads to Higher Revenue.”)

**“Three-by-Five” Product Loading and Compensation.** Too many products per salesperson leads to underperformance. In pharmaceuticals, the magic number is four products per seller. In asset management, individual wholesalers and broker-advisers rarely sell more than five products effectively (with three possible variations). Compensation should be based not just on sales volumes but also on retention, profitability, and performance against key targets.

**Rigorous Product Development and Management.** To focus full resources on winning products, asset managers need rigorous product-development processes that are linked to market need, with strict “choke points” for less attractive offerings. The pharmaceutical industry has highly evolved product-development systems that financial institutions could learn from.

**AGGRESSIVE PROMOTION EARLY IN THE PERFORMANCE WINDOW LEADS TO HIGHER REVENUE**

<table>
<thead>
<tr>
<th>Revenue ($millions)</th>
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</thead>
<tbody>
<tr>
<td>800</td>
</tr>
<tr>
<td>600</td>
</tr>
<tr>
<td>400</td>
</tr>
<tr>
<td>200</td>
</tr>
</tbody>
</table>

- **Effective and well-executed launch**
- **Poorly executed launch**
- **Value differential: about $150 million in NPV**

*Source: BCG case work.*

1Based on peak sales of $750 million for the well-launched product.
distribution organization. The asset manager is thus selling a product that the distributor barely understands, and service is provided at long distance with little regard for local market needs or language skills.

In our view, sales force productivity depends on a straightforward product set that is easy for both the adviser and the customer to understand, and that has a clear pricing structure. The sales force can then be optimized through high quality and quantity in leads, efficient sales processes, transparent pricing, and easy communication with customers.

The asset manager can then pick up the ball again by ensuring that, from the point of sale, everything is straight-through-processed and administered with a minimum of input from the adviser. On the back of the sales information, rewards can be fed back to the sales force and updates given to the lead-generation process.

We have observed that firms with specialized sales teams—such as groups to manage investment consultants or corporate nonpension clients—tend to outperform their peers.

**Realizing Scale and Best-in-Class Cost Structure.** Our benchmarking data clearly illustrate that operational effectiveness, price realization, product management, production efficiency, and administrative control vary widely across asset managers. Within this category of opportunity, we see three important initiatives:

*Align portfolio management efforts to product goals and profitability.* Best-practice players concentrate portfolio management and research efforts on creating “alpha” on push products. They industrialize commodity and low-value-added products to reduce overall unit cost, often by taking a more quantitative approach. This can lead to savings of more than 20 percent in front-office costs.

*Achieve scale by product or fund, and by location.* Top players manufacture a product in only one location. They rationalize operations—research, portfolio management, trading, administrative, and accounting—across locations. In our experience, 30 to 40 percent of total costs can be saved by rationalizing operations, applying best practices, and creating platform efficiency. (See Exhibit 27, page 38.)

*Support cost realignment.* Asset managers can potentially save between 20 and 35 percent of support costs by challenging the value-added of each function in the light of a more rationalized organization. For U.S. players, our research indicates a clear
correlation between high use of outsourcing and profitability.

Moreover, we urge players that are contemplating acquisitions to consider three observations we have made from our research and case work: the most successful mergers tend to be based on pure consolidation, with complementary products a secondary feature; complementary mergers succeed only where a clearly shared philosophy drives cooperation and precludes competition; and mergers aimed at achieving transregional cross-selling are becoming increasingly difficult to execute.

Optimizing the Product Portfolio. Every asset manager has a “tail” of products with one or more of the following characteristics: they lose money on a marginal or full-cost basis, are subscale, have low or no inflows, and perform poorly. Although some offerings may mature into future revenue and profit drivers, others may never be successful. In our experience, initiatives to identify and retire weak products can have a big impact on the bottom line.

Of course, once the product range has been trimmed, the next issue is to keep it tightly managed. Through our discussions with benchmark participants, we have observed that new-product-development processes should be based on best practices and that there is a positive correlation between rejecting a high percentage of ideas for potential products and a firm’s overall profitability. Our survey revealed that roughly half of asset managers launch new products without fully assessing their economic ramifications. (See Exhibit 28.)

Another strategy that is gaining ground is subadvising products to other asset managers. This makes sense because subadvising enables players to deal in products that are outside their current capabilities (such as alternative vehicles); to avoid the fixed costs associated with new offerings (such as index products); and to allow the organization to concentrate on key areas of competence (such as European insurers focusing on euro bonds and equities, and subadvising global products). While relatively few players consider subadvising, our survey showed that top performers make good use of it.

*   *   *

To conclude, we would like to say that perhaps the most important insight to emerge from our study is that asset managers have the potential to shape their own destinies. Taken as a whole, the amount of energy, experience, and sheer expertise in the industry is truly remarkable. The task at hand for each player is simply to harness its energy, draw on its experience, and act on its expertise.

Of course, such undertakings are far from simple. They take time, resources, lots of roll-up-the-sleeves

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**EXHIBIT 27**

**PLATFORM EFFICIENCY HELPS CUT COSTS**

<table>
<thead>
<tr>
<th>Sublevers</th>
<th>Best-in-class unit costs</th>
<th>Achieve scale</th>
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</thead>
<tbody>
<tr>
<td>Redesign processes and organizational structure</td>
<td>![Graph of cost per unit vs. unit for best-in-class unit costs]</td>
<td>![Graph of cost per unit vs. unit for achieve scale]</td>
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<tr>
<td>Increase level of automation</td>
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<table>
<thead>
<tr>
<th>Sublevers</th>
<th>Internal</th>
<th>External</th>
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<tbody>
<tr>
<td>Consolidate locations</td>
<td>![Graph of cost per unit vs. unit for internal]</td>
<td>![Graph of cost per unit vs. unit for external]</td>
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<tr>
<td>Consolidate certain functions in one location</td>
<td></td>
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<tr>
<td>Merge funds and portfolio manufacturing</td>
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</table>

**Sublevers**

- Outsource to external provider
- Outsource to joint venture

**Sources:** BCG asset-management database; BCG analysis.
Navigating the Maze

labor, and an ability to get up again after being knocked down a few times by the market and by clients. To succeed, asset management firms need to expand beyond their current capabilities and refocus on their most attractive chances in the market. (No player in our survey exhibited all of the best practices in the industry.) The opportunities are indeed there for the taking, and the most nimble players will seize them.

At BCG, we welcome the opportunity to discuss with asset managers their successes, their challenges, and ways in which they might confront those challenges to ensure a brighter future for their organizations.

And last, but far from least, we would like to thank all asset managers, as well as all other interested parties, for taking the time to read this report.
Methodology

The BCG benchmarking survey included a total of 42 institutions, many of them active in both retail and institutional asset management. Since our questionnaire contained separate sections for each segment, we counted the return of each section as one response. Hence the totals of 19 institutional responses and 12 retail responses in North America, and 21 institutional and 19 retail in Europe, including the United Kingdom.

In market sizing, we included only professionally managed assets—those for which a management fee is paid. On the retail side, these consisted of mutual funds (including those held by high-net-worth individuals), unit-linked life and pension products (also called variable annuities in North America), and other assets managed for wealthy clients in the private banking sector (for example, mandates), but excluding directly held securities for which no management fee is charged. On the institutional side, they included professionally managed assets for insurance firms (excluding unit-linked products already counted in retail), pensions, corporations (nonpension), charities, governments, and banks.

Key sources of market sizing included statistics from national governments, stock markets, central banks, and asset-management industry associations.4

In calculating market forecasts, we estimated projections in two steps: market impact (based on evolution of asset mix, with different scenarios of stock market conditions) and inflows.

We made the following assumptions to calculate market impact:

- **Stock Market Conditions:** We considered a possible CAGR of minus 2 percent, 2 percent, or 5 percent over 2002–2006 (which, if there is a 10 percent market decrease in 2003, would translate into respective CAGRs for 2003–2006 of 1 percent, 6 percent, and 11 percent). We referred to these growth scenarios as “low,” “medium,” and “high,” respectively.

- **Asset-Mix Shift:** Growth of de-correlated assets was two points in the low scenario, one point otherwise.

- **Other Assets:** The low scenario assumed a six-point decrease in equity AuM by 2006; the medium scenario assumed the same asset mix in 2006 as in 2002; and the high scenario assumed a five-point increase in equity AuM by 2006, which corresponds to a shift back to the 2001 level.

Other assumptions:

- **Inflows** were based on historical levels. We assumed inflows of 0.5 percent, 2.5 percent, and 3.5 percent of AuM for our three scenarios, versus 4.5 percent over 1995–2000, 3.8 percent in 2001, and 1.5 percent in 2002. We chose this pragmatic approach because we did not observe any correlation between historical inflows and other macroeconomic indicators such as GDP, interest rates, and stock market indexes over the period 1990–2002.

- **Two-thirds of earnings of debt and money market products are reinvested in mandates or funds.**

- **We deducted 100 basis points of service fees (such as management, custody, and brokerage fees) yearly from all AuM.**

4. These sources included the following: **United States:** The Federal Reserve Board, American Council of Life Insurers, **United Kingdom:** National Statistics, the Association of British Insurers, **Canada:** Statistics Canada, Canadian Life and Health Insurance Association, Benefits Canada, the Investment Funds Institute of Canada, **France:** Fédération Française des Sociétés d’Assurance, Commission des Opérations de Bourse, Banque de France; **Germany:** BVI Bundesverband Investment und Asset Management, Deutsche Bundesbank, Hans Karl Kandlbinder; **Netherlands:** De Nederlandsche Bank, Pensioen- & Verzekeringenkamer, Centraal Bureau voor de Statistiek, Bureau Bosch; **Italy:** Assogestioni, Banca d’Italia; **Switzerland:** Swiss National Bank, Swiss Funds Association; **Japan:** Banca of Japan, the Investment Trusts Association, Japan Securities Investment Advisers Association.
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**GLOBAL ASSET MANAGEMENT 2003**

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