

REPORT

GLOBAL ASSET MANAGEMENT 2010

In Search of Stable Growth



THE BOSTON CONSULTING GROUP

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In Search of Stable Growth

Global Asset Management 2010

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Executive Summary

In *Search of Stable Growth: Global Asset Management 2010* is *The Boston Consulting Group's eighth annual study of the worldwide asset-management industry. Like previous reports, this edition reflects a comprehensive market-sizing effort. We covered 34 major markets (representing more than 95 percent of the global asset-management market) and focused exclusively on assets that are professionally managed in exchange for a fee. We also conducted a detailed analysis of the forces that are shaping the fortunes of asset management institutions across the globe.*

In addition, this report contains conclusions drawn from a detailed benchmarking study of leading industry competitors that BCG conducted early in 2010. Our goal was to collect data on fees, products, distribution channels, and costs in order to gain insights into the current state of the industry and its underlying drivers of profitability.

In our 2009 asset-management report, Conquering the Crisis, we focused on the cumulative effects of the global financial crisis and the dilemmas that asset managers faced in their efforts not only to survive the turmoil but also to emerge from it in a strong competitive position. A year later, although the worst days of the crisis appear to be behind us, asset managers still face an enormously challenging environment.

The global asset-management industry rebounded strongly in 2009. The value of professionally managed assets rose by 12 percent to \$52.6 trillion. This increase followed a decline of 17 percent in 2008 and average growth of 12 percent per year from 2002 through 2007. There were wide variations across regions.

◇ On average, assets under management (AuM) rose by 11 percent in North America, 12 percent in Europe, 7 percent in Japan and Australia, and 25 percent in the

rest of Asia. Strong growth of 22 percent was observed in Latin America.

- ◇ On a global level, the increase in AuM was driven chiefly by market impact, with only about 1 percent coming from new net inflows, despite a global rebound in sales of long-only assets.
- ◇ In terms of global asset mix, a shift toward equity and fixed-income AuM—and away from money market funds, hybrid (balanced) assets, structured products, and alternative investments—was evident in 2009. As for client segments, retail AuM—rising 14 percent to \$20.9 trillion and driven by higher equity allocations—posted slightly higher growth than institutional AuM, which rose 10 percent to \$31.7 trillion.

Although the value of global AuM increased in 2009, average AuM and the economics of asset managers deteriorated for the second consecutive year. Average AuM fell by 4 percent, net revenues by 11 percent, and operating margins by 19 percent. Asset managers were able to reduce overall costs by an average of 7 percent in 2009.

- ◇ Our benchmarking study revealed a widening performance gap across institutions in terms of revenues, costs, and profits. The few institutions that raised their profitability were typically those that managed to increase revenues and whose recognized product expertise has enabled them to attract very large inflows while maintaining price levels.
- ◇ There was wide variation in the ability to attract net inflows, with a few top institutions taking the lion's share. The top 20 percent of competitors attracted 88 percent of net sales in 2009—and represented only

23 percent of AuM—while 37 percent of asset managers posted outflows.

The sophistication of investors and, in turn, the demands that they place on their asset managers continue to grow. The performance of asset managers and financial advisors has come under increasing scrutiny. Products and pricing are in flux.

- ◇ Passively managed products are growing more dynamically than actively managed ones.
- ◇ The outlook for growth in both equities and fixed-income investments remains foggy, as forecasts of interest rates, inflation, stock market performance, and the pace of economic recovery vary widely.

Given higher anticipated levels of AuM and a better expected product mix than in 2009, average profit margins may rebound to as much as 35 percent of net revenues in 2010—compared with about 31 percent in 2009, 34 percent in 2008, and the historic peak of 40 percent in 2006 (for institutions that participated in our benchmarking).

- ◇ Emerging markets will continue to gain prominence and could represent more than 25 percent of net sales between 2010 and 2014. A key issue in the minds of asset managers is whether in the long term they can afford *not* to be in countries such as India and China.
- ◇ Mature markets will continue to experience relatively low growth. The negative effects of the crisis will continue to linger, although they will affect some regions more than others. The result will be less wealth accumulation than in the years just before the crisis.

Asset managers of diverse specialties, sizes, and geographic footprints will consider myriad ways to grow and become more profitable. But there are several actions that should be considered by all institutions regardless of their specific circumstances: sharpening business models, determining global aspirations, and exploring mergers and acquisitions (M&A).

- ◇ Following cost-cutting initiatives carried out over the past two years, asset managers have fewer resources at their disposal. This means that they must sharpen their business models—making bolder choices regard-

ing products, target markets, and distribution—and focus on what they do best given their particular strengths and weaknesses.

- ◇ As a practical first step in potentially expanding abroad, asset managers must assess and fortify their positions in their home market—recognizing that foreign competitors may themselves be looking to expand across borders. Second, they need to take an honest look at their own resources—both strengths and weaknesses—and determine which new markets are most attractive given their particular skill set as well as the competitive and regulatory environment in target markets.
- ◇ Well-thought-out and well-executed M&A can still add value in the asset management industry. In some cases, M&A can contribute mightily to achieving competitive advantage. Potential good fits should therefore always be part of senior management’s thinking regarding growth options. But any deal must be sound strategically, culturally, and financially.

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A Snapshot of the Industry

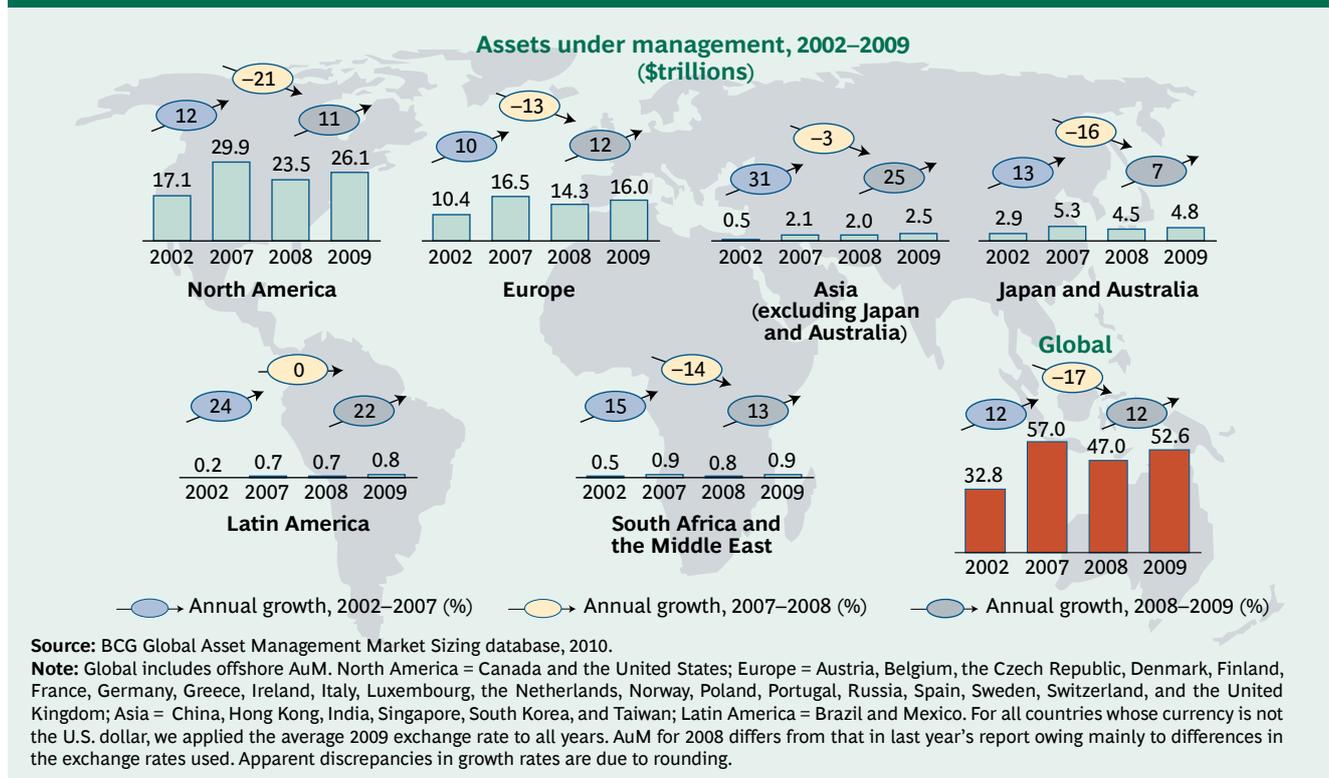
In many ways, the global asset-management industry rebounded strongly in 2009. Yet even as the bleakest days of the worldwide financial crisis receded and the overall economic outlook improved in many regions, the year was not without its difficulties. The impact of the crisis lingered over average levels of assets under management (AuM), investor trust, and the core economics of the business. The performance gap across institutions became wider. Ultimately,

despite a brighter outlook than a year ago, tall challenges remain.

In 2009, the global value of professionally managed assets rose by 12 percent to \$52.6 trillion.¹ (See Exhibit 1.)

1. Owing to changes in methodology or currency rates and updated historical data, market-sizing totals are not consistent with those stated in BCG's previous Asset Management reports.

Exhibit 1. Global AuM Recovered in 2009



This increase followed a decline of 17 percent in 2008 and average growth of 12 percent per year from 2002 through 2007. There were wide variations across regions.

On average, AuM rose by 11 percent in North America, 12 percent in Europe, 7 percent in Japan and Australia, and 25 percent in the rest of Asia. India, at 51 percent, and China, at 29 percent, showed the most robust expansion.² Strong growth of 22 percent was observed in Latin America. The differences in regional AuM growth were driven mainly by variations in net sales and exposure to equity markets.

On a global level, the increase in AuM was driven chiefly by market impact, with only about 1 percent coming from new net inflows despite a global rebound in sales of long-only assets. (See Exhibit 2.) Net inflows into long-only (non-money-market) mutual funds and exchange-traded funds (ETFs) reached close to \$900 billion, with inflow rates varying from 4 percent of end-2008 AuM in Europe to about 8 percent in Asia. At the same time, we witnessed \$580 billion in net outflows from money mar-

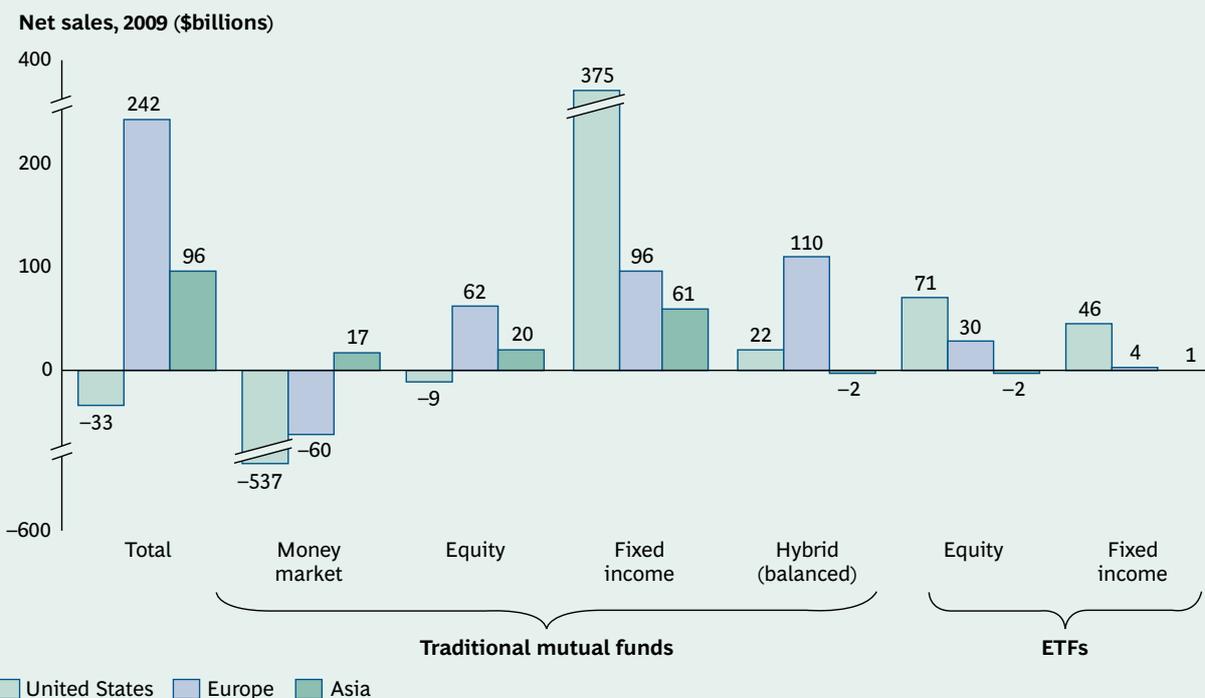
ket funds (mainly in the U.S. market). Globally, fixed-income mutual funds and fixed-income ETFs posted \$583 billion in net sales in 2009, with equity and hybrid (balanced) funds also in positive territory at \$172 billion and \$130 billion, respectively.

The volatile market environment led to different dynamics between average and end-of-year AuM patterns. (See Exhibit 3.) Overall, in terms of end-of-year asset mix, a shift toward equity and fixed-income AuM—and away from money market funds, hybrid assets, structured products, and alternative investments—was evident in 2009 compared with the previous year. This shift will have a positive impact on asset managers’ revenues going forward.

As for client segments, retail AuM—rising 14 percent to \$20.9 trillion and driven by higher equity allocations—

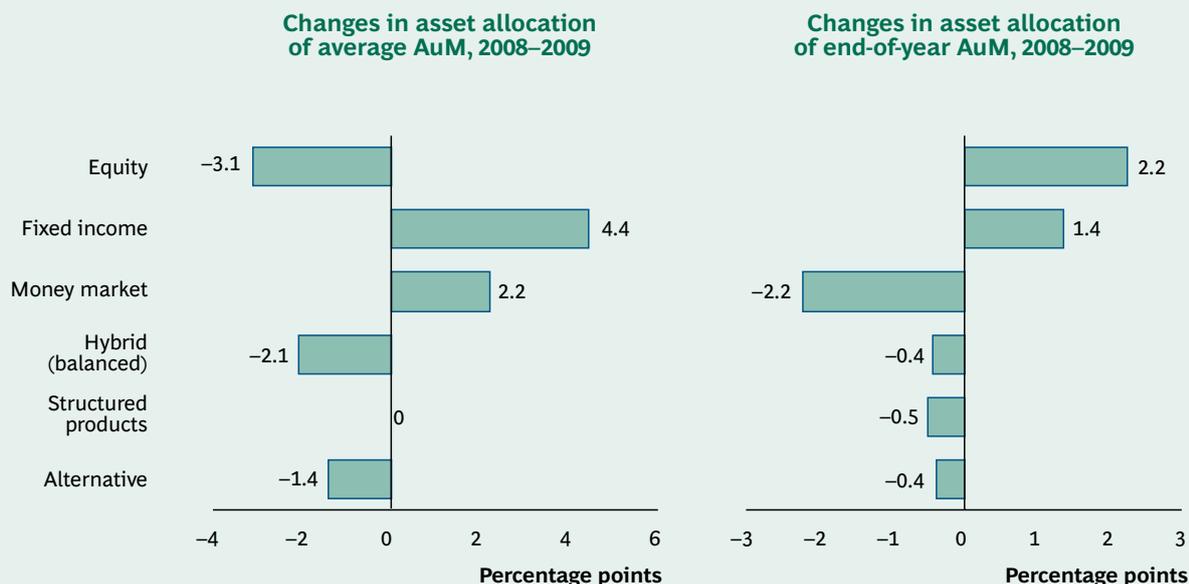
2. For all countries whose currency is not the U.S. dollar, we used the average 2009 exchange rate for all years to avoid a currency impact on growth rates.

Exhibit 2. Sales of Long-Only Assets Rebounded Globally



Source: BCG analysis.

Exhibit 3. Volatile Markets Have Led to Different Dynamics in Average and End-of-Year AuM Patterns



Source: BCG Global Asset Management Benchmarking, 2009 and 2010.

posted slightly higher growth in 2009 than institutional AuM, which rose 10 percent to \$31.7 trillion. (See Exhibit 4.) On the retail side, robust growth was seen in mutual funds and in unit-linked insurance and pension instruments (such as individual retirement accounts, or IRAs, in the United States). On the institutional side, growth was heavily supported by pension funds, which represent the largest segment globally (roughly one-third of global AuM).

Although the value of global AuM rose in 2009, average AuM and the economics of asset managers deteriorated for the second consecutive year. Indeed, average AuM fell by 4 percent, net revenues by 11 percent, and operating margins by 19 percent. Asset managers were able to reduce overall costs by an average of 7 percent in 2009. More than 80 percent of our survey participants said they were actively involved in cost-cutting initiatives.

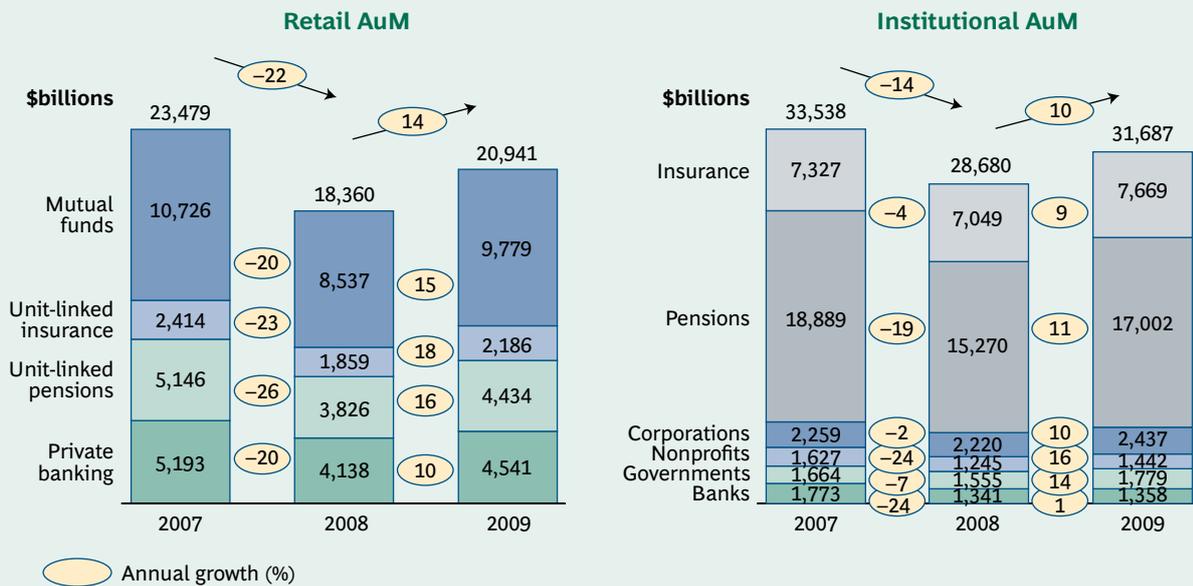
The strong decrease in revenue margins was driven mainly by product mix. This might seem illogical given the rise in equity AuM during the last three quarters of 2009. But a comparison of the *average* 2008 and 2009 mix of AuM reveals an increase in fixed-income and money market

assets at the expense of equity, balanced, and alternative assets. By contrast, despite pressure from institutions, fee levels across traditional asset classes remained constant—and in some cases increased—with a significant decline occurring only in hedge funds. Fees decreased slightly in real estate, passive equity, and institutional structured products.

Moreover, our benchmarking revealed a widening performance gap among asset managers in terms of revenues, costs, and profits. (See Exhibit 5.) In terms of absolute profit change, there were few clear winners, and many institutions saw their profits fall in 2009. The few that raised their profitability were typically those that managed to increase revenues and whose recognized product expertise has enabled them to attract very large inflows while maintaining price levels.

There was also wide variation in the ability to attract net inflows, with a few top competitors taking the lion's share. The top 20 percent of institutions in our benchmarking study attracted 88 percent of net sales in 2009—and represented only 23 percent of AuM—while 37 percent of asset managers posted outflows.

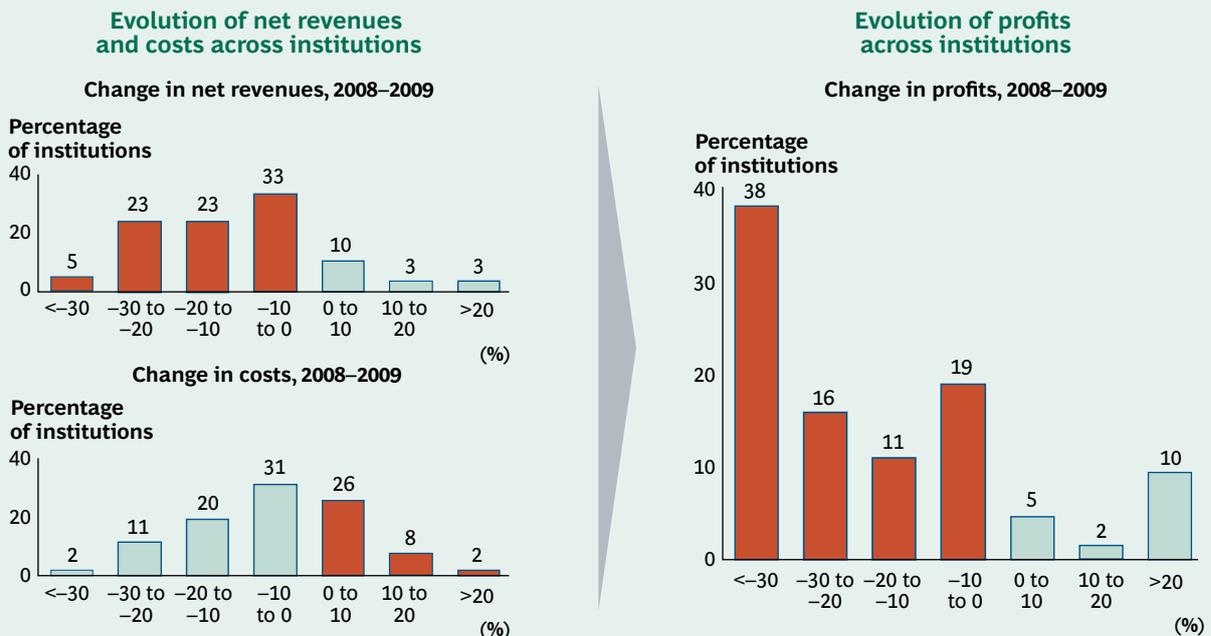
Exhibit 4. Retail AuM Grew Faster Than Institutional AuM in 2009



Source: BCG Global Asset Management Market Sizing database, 2010.

Note: For all countries whose currency is not the U.S. dollar, we applied the average 2009 exchange rate to all years. Some figures do not add up to the totals shown because of rounding.

Exhibit 5. The Performance Gap Widened Among Asset Managers in 2009



Source: BCG Global Asset Management Market Sizing database, 2010.



The Altered Playing Field in Asset Management

Expressions such as “a new playing field” and “the new normal” have been bandied about in the financial industry ever since the severity of the recent crisis first became evident. They suggest that things will never be quite the same as they were between 2003 and 2007—or in previous bull-market eras—because people now think about investing in a fundamentally different way.

In our view, there is some truth to this way of thinking. Despite the recovery of equity markets in the second half of 2009 and in early 2010—and the tendency of some investors to again relax their vigilance on risk—the playing field has indeed shifted. It may not be entirely new compared with the precrisis era, but it has been altered. This evolution is illustrated by the following trends: increasingly demanding investors, changing dynamics in products and pricing, and the continuing rise of emerging markets. Finally, although there is widespread uncertainty in the market, a positive profitability outlook for 2010 is providing some needed optimism.

The Crisis Has Made Investors Even More Demanding

The sophistication of investors and, in turn, the demands that they place on their asset managers have been growing steadily for the past decade. The financial crisis has provided momentum to this trend, as the performance of asset managers and financial advisors has come under increasing scrutiny. The exact dynamics vary somewhat between institutional and private investors.

Institutional Investors. The standards of institutional investors in selecting and evaluating asset managers are

becoming increasingly rigorous—involving lengthier, more structured reviews of investment processes, historical performance, and risk management systems. This is particularly true of pension funds—the largest segment of institutional business. Overall, institutions are keeping their asset managers on a tighter leash. They want more transparency and less discretionary style drift.

Institutions are also looking inward to improve oversight of their investments. They are seeking to improve internal risk-management practices by sharpening governance structures and raising in-house knowledge and skills. New metrics are being put in place, as are standards for truly understanding asset management offerings in the wake of well-publicized disasters involving highly complex products whose risk profiles were grasped by few. Internal investment committees are also realizing that they will have to explain their allocation decisions to stakeholders, and this fact is influencing their choices.

One consequence of these trends, as well as an accelerator of them, is the increased use of investment consultants. In a BCG survey of institutional asset managers based in Europe, conducted in December 2009, more than a third said they expected consultants’ role to increase in key markets such as the United Kingdom, Germany, and France. Nearly 50 percent forecast greater influence by consultants in the Middle East and Asia.

Private Investors. The overall picture is more diverse for private investors. But if one thing is clear, it is the need for distributors to provide a far higher level of transparency and overall professionalism. This dynamic is being driven partly by the toughening regulatory climate. Indeed, if the crisis has one positive result, it will be the

emergence of new standards for clarity on products, fees, and risk—provided the standards are instituted in a meaningful way. Of course, not all private investors have turned ultraconservative, ruling out new and alternative offerings. Sales of retail structured products, whose reputation plummeted during the crisis, are growing again in 2010. But for obvious reasons, more people feel the need to know exactly what they are buying—as opposed to unquestioningly accepting whatever their relationship manager might say, as many private investors did in precrisis times.

In addition, the regulatory decisions stemming from talks in progress around the world will eventually be felt by private investors. The jury is still out on exactly what the impact will be, as the new regulations—including those recently forged in the United States—will vary by market and region. But the new rules will certainly aim to protect

investors. (See the sidebar “In Europe, the Evolving Regulatory Climate Will Influence Asset Managers.”)

Obviously, anything that affects private investors affects the distribution channels that they use. And distributors, like investors themselves, are demanding higher-quality service from their asset managers both to increase sales and to avoid the claims of misselling that arose during the crisis. They want a range of offerings tailored to their customers’ needs in terms of both pricing and transparency. In mature, open markets, many distributors are reducing the number of asset managers that they use, raising the stakes for the latter and creating a climate of winners versus losers.

In continental Europe, where bank channels dominate, the breadth and depth of support provided by asset managers can vary significantly among institutions. In order

In Europe, the Evolving Regulatory Climate Will Influence Asset Managers

The global financial crisis has undoubtedly increased regulatory pressure on the asset management industry over the past two years. This scrutiny may increase further in the near term or could relax to some extent, largely depending on political will.

Broadly speaking, both existing and proposed regulations aim to protect investors by increasing transparency—in terms of the nature of products, their purported benefits and risks, and the fees that they carry. Greater transparency is also intended to help stimulate competition.

In Europe, both the Markets in Financial Instruments Directive (MiFID), implemented in 2006, and the fourth generation of Undertakings for Collective Investments in Transferable Securities (UCITS IV), to be implemented in mid-2011, have some of these general goals in common. MiFID has imposed restrictions on the procedures for categorizing clients and determining their suitability for different types of investments. UCITS IV will introduce mechanisms to increase cross-border competition, drive down costs, and enhance transparency.

The question, of course, is how these and other new regulations will affect the asset management industry over the next few years. MiFID supports higher-quality distribution, although ultimately a strong link between asset managers and distributors remains critical and is more important than any specific requirements that regula-

tion can bring. Indeed, the crisis has proved that despite MiFID, dialogue between distributors and investors was often insufficient.

We believe that investment advice and proposals for effective investment solutions work best when asset managers provide strong support to distributors. We therefore feel that a greater degree of open architecture, intended to separate production from distribution and, in theory, eliminate potential conflicts of interest—a key topic in ongoing regulatory discussions in continental Europe—is neither the only nor the most beneficial way to protect investors. Asset managers are often well positioned to help distributors provide investors with solid advice and solutions in a cost-efficient manner.

More comprehensive regulation, although it typically brings higher costs, can also create opportunities. For example, increased regulatory harmonization in Europe has helped make an exportable brand out of UCITS. And the regulatory climate is still evolving. Many pieces of legislation are under consideration, such as the Alternative Investment Fund Managers Directive (AIFM), another European harmonization measure. As this and other initiatives that affect various markets are debated, asset managers must remain sharply attentive and formulate workable responses to any new constraints and requirements that are put in place.

both to restore investor confidence and to regain market share against other investment products such as deposit accounts—especially at a time when many banks still have acute funding needs—all retail-network asset managers need to provide optimal support to branch staff.

The first requirement is to develop a well-targeted and simple offering—a much-discussed initiative that asset managers can no longer avoid. Branch-based salespeople are required to handle all types of banking products and cannot be expected to become asset management specialists. Also, there must be a sufficient level of value-added support. This can include training on products and sales techniques, as well as rapid access to specific sales tools and advice. Asset managers who neglect these tasks may see their share of mutual funds in captive networks diminish.

A further potential threat for captive-asset managers is liberalized distribution, although currently this risk appears to be limited. Open architecture in Europe should remain on its precrisis trajectory of very slow growth. In addition, the increasing role of independent financial advisors (IFAs) should not significantly dent the domination of the bank channel in most continental European markets—the possible exception being Italy. Overall, retail banks see limited value in pushing beyond the guided architecture structures that they have put in place, which can still rely heavily on captive funds.

In the continental European private-banking arena, we are seeing greater cooperation between the asset and wealth management sides of the fully integrated private bank. In the future, the former will likely have a clearer view on which products the latter needs to put on the shelf or include within mandates. In private banks without their own asset manager or with a large share of third-party funds, we will see a more careful selection of both asset managers and specific funds.

In mature, open markets such as the United States, growth in distribution by IFAs and brokers is being driven by investors' increasing need for personalized advice. The asset management industry's tainted image, greater awareness of investment risk, and market volatility are presenting an opportunity for channels that permit more customized service. Despite ongoing cost pressure, win-

ning models may well be those that offer managed- or guaranteed-income programs. Also, in the United States, increased focus on the IRA/rollover market will benefit those who have established close advisory relationships with clients before they retire.

Products and Pricing Are in Flux

Although the crisis has undoubtedly had an impact on product trends, the dust is still settling. A clearer picture of the post-crisis product landscape will take a while to evolve. Still, there are some developments to observe.

Actively Managed Versus Passively Managed Products. There is no doubt that passively managed products are growing more dynamically than actively managed ones. The low cost of passive funds and mandates remains appealing as the majority of active managers do not, on average, manage to beat the market consistently over time. Moreover, there is ample room for growth. In the United States, for example, only about 15 percent of institutions utilize passive products. On the retail side, increasing demand for balanced products—which derive their performance from asset allocation and risk-return profile rather than stock picking—could bolster the use of passive products.

However, in some regions (including Europe), strong growth of passive products among private investors may remain difficult to achieve because these products do not offer attractive commissions for bank and IFA distribution networks. This dynamic could be altered in some markets by regulatory initiatives. In the United Kingdom, for example, the Financial Services Authority's Retail Distribution Review law, set to take effect in 2012, will require IFAs to disclose advice fees separately from product management fees, possibly—although not necessarily—leading to growth in products with no distribution fees, such as ETFs. Regulators in some markets are even considering ways to steer more investors toward passive products.

It is also worth noting that investors can use different types of passive vehicles, such as ETFs, index mutual funds, and index mandates. Many institutional investors

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prefer index mandates because they are priced lower. But ETFs can be a sound alternative, especially for short-term bets, since setting up mandates can be time consuming. Moreover, the pricing of ETFs can be lower than it seems. For example, for large investments, it is possible to share with the asset manager revenues generated by securities lending. ETFs have the added advantage of providing daily and intraday liquidity.

Overall, despite passive management's stronger growth dynamic, there is little danger of the demise of active management—which remains critical in some client segments and channels. Actually, a large majority of institutional investors continue to favor active strategies. The use of active strategies may even pick up in the short term, as numerous institutions maintain that accepting average market performance in volatile times is, by and large, a losing strategy. Many institutions also maintain that active management is preferable in markets that do not have clear benchmarks by which to measure performance. Active management also benefits somewhat from client inertia—a circumstance that asset managers have benefited from in the past. For example, although participants in U.S. defined-contribution programs tend to apply new investment preferences to new contributions, they rarely move existing assets from one product to another.

Equities Versus Fixed-Income Vehicles. The outlook for growth in both equities and fixed-income investments remains foggy, as forecasts of interest rates, inflation, stock market performance, and the pace of economic recovery vary widely.

On the one hand, as we discussed in our 2009 report, a number of factors will make it difficult for traditional equity mandates to reclaim their historically dominant share in the portfolios of both institutional and private investors. First, there is the demographic shift. As baby boomers start to retire, many pension funds will move into assets that are less volatile than equities. Also, the relatively low equity returns of the past decade, along with the effects of the crisis, have shaken the belief that risk-adjusted returns in equities will always be superior to fixed-income returns in the long term. Further, new market regulations such as the Solvency II Directive in Europe may require financial institutions to skew their asset

holdings away from equities to some degree. True, we have seen a resurgence in equities lately, but that could be more tactical than fundamental.

On the other hand, there are also reasons for asset managers to have relatively low expectations for fixed-income business, at least in the short term. Possible defaults of government debt could make sovereign bonds the next heavily punished asset class. Also, factoring in the overall low-yield environment, fixed-income returns may not be sufficient to meet the goals of many pension funds and insurers.

The outlook for growth in both equities and fixed-income investments remains foggy.

Still, the crisis has changed the way in which the fixed-income asset class will be perceived going forward. For example, credit and high yield are now asset classes per se, and the fixed-income selection skills of asset managers are being perceived in the same light as expertise in stock selection. As has long been the case with equities, there is ample room for value-added services in fixed income—and many investors will be willing to pay for them.

Ultimately, at a time when opinions on how markets will evolve are so confusingly diverse, institutional investors seem to have returned to their historical performance expectations on the various asset classes—probably because they lack any convincing reasons to think otherwise.

Balanced Mandates and Liability-Driven Investment. Amid such uncertainty, the demand of many investors for absolute-return products with low volatility may be difficult to meet. The increasing use of balanced mandates, especially for high-net-worth individuals, is a clear response. Moreover, within balanced mandates, we are seeing a new trend toward multiasset mandates that incorporate alternative-investment classes such as real estate and commodities.

Within this context, on the institutional side, we are also seeing a greater need for solutions that are tailored to individual situations—witness the exceptional growth of liability-driven investment (LDI) strategies over the past two years. To be sure, the definition of what constitutes LDI has broadened, but it remains striking that LDI use among pension funds grew from about 20 percent in 2007 to roughly 54 percent in 2009. Looking ahead, it is unclear whether this growth dynamic will continue.

Alternative Investments. As everyone knows, real estate, hedge funds, and private equity (PE) have suffered greatly during the financial crisis. Nonetheless, the outlook for alternative investments (AI) as an asset class remains positive. For example, the amount of AuM in hedge funds at the end of 2009 was about 15 percent higher than at the end of 2008. Since the third quarter of 2009, net inflows have been positive.

Many investors, reassured by promises of a more rigorous risk-management climate, are feeling comfortable turning back to AI for diversification. Several recent surveys showed that the majority of investors would like to maintain or even increase the share of AI in their portfolios. In addition, we are likely to see an increase in new hedge-fund launches in the near term, owing partly to the level of investment talent they attract and the freedom they enjoy regarding investment strategies.

That said, certain aspects of some hedge funds, such as redemption fees and redemption gates, will likely come under increasing criticism. And tighter hedge-fund regulation will indeed happen. Investors will demand far greater transparency regarding overall strategy, risk management, trading activity, administration, and custody. Hedge funds that promise the most stability (and that deliver on that promise) will have a distinct advantage. Some are already doing so, as evidenced by the sharp rise in managed-fund platforms—given their relatively small base. Indeed, the need for more transparency will continue to provide an avenue for managed accounts.

The crisis has certainly influenced hedge fund pricing. Although top-performing funds continue to charge a 2 percent management fee plus a 20 percent performance fee, new funds are often launching at the 1.5 to 15 percent level.

As for PE, many investors want to maintain or even increase their exposure, but numerous private-equity funds are under severe pressure. One factor is that many of the companies in their portfolios are still struggling to achieve their business goals or are already in distress. Some have already defaulted. PE firms are working hard to turn portfolio companies around, and some banks are granting waivers and debt extensions in order to avoid depreciations. Moreover, the sources of value creation in PE are

shifting as raising sufficient debt becomes more challenging, competition for deals gets tighter, and the relative importance of operational value creation within PE funds—improving sales and margins—rises. There will likely be a shakeout in the PE space, with many funds disappearing as investors (such as pension funds and endowments) become increasingly sophisticated regarding their PE allocations and as funding generally becomes more difficult.

Prices for asset managers are under pressure, to a degree that varies with asset class.

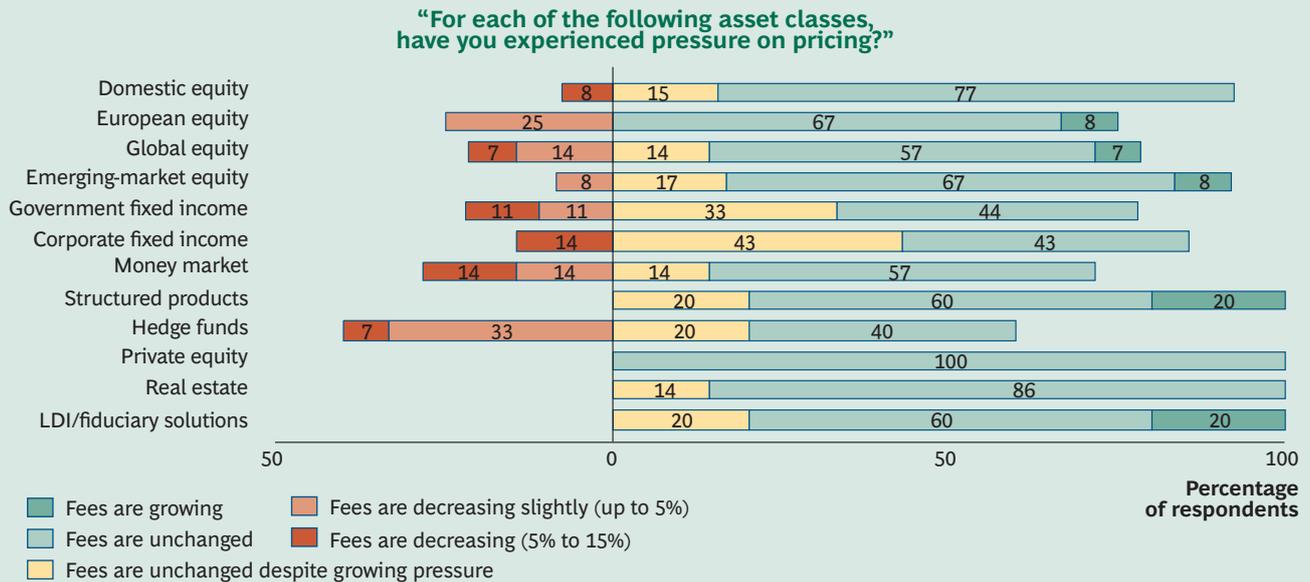
Pricing. As in the entire banking and financial industry, prices for asset managers are under pressure, to a degree that varies with asset class. Also, in the wake of the financial crisis, some investors expect new pricing structures from their asset managers.

According to a survey of institutional asset managers we conducted in December 2009, pricing pressure is considerable, with investors becoming pickier about the prices they are willing to pay. (See Exhibit 6.)

It is important to note, however, that for many institutional and private investors, prices and fees on actively managed funds are not typically the key decision criteria. Consequently, many leading asset managers have been able to resist downward price pressure. According to our survey, less than 25 percent of institutional asset managers in Europe have suffered price declines in core asset classes such as equity and fixed income, although money market and hedge funds have been more severely hit. However, according to our benchmarking, fees across asset classes have maintained their levels or even increased, with the exception of hedge funds and, to a lesser degree, real estate, passive equity, and institutional structured products. Margin declines have stemmed from product shifts, which will work in asset managers' favor in 2010. A key point is that clients are not necessarily looking for lower prices as such but for better pricing structures and sharing of value. As a result, we believe that pricing structures will grow more complex.

Today, taking all industry dynamics into consideration—including increasingly demanding investors and shifting product and pricing trends—we seem to have returned to the historical pattern of traditional, actively managed products being squeezed by the incursion of passive and alternative offerings. This picture changed somewhat in 2009 for the first time, with alternative products going through more restructuring than other asset classes. But

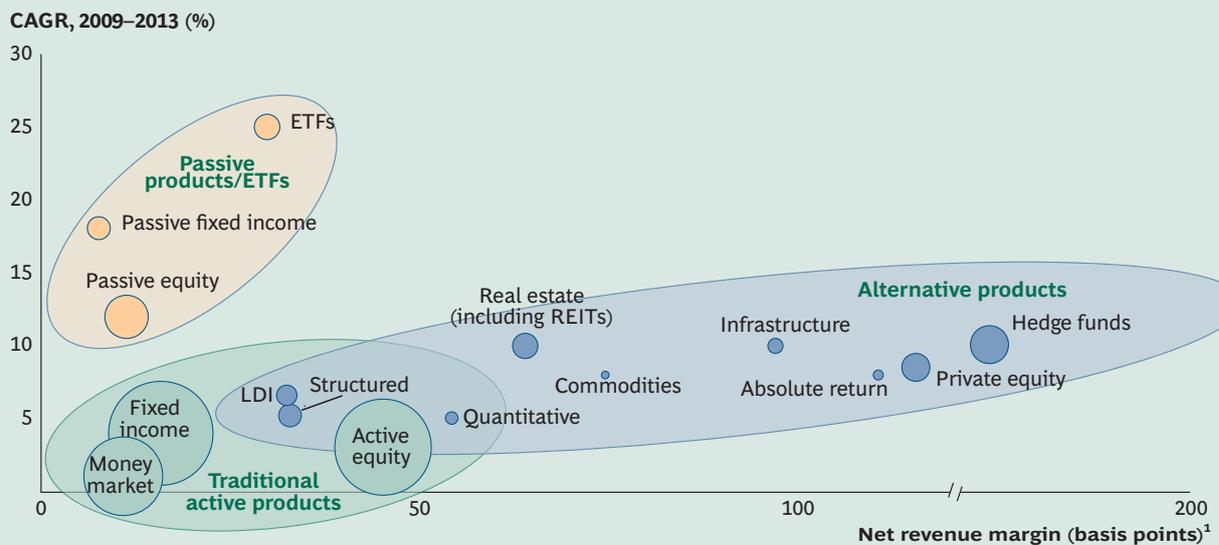
Exhibit 6. Investors Are Becoming Pickier on Pricing



Sources: BCG Institutional Investor survey, 2009; BCG analysis.

Note: The survey sample comprised 23 respondents with total AuM of \$2.8 trillion; the sample was biased toward Nordic players and away from U.K. players. Some percentages do not add up to 100 because of rounding.

Exhibit 7. Alternative and Passive Products Are Expected to Keep Growing Faster Than Traditional Active Products



Legend: ● Traditional active ● Passive ● Alternative ○ Estimated size, 2009 (\$trillions) Scale = \$1 trillion

Source: BCG analysis.

Note: This analysis assumes a conservative scenario of 5 percent annual growth of equity markets.

¹Management fees net of distribution costs.

with this evolution now well under way, precrisis product trends are apparently returning. (See Exhibit 7.)

Emerging Markets Will Continue to Gain Prominence

Between 2002 and 2009, AuM grew annually by 25 percent in Asia (excluding Japan and Australia), 20 percent in Latin America, and 10 percent in the Middle East and South Africa. These rates compared with 6 percent in North America, 7 percent in Europe, and 8 percent in Japan and Australia. The trend of AuM growth rates in developing markets overshadowing those in developed markets shows no signs of slowing down.³

In our view, emerging markets' share of global AuM and revenue pools will remain relatively constant over the next few years. More important, these markets will likely

represent more than 25 percent of net sales between 2010 and 2014. (See Exhibit 8.)

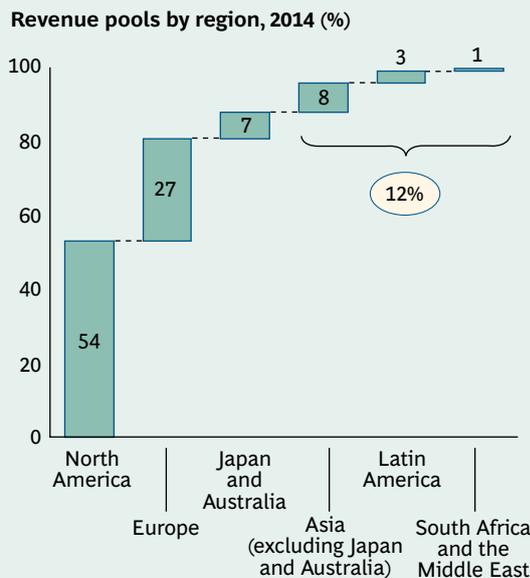
The forces behind this dynamic are clear. First, the level of both economic growth and wealth creation in developing markets continues to surpass that in mature markets—albeit starting from a much lower base. Second, demographics are a factor. With their relatively young populations, numerous emerging markets will benefit from substantial inflows into pension systems in the coming years.

Moreover, the penetration of asset management products in many emerging markets is poised to rise in step with

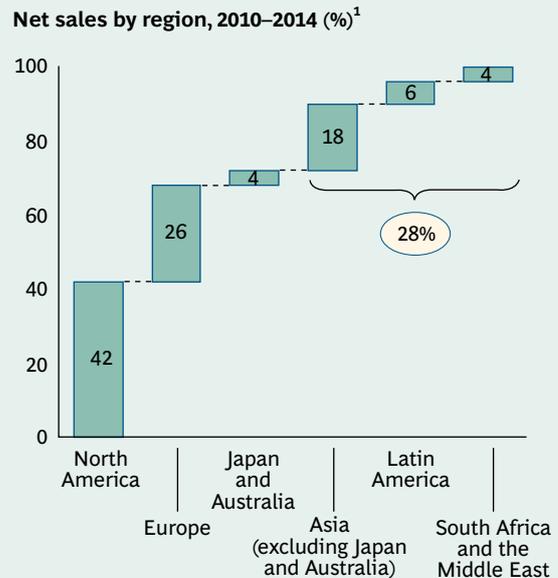
3. The developed markets are North America, Western Europe, Japan, and Australia. The developing markets are Latin America, Eastern Europe, South Africa and the Middle East, and all Asian countries except Japan and Australia.

Exhibit 8. Emerging Markets Will Likely Capture More Than 25 Percent of Net Sales Between 2010 and 2014

Distribution of global revenue pools, 2014



Distribution of net sales, 2010–2014



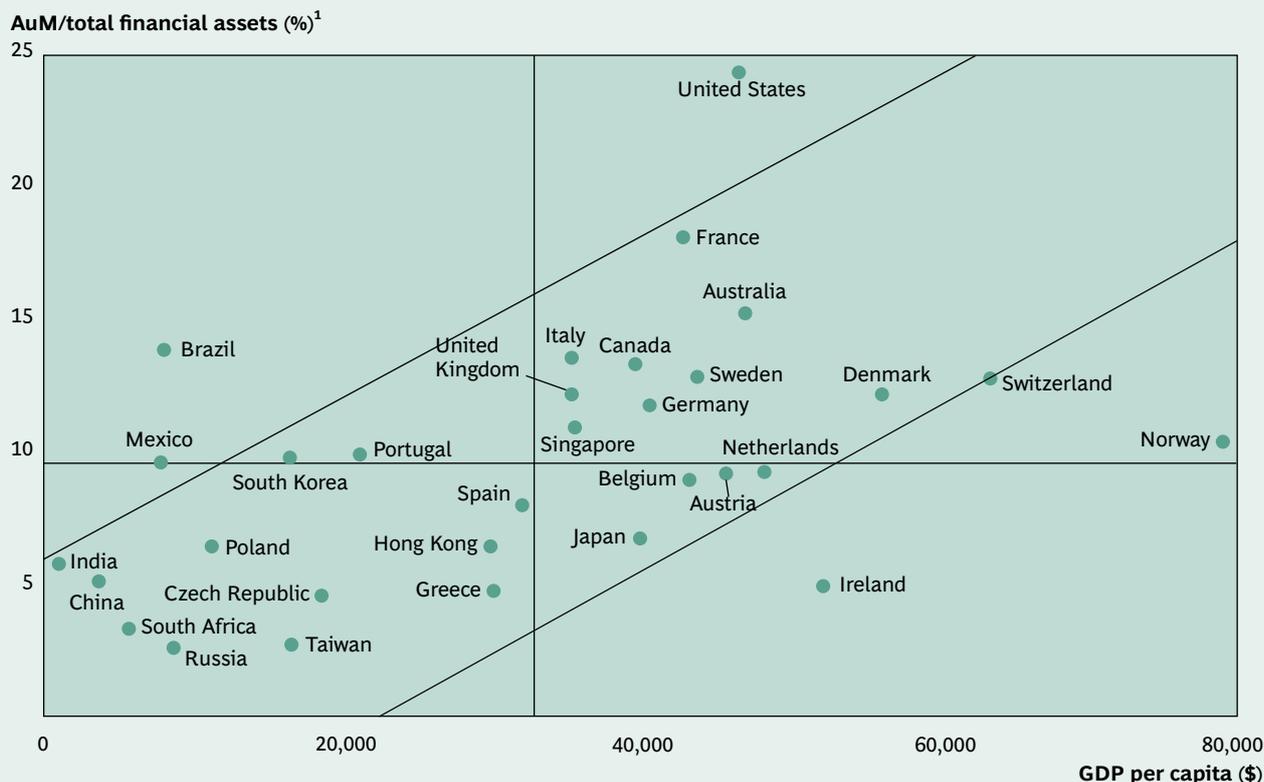
Sources: BCG Global Asset Management Market Sizing database, 2010; Cerulli; BCG analysis.

Note: North America = Canada and the United States; Europe = Austria, Belgium, the Czech Republic, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Poland, Portugal, Russia, Spain, Sweden, Switzerland, and the United Kingdom; Asia = China, Hong Kong, India, Singapore, South Korea, and Taiwan; Latin America = Brazil and Mexico. For all countries whose currency is not the U.S. dollar, we applied the average 2009 exchange rate to all years.

¹Assumes the following average net-inflow rates: North America and Europe, 2 percent; Japan and Australia, 1 percent; Asia (excluding Japan and Australia), 8 percent; Latin America, 7.5 percent; South Africa and the Middle East, 6.5 percent.

Exhibit 9. As GDP Per Capita Grows, So Do Managed Assets

AuM as a percentage of total financial assets versus GDP per capita, 2009



Sources: Economist Intelligence Unit; BCG Asset Management Market Sizing database, 2010; BCG analysis.

¹Country financial assets are not fully cleaned of offshore assets, and offshore assets are not included in managed assets, affecting Ireland, Switzerland, and the United Kingdom, in particular.

the creation of new investable assets. This will likely occur most rapidly in countries where levels of both managed assets and GDP per capita are still relatively low—such as China, India, and Mexico. (See Exhibit 9.)

Indeed, the question of how to grow globally—and the attractiveness of developing markets—is a recurring theme in our conversations with asset managers. While many institutions recognize the potential of these markets, they are also rightfully concerned about managing the risks involved, retaining their own corporate and investment cultures, and coping with unfamiliar regulatory constraints. A key issue in their minds is whether in the long term they can afford *not* to be in countries such as India and China.

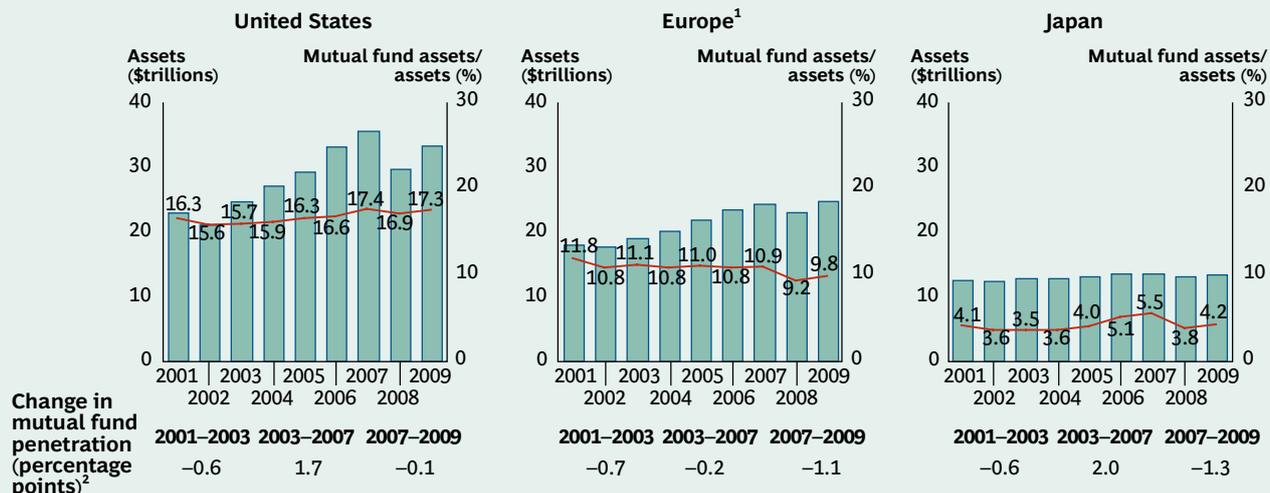
When it comes to mature markets, the fallout from the financial crisis will likely lead to a relatively slow-growth

environment for many years to come. The result will be less wealth accumulation than we witnessed in the years just before the crisis. Simply put, the negative effects of the crisis will continue to linger, although they will affect some regions more than others. Indeed, mutual funds—which took an even more severe hit following the dot-com bust of the late 1990s—have already lost some of their luster in Europe. Other regions, such as the United States, are faring better. (See Exhibit 10.)

Another factor in mature markets is the gradual retirement of the postwar baby-boom generation. People born in 1945 are turning 65 in 2010. As waves of baby boomers gradually leave the workforce, inflows into pension funds will diminish. In the United Kingdom and in some Nordic countries, we are already seeing more outflows from defined-benefit pension funds than inflows. In the United States, defined-contribution plans have seen negative in-

Exhibit 10. Retail Mutual Funds Have Fared Differently by Region

Household financial assets, 2001–2009



Sources: National statistics; BCG analysis.

Note: Assets are private-household financial assets, such as cash deposits, money market funds, listed securities held directly or indirectly through managed investments, life insurance, and pension assets. Average 2009 exchange rate applied to all years for Europe and Japan.

¹Europe = France, Germany, Italy, Switzerland, and the United Kingdom.

²Mutual fund assets divided by the total financial assets of private households.

flows since 2007, influenced by heavy rollovers into IRA accounts. Ultimately, AuM growth rates in developed markets are likely to slide considerably. (See the sidebar “In the United States and Continental Europe, Different Dynamics Prevail in the Retirement Market.”)

Amid Much Uncertainty, Room for Optimism

Trends such as increasingly demanding investors, changing dynamics in products and pricing, and the continuing rise of emerging markets are influencing the ways in which asset managers forge their strategies for the future. Since the postcrisis era will also be characterized by slower growth, efforts to rebuild client trust, and a widening performance gap across institutions, a great deal of uncertainty is in the air. But there is room for optimism. For one thing, overall industry profitability will improve in 2010. Given higher anticipated AuM levels and a better expected product mix than in 2009, average profit margins may rebound to as much as 35 percent of net revenues—compared with about 31 percent in 2009, 34 percent in 2008, and the historic peak of 40 percent in 2006

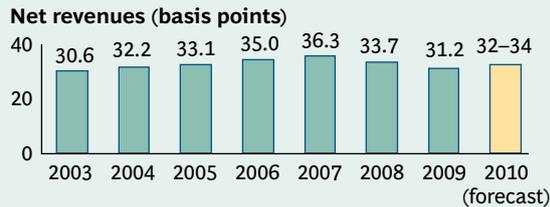
(for institutions that participated in our benchmarking). (See Exhibit 11.)

Of course, widespread uncertainty will also lead to more speculation regarding potential mergers and acquisitions (M&A) in the industry. In 2009, the number of deals again declined, although a record amount of AuM was transacted. (See Exhibit 12.) There were 146 M&A deals in 2009 worth a total of \$4 trillion—more than half of which was associated with BlackRock’s acquisition of Barclays Global Investors and with the creation of Amundi from the merger of the fund units of Crédit Agricole and Société Générale. This compared with 219 deals valued at \$2 trillion in 2008 and 243 deals valued at \$2 trillion in 2007. Thus far in 2010, M&A activity has been extremely sparse.

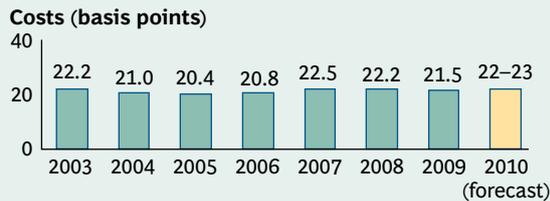
There were diverse strategic rationales for the M&A moves that occurred in 2009, including the desire for scale advantages in certain parts of the value chain, the addition of specific new products or expertise, and expansion into new regions. In some cases, deals were made in order for asset-manager parent firms hit hard by the crisis to obtain new capital and focus on core activities.

Exhibit 11. Industry Profitability Will Likely Improve in 2010

Net revenues will benefit from a more favorable product mix



Most asset managers plan to raise costs in 2010



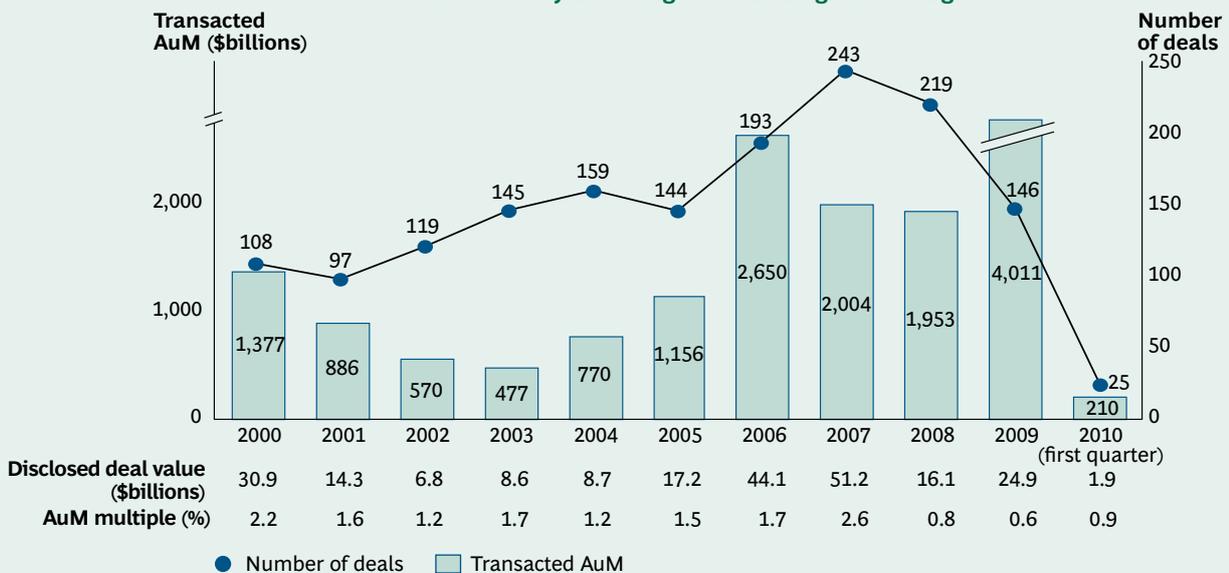
Profit margins should rebound in 2010



Source: BCG Global Asset Management Benchmarking, 2010.

Exhibit 12. Despite a Record Amount of AuM Transacted in 2009, the Number of M&A Deals Keeps Declining

Transaction activity involving asset management targets



Sources: Jefferies Putnam Lovell; BCG analysis.

Note: Includes minority transactions, recapitalizations, and IPOs.

In the United States and Continental Europe, Different Dynamics Prevail in the Retirement Market

Providing for retirement is one of the foremost goals of most investors. But longstanding cultural differences have led to varying approaches among regions. These differences, although they are narrowing in some ways, still exist today and have meaningful implications for asset managers.

The United States. The U.S. retirement market holds considerable opportunity for asset managers. But following the crisis, only those institutions that forge the most compelling strategies and execute them crisply will prevail.

At the end of 2009, the total retirement market accounted for about \$14.8 trillion in AuM. Growth of 6 to 7 percent annually is forecast through 2014, in line with the average growth forecast for the U.S. asset-management market overall. Several factors are driving this growth.

First, amid an extremely uncertain economic outlook and high unemployment, Americans are feeling an increased urgency to save for retirement. (Indeed, the effects of the crisis have delayed retirement for many.) And although the first wave of the baby-boom generation is now beginning to leave the workforce, only a relatively small percentage has fully crossed over from asset accumulation to asset “decumulation” mode.

Second, workforce participation in retirement plans continues to rise, having increased from 75 percent in 2005 to 81 percent in 2009. Also, many employers that have withheld matching pension contributions will likely resume contributions, providing a needed lift. Pension Protection Act legislation is continuing to gain traction.

The U.S. retirement market consists of three major segments. The corporate defined-contribution (DC) market, with \$3.1 trillion in AuM in 2009, is forecast to grow annually at about 7 percent in the near term. The IRA market, with \$4.4 trillion in AuM, is growing at about 9 percent annually, driven by a strong flow of rollovers from DC plans (due to demographic shifts). An estimated \$300 billion will roll over in 2010.

The remainder of the market, consisting of corporate defined-benefit (DB) plans and public DC plans, are less promising for asset managers, as sponsors continue to move away from or freeze DB plans and the crisis continues to strain the funding status of public DC plans.

Winning in the U.S. retirement market will require a careful strategy. Plan sponsors have become far more price sensitive given market volatility and increasing intermediation by pension consultants. Demands for greater fee transparency are becoming more strident. Trends such as these are favoring the use of passive products—particularly in DC plans, which historically have not used them extensively. Bundle providers remain the largest portion of the DC market, but asset managers should think twice before they consider moving in that direction. Investment-only providers, with about 50 percent of DC assets, continue to gain share.

Overall, asset managers in the U.S. retirement market should focus on the following core initiatives:

- ◇ *Reevaluate market priorities.* Asset managers should shed products, segments, and markets in which they are not truly competitive. They should also review M&A opportunities in priority markets.
- ◇ *Stay close to your clients' thinking.* Despite increasing interest in retirement-income solutions, no one has yet cracked the code. Plan sponsors are still dipping their toes in the water when it comes to providing these solutions inside DC plans. Asset managers need to stay on top of this issue as it develops.
- ◇ *Focus on client retention in rollover events.* Perhaps the most critical issue for asset managers in the U.S. retirement space is how to retain assets that move from a DB or DC plan to an IRA. Demographic shifts and corresponding asset flows will only raise the stakes. Asset managers must deliver a compelling, differentiated, and unique value proposition in each of the DC and rollover markets in order to stand out in a crowded field.
- ◇ *Develop a clearly defined and differentiated investment offering.* This will be critical to success in winning DB mandates, attracting assets on DC platforms, and retaining and attracting IRA assets through advisors.
- ◇ *Maintain cost discipline.* Many asset managers have succeeded in cutting some costs, but the postcrisis era will likely require even more discipline.
- ◇ *Rethink operating models.* This will be necessary in order to better support cost reduction and client retention objectives.

Continental Europe. The traditional reliance on state-sponsored retirement schemes in continental Europe has been softening for many years as supplementary private plans increasingly come to the fore—to the benefit of asset managers. Nonetheless, it has become apparent in recent years that existing asset-management products in Europe do not, in general, have time horizons long enough to generate the level of return that will be needed for waves of future retirees. This mismatch needs to be addressed.

Indeed, many national retirement schemes are forecasting substantial deficits in the 2030 to 2040 time frame. Unfunded liabilities in EU member states—the difference between the projected cost of government social policies and net expected tax revenues—currently reach an average of 434 percent of GDP. And with new regula-

tory measures aimed at limiting risk having the potential to limit returns as well, asset managers in Europe have both a financial and a social opportunity. By creating products with long-term time horizons and educating investors about their importance, asset managers can help reduce dependence on state schemes and help investors plan for retirement more effectively. At the same time, they can enhance their own revenue streams.

Obviously, asset managers will not be able to solve the problem of state pension deficits on their own. But they have a distinct role to play. Those that develop the skills needed to manage assets over the long term—20 to 30 years—and that formulate creative solutions and market them effectively will benefit substantially.

Indeed, some of the year's M&A events might not have happened under calmer market conditions.

The question of the moment is whether or not current circumstances favor a new wave of intensified consolidation. On the one hand, overcapacity and margin pressure in the industry—along with the fact that distributors are streamlining their shelves and number of providers—would bolster the case for increasing consolidation. On the other hand, many asset managers are owned by banks, insurance companies, and other organizations that are in no hurry to divest unless they come under duress themselves.

Taking everything into consideration, we believe that industry consolidation will continue but at a slow to mod-

erate pace. There may be some excellent opportunities for asset managers looking to beef up their capabilities in specific ways. Among the challenges is the fact that the prices of many attractive properties have returned to 2007 levels of valuation, making value creation from acquisitions difficult to achieve. And less attractive properties, often on the wrong side of product trends, simply aren't worth buying.

Ultimately, of course, there are any number of possible responses to the dynamics affecting the global asset-management industry. The key to success in the postcrisis era will be to get a firm grip on short- and long-term goals, assess in-house resources and capabilities, and, as always, take the actions necessary to achieve your objectives.



Actions for Asset Managers

A sset managers of diverse specialties, sizes, and geographic footprints will consider myriad ways to grow and become more profitable. But in our view, several actions should be considered by all institutions regardless of their specific circumstances. Asset managers must sharpen their business models, determine their global aspirations, and explore M&A.

Sharpen Business Models

Despite the degree of economic recovery that occurred in 2009—and that has continued into 2010—the asset management industry has a different mindset today than in the heady precrisis days. One trend is the widening performance gap across institutions—a pattern that will likely continue, clearly demonstrating the importance of differentiating oneself from the competition. Yet as investor needs become more sophisticated, this task is becoming more difficult.

Compounding the situation is the fact that, following cost-cutting initiatives carried out over the past two years, asset managers have fewer resources at their disposal. This means that they must sharpen their business models, making bolder choices regarding products, target markets, and distribution.

To be sure, the business models of asset managers have long been growing more distinct depending on the business mix. For instance, because of the varying requirements of investors, retail and institutional businesses have evolved into completely different strategic segments. Many large asset managers have split their front-office organizations accordingly—even if some support or opera-

tional services can still be shared. Moreover, further segmentation within retail and institutional businesses—such as separating captive from third-party distributors or institutions, or creating separate investment and distribution organizations for specific channels that have distinct needs (such as insurance companies)—can add value.

Business mix will obviously be a major factor in determining the direction that asset managers should take in sharpening their business models. For example, captive-asset managers belonging to retail banks should concede on the hunt for “alpha,” focusing instead on the interface with their captive channel. What matters most for this type of institution is having a complete yet simple offering that provides decent performance for investors and optimal support to branch networks. Branch-based salespeople need to rely on a small number of products that will meet the needs of most retail client segments. And since branch advisors are rarely fund experts, they often need mentoring from their captive providers to bolster sales and market share.

By contrast, the key success factor for institutional asset managers is strong investment performance backed up by equally strong service. As one executive told us, “We get mandates on performance and keep them thanks to service.” Top service is typically a function of these characteristics:

- ◇ Overall expertise level of the sales force
- ◇ Degree of access to product experts
- ◇ Solution capabilities (particularly the ability to advise on asset allocation and be a thought partner on specific research areas)

- ◇ Quality of risk management
- ◇ Depth and quality of reporting
- ◇ Ability to access detailed information rapidly in response to ad hoc questions

Few institutional asset managers are able to stand out in all areas, so it is critical to offer the highest possible service level to top-priority clients, while providing a more industrialized approach to others. On the product side, the greatest focus should be on areas where the most differentiation is possible. Some institutional asset managers benefit from concentrating on specific types of clients with special needs.

Third-party-distributor business models lie somewhere in between retail captive-asset managers and institutional-oriented players. These asset managers, apart from a few giants, need to refocus—concentrating their efforts on where they can differentiate themselves in terms of performance and investment approach. A key challenge is the ability to ride out fundamental product shifts when particular offerings fall out of favor. Such institutions should also consider providing a high level of service to all channels—by offering specific sales tools based on proprietary research, for example, or by customizing products for specific channels. On the risk management side, they can take a more industrialized approach, since they will not need to provide as much transparency and detailed information.

Determine Global Aspirations

Virtually all asset managers seek growth opportunities. And of course, for every story of a successful move across borders, there are numerous tales with less than happy endings. The question is how asset managers can best prepare and position themselves for growth in new markets.

As a practical first step in potentially expanding abroad, asset managers must assess and fortify their positions in their home market—recognizing that foreign competitors may themselves be looking to expand across borders. Second, they need to take an honest look at their own resources—both strengths and weaknesses—and deter-

mine which new markets are most attractive given their particular skill set, as well as the competitive and regulatory environment in target markets.

Currently, in the wake of the financial crisis, emerging markets are expected to grow much faster and offer higher operating profits to asset managers—and therefore attract new entrants. China, India, Brazil, and the Middle East present the greatest growth possibilities.

When moving into emerging markets, asset managers must review all potential opportunities and evaluate them against their own growth objectives and starting point. They must select the optimal entry path—organic, a local partnership, M&A, or some combination of these. They must interface well with regulators, successfully choose and manage any joint-venture partners, and above all understand the core capabilities needed in the local target market—as these requirements will likely be different from those in their home market.

Broadly speaking, expansion from developing into developed markets will offer a higher absolute-growth opportunity but growth rates and operating margins will be lower. Conversely, expansion from developed into developing markets will offer less absolute growth but will help move the overall portfolio onto a better growth trajectory.

Finally, asset managers seeking success in new markets must keep in mind the importance of meticulously thinking through the design of their overall organization and operating model, of ensuring that their institution’s core culture and values are transported efficiently, and of developing robust and integrated risk management. It is also essential to consider the real human cost of travel and working across multiple time zones.

Explore M&A

M&A that are well thought out and well executed can still add value in the asset management industry. In some cases, they can contribute mightily to achieving competitive advantage. Potential good fits should therefore always be part of senior management’s thinking regarding growth options. But any deal must be sound strategically, culturally, and financially.

M&A that are well thought out and well executed can still add value in the asset management industry.

Many opportunities exist in today’s asset-management landscape. Some large financial institutions may still be interested in divesting their asset-management divisions in order both to gain access to fresh capital and to refocus on core activities. Some smaller competitors are looking to fill gaps in their products, geographic reach, and overall expertise. Asset management remains a “people” business, and a small number of talented professionals at any one institution can make a huge difference in achieving competitive advantage.

Of course, cost rationalization is typically a key objective in any M&A deal. And despite the inherent complexity of the post-merger integration (PMI) process, significant synergies can certainly be achieved. For example, in recent deals involving two institutions of significant size, cost synergies typically represented between 10 and 20 percent of the overall cost base. In cases where the target company is significantly smaller than the acquirer, synergies can reach up to two-thirds of the former’s costs. The key, of course, is to reach new cost goals without compromising revenues and service levels. At the same time, the new entity must eliminate redundant tasks and retain the best people from each side of the deal.

In continental Europe, where regulators are pushing for a higher degree of open architecture, approval for domestic consolidation may be somewhat difficult to obtain. These circumstances may require expansion-minded institutions to look abroad. However, the typical benefits of domestic M&A—which is often a cost-synergy game aimed at eliminating redundancies—are different from those of cross-border M&A, which is often more of a revenue-driven move.

Ultimately, mergers in the asset management business cannot help but be extremely complicated endeavors. In our client work, we have identified some key rules for PMI success.

- ◇ *Limit the people involved in premerger work groups* to executives and senior managers, while keeping most operational managers focused on business-as-usual activities
- ◇ *Allocate senior-management time* so that senior teams can maintain the level of attention and bandwidth re-

quired to make quick decisions regarding ongoing business matters

- ◇ *Evaluate human resources for key positions* as early as possible, identify target positions for specific individuals, and mobilize these people to build a new business strategy and organization structure
- ◇ *Begin constructing the target organization* with the future senior-management team as early as possible
- ◇ *Dedicate sufficient time and resources to regulatory issues* linked to the merger, such as industry regulation, antitrust matters, and communications with institutional clients
- ◇ *Ensure alignment of key messages about the deal* between the two merging entities, while also maintaining the appropriate Chinese Wall regarding confidential information during the premerger phase
- ◇ *Mobilize top executives immediately after the merger announcement* to explain to clients and investment consultants the rationale behind the deal and the positive impact it will have on existing and prospective clients
- ◇ *Communicate, communicate, communicate* with all stakeholders on an ongoing basis in order to build and maintain momentum for the merger

Despite promising profit trends, asset managers will have to keep a stern eye on costs.

Taking the long view, we offer the following concluding thoughts. Major financial upheavals such as the one we have witnessed over the past 24 to 36 months—dire as they may seem for a time—present opportunities, not just threats, to asset managers that develop the most robust business models and the most creative strategies. Obviously, the environment is still highly uncertain. Despite promising profit trends, asset managers will have to keep a stern eye on costs as they move forward. But in times such as these, the best institutions seize the moment. In search of stable growth, they may find substantial growth.



For Further Reading

The Boston Consulting Group publishes other reports and articles that may be of interest to senior financial executives. Recent examples include:

Crisis as Opportunity: Global Corporate Banking 2010

A report by The Boston Consulting Group, June 2010

Regaining Lost Ground: Global Wealth 2010

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Life Insurance in Asia: New Realities and Emerging Opportunities

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Value Creation in Insurance: Laying a Foundation for Successful M&A

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Note to the Reader

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