

GLOBAL ASSET MANAGEMENT 2014

STEERING THE COURSE TO GROWTH



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INTRODUCTION

GLOBAL ASSET MANAGEMENT 2014: *Steering the Course to Growth* is The Boston Consulting Group's twelfth annual worldwide study of the asset management industry. Our research found that asset managers in 2013 finally recorded their second consecutive—and strongest—year of solid growth since before the crisis. Global assets under management rose to record levels, profits were strong, and net new flows made solid gains.

The results reflected the expansion of a real recovery from the year before, when the industry finally returned to growth after four years of inertia, as we noted in *Global Asset Management 2013: Capitalizing on the Recovery*. This was the case particularly in most developed markets, where asset growth gathered speed even as growth slowed in many emerging markets.

Yet, as this year's report makes clear, now is not the time for complacency. Asset growth continues to be largely the result of rising equity prices on global financial markets. Net flows remain a modest part of total growth, and most of those new flows go to specialists, solution providers, and nontraditional asset managers. The global profit pool remains under pressure, while net revenues lag below the peaks achieved before the financial crisis.

As traditional actively managed core assets remain vulnerable to the market's evolution, the future for all types of managers looks increasingly complex, costly, and constrained by waves of regulation. Managers need a long-term strategy that anticipates those changes.

For all these reasons, developing the right target operating model is crucial for steering a course to profitable growth, as we discuss in the second half of this report.

A target operating model—beyond boosting efficiency—can provide the blueprint that managers need to unlock cash and free management attention for product innovation, entry into new asset classes, and development of client relationships. We believe it is a key to flexibility, scalability, and profitable growth.

This report, like its predecessors, is the product of comprehensive market-sizing research. We covered 43 major country markets (representing more than 98 percent of the global asset-management market) and focused exclusively on assets that are professionally managed for a fee. We also analyzed the external forces shaping the fortunes of asset management institutions worldwide.

In addition, this report includes insights drawn from a 2014 benchmarking study of more than 120 leading asset managers—representing 53 percent of global AuM. Our aim was to collect data on fees, products, distribution channels, operating systems, and costs in order to gain insights into the current state of the industry and its underlying drivers of profitability.

More than a decade after BCG's first annual Global Asset Management report, the breadth of our market-sizing research and benchmarking studies has expanded. The goals of the report, however, remain steadfast: to probe beneath the surface of the market's evolution, identify trends, and provide insights that help managers build strong and prosperous paths to the future.

A SNAPSHOT OF THE INDUSTRY

THE ASSET MANAGEMENT INDUSTRY has achieved its strongest year of growth since the onset of the financial crisis. For the second consecutive year, in 2013, the value of professionally managed assets rose to a record high. Net asset flows recorded their strongest postcrisis gains—also for the second year in a row. Industry profits surged to \$93 billion, and profits as a percentage of revenues made gains.

Managed Assets Rise to a Record \$68.7 Trillion

Total assets under management (AuM) increased 13 percent to a record \$68.7 trillion in 2013, after rising 11 percent to \$60.9 trillion in 2012. By comparison, AuM stood at \$54.7 trillion in 2007, the year before the financial crisis began. (See Exhibit 1.)

That said, most AuM growth in 2013 represented increased asset values produced by the global surge in equity markets, rather than new asset flows. Still, new asset flows recorded their strongest postcrisis gains for the second year in a row. They increased to 1.6 percent of prior-year AuM, up from 1.2 percent in 2012. By comparison, precrisis gains ranged from 3 to 6 percent. Net flows in 2013 were driven foremost by retail investors' revived interest in rising equity markets, as well as by the continued resilience of institutional investors. Retail net flows averaged

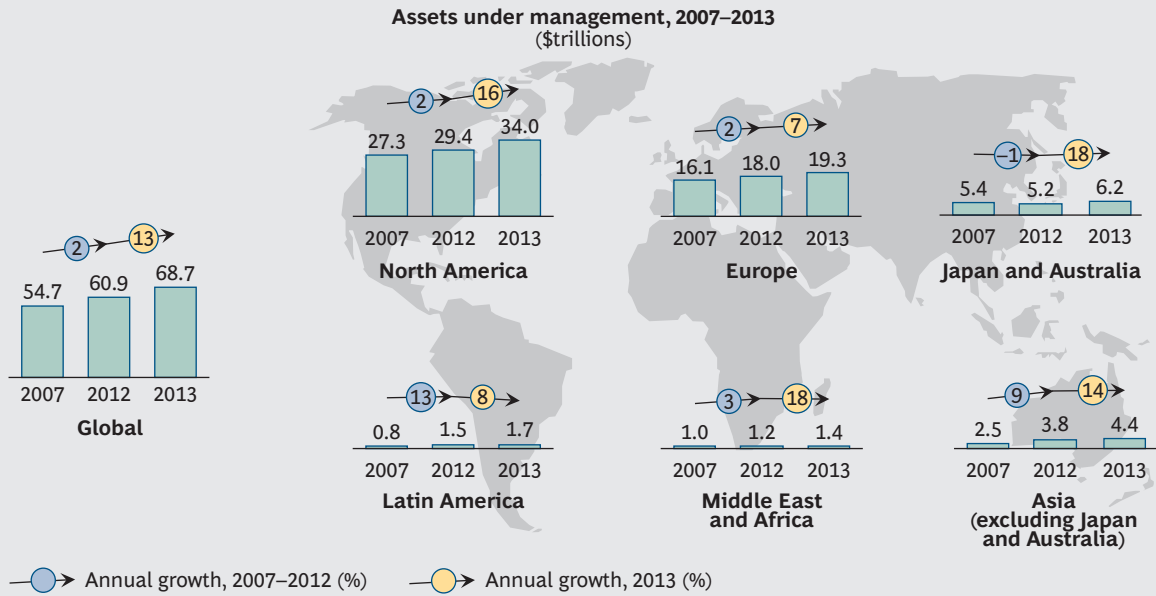
2.5 percent of AuM, and institutional flows reached 0.9 percent, compared with 1.8 percent and 0.8 percent, respectively, the year before.

Asset management continues to rank among the most profitable industries.

Asset management continues to rank among the most profitable industries. Operating margins, or profits as a percentage of net revenues, grew from 37 percent in 2012 to 39 percent, approaching the precrisis high of 41 percent, as costs grew less quickly than revenues. Indeed, in basis points—or on an asset-adjusted basis—net revenues remained relatively flat and below their peak while costs decreased from 18.5 basis points to 17.9 basis points. (See Exhibit 2.)

Profits in absolute terms grew to \$93 billion in 2013, a 17 percent rise from \$79 billion the year before. Despite this advance, the global profit pool still lagged about 7 percent behind its historic peak, before the crisis. Revenues have grown more slowly than assets, the victim of lower-than-historic revenue margins due to the shift away from higher-margin products and increased price pressure in some

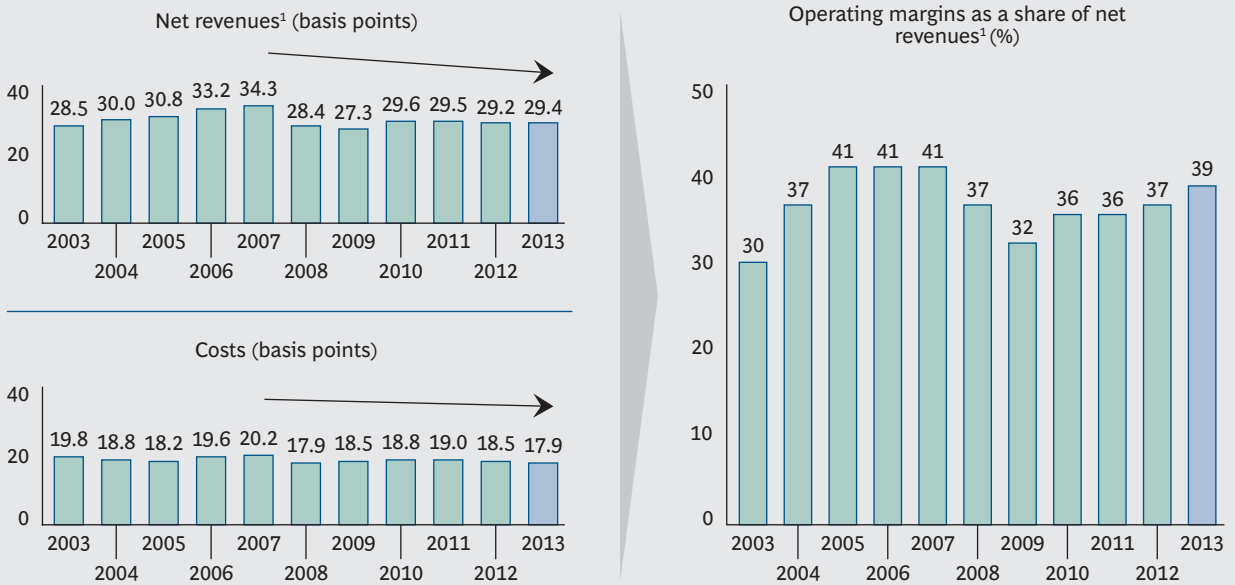
EXHIBIT 1 | Global Assets Under Management Grew to a Record \$68.7 Trillion in 2013



Source: BCG Global Asset Management Market Sizing Database, 2014.

Note: Sizing corresponds to assets under management (AuM) sourced from each region and professionally managed in exchange for a fee. AuM includes captive AuM of insurance groups or pension funds if those assets are delegated to asset management entities with fees paid. Forty-three markets were covered globally, including offshore AuM. North America = Canada and the United States; Europe = Austria, Belgium, the Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Italy, Luxembourg, the Netherlands, Norway, Poland, Portugal, Russia, Spain, Sweden, Switzerland, Turkey, and the United Kingdom; Asia = China, Hong Kong, India, Indonesia, Malaysia, Singapore, South Korea, Taiwan, and Thailand; Middle East and Africa = selected sovereign-wealth funds of the region, Morocco, and South Africa; Latin America = Argentina, Brazil, Chile, Colombia, and Mexico. For all countries whose currency is not the U.S. dollar, we applied the average 2013 exchange rate to all years. AuM numbers differ from those in last year's report mainly as a result of differences in the exchange rates and also because of revisions in country data. Any apparent discrepancies in growth rates are due to rounding.

EXHIBIT 2 | Asset Managers' Profitability Rose, but Net Revenues Remained Flat and Below Their Precrisis Peak



Managers are now focusing more tightly on costs

Source: BCG Global Asset Management Benchmarking Database, 2014.

Note: Based on our benchmarking sample.

¹Management fees net of distribution costs.

product categories. Since the crisis, costs have risen faster than revenues. Revenues were 2 percent higher in 2013 than in 2007, but costs were 6 percent higher. (See Exhibit 3.)

The “Two Speed World” Shifts to Multiple Speed Lanes

Asset management’s two-speed world shifted to multiple speed lanes in 2013. AuM growth slowed in many emerging markets, gathered speed in most developed markets, and advanced robustly in other emerging markets, particularly in Asia and in the Middle East and Africa. On average, AuM grew 14 percent in emerging markets and 13 percent in developed markets, compared with 18 percent and 10 percent, respectively, in 2012. As a result, developing markets did not expand their global share in 2013 and represent roughly 9 percent of AuM, compared with 6 percent in 2007.

Viewed regionally, AuM growth varied widely in 2013. In North America, the Middle East and Africa, Japan, Australia, and Asia, it increased from 14 percent to 20 percent. Europe and Latin America averaged 8 percent and 7 percent, respectively. As with AuM

growth globally, growth regionally was driven largely by equity market performance. Differences in market performance were the main source of regional variation.

Net new asset flows also varied widely among developed markets, as they did among developing markets.

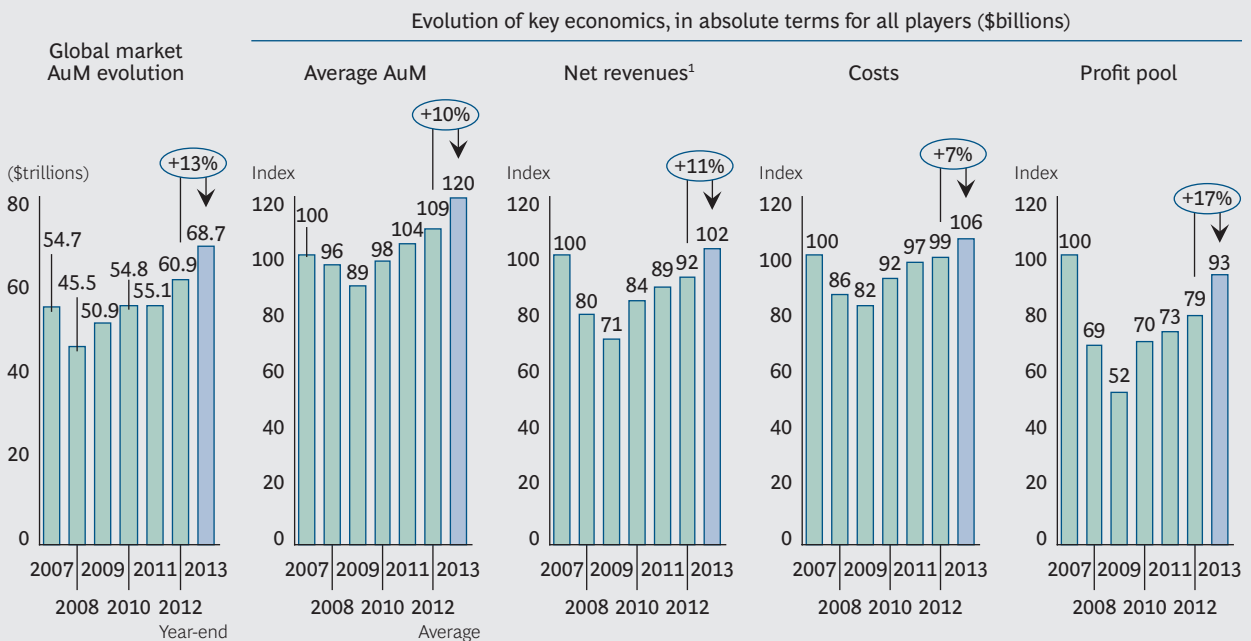
In most developed markets, net flows ranged from 1 to 2 percent. However, they reached 3 to 5 percent in Japan, Canada, and the Nordic countries—and even higher in Italy and Spain, driven by revived retail interest. At the same time, net flows were negative in Benelux and France.

In developing markets including Latin America, Eastern Europe, and Asia, and excluding Japan and Australia, net flows represented 4 percent. In the Middle East, net flows reached 8 percent.

Five “New New Normal” Trends Affecting Asset Managers

Despite recovery from the crisis and rising profits, asset managers continue to navigate

EXHIBIT 3 | The Global Profit Pool Gained 17 Percent on Stronger Revenues but Remained 7 Percent Below Its Precrisis High



Sources: BCG Global Asset Management Market Sizing Database, 2014; BCG Global Asset Management Benchmarking Database, 2014.
 Note: Values with fixed exchange rates at the year-end 2013 rate.
¹Management fees net of distribution costs.

the financial industry's turbulent structural shifts. The challenge—for them and for other financial-services companies—is exacerbated by a new new-normal environment of heightened global competition, rapid change, and restricted room to maneuver.

We have identified five disruptive trends that asset managers must take into account in this environment: regulatory change, the digital and data revolution, more demanding investors with a growing preference for nontraditional assets, new competitors providing nontraditional assets, and globalization.

Digital technologies and data innovation are quickly becoming sources of competitive advantage.

Regulatory Change. Since the onset of the financial crisis, all global financial institutions have been confronted with a tsunami of regulatory tightening and public pressure for change. Tightening regulations affect asset managers as well as clients and distributors, requiring managers to continually adapt to new rules in multiple markets. Greater compliance burdens increase operational complexity and pose strategic challenges on issues ranging from product innovation to international growth—for example, meeting regulatory reporting requirements in a new market. Asset managers must be able to build, evolve, and scale new functionalities in an accelerated way, typically within months—not years, as in the past.

The Digital and Data Revolution. At first glance, asset managers may seem less exposed than wealth managers to the escalating impact of digitization. Wirehouses, retail banks, independent financial advisors, and insurers are all expanding their use of digital channels and platforms.

Yet digital technologies and data innovation are quickly transforming operational aspects of asset management, becoming sources of competitive advantage.

Our research revealed a rapid increase in electronification. Among our benchmarking participants, 96 percent of equity trades were managed electronically in 2013, compared with about 90 percent in 2011. In fixed-income and money market trading, 86 percent of trades were managed electronically in 2013, compared with 75 to 80 percent in 2011.

The benefits of more advanced enterprise-wide data management in particular have become an increasingly critical focus for asset managers. This became evident in our study of the data management practices of our benchmarking participants in four dimensions: organization and governance, advanced analytics and modeling capabilities, data definitions and standards, and processes and infrastructure.

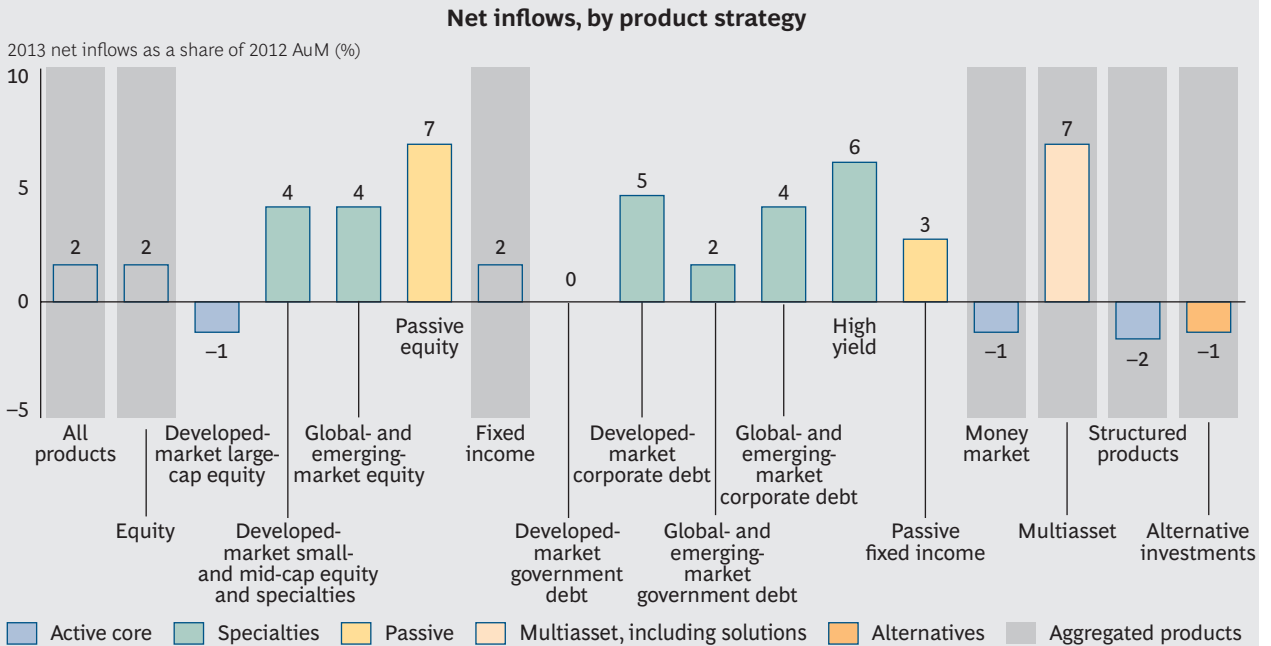
Most participants cited the significant potential for improved data-management practices. In particular, they noted the benefits of migrating from current practices of local management divided among silos to more enterprise-wide management and sharing.

This evolution allows for greater company-wide integration and optimization of investment strategies, portfolio analytics, business processes, and data usage.

More Demanding Investors with a Growing Preference for Nontraditional Assets. Persistently lower interest rates and a shift in investor preferences have boosted the growing appetite for specialties, solutions, multi-asset capabilities, and passive products. Investors have become more demanding and more likely to prefer particular outcomes or solutions that are specifically oriented to their needs, beyond performance relative to a benchmark. (See Exhibit 4.)

The market shift away from actively managed core assets continues to erode the share of traditional assets in the global AuM pool—which was 45 percent in 2013, compared with 56 percent in 2008—and among net flows. The continuing rapid advance of solutions and specialties in 2013 confirms a structural shift in the market. Managers that cling exclusively to traditional assets will continue to be squeezed. (See Exhibit 5.)

EXHIBIT 4 | Investors Continued to Shift from Active Core Assets to Specialties, Solutions, and Passive Products



Source: BCG Global Asset Management Benchmarking Database, 2014.

Note: A single exchange rate was used for both year-end 2012 AuM and 2013 flows to avoid currency impact.

The demand for specialization and solutions in 2013 was again evident in the ranking of mutual-fund product strategies that received the highest net flows. In the U.S., the top ten strategies included specialties such as foreign large-blend funds, bank loans, nontraditional bonds, and solutions such as target date funds. In Europe, the strategies included specialties such as global bonds, global equity, high-yield bonds, and solutions such as flexible and absolute-return funds. (See Exhibit 6.)

This ongoing shift in investor preferences helped maintain the industry's winner-takes-all trend again in 2013, although it has begun to slow, particularly in Europe. (See Exhibit 7.) The top ten managers, in mutual-fund net flows in the U.S. and Europe, captured 73 percent and 42 percent, respectively, of all net new asset flows, compared with 94 percent and 51 percent in 2012.

The trend is driven partly by the higher concentration of competitors in specialties and passive products, compared with the slower-growing traditional products, as noted in last year's report. (See *Global Asset Manage-*

ment 2013: Capitalizing on the Recovery, BCG report, July 2013.) It is not surprising that out of the top ten fund providers in 2013, seven had already been among the top ten in either 2011 or 2012 in both the U.S. and Europe.

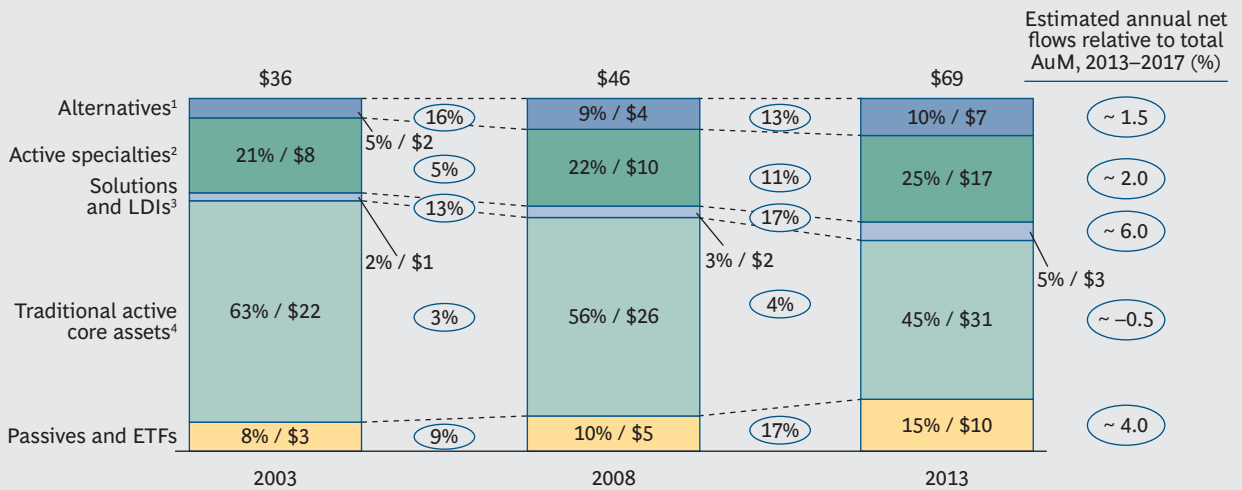
Tougher competition is raising the bar on service, as customers become more demanding. Asset managers need to shift their focus from selling products to solving client problems—addressing, for example, the growing demand for yield or retirement income—on both the institutional and retail sides. Institutional investors are demanding greater transparency, which requires more flexible real-time data and analytics, and the ability to demonstrate stronger risk-management skills.

Enhanced competition also means continued pressure on fees. We observed a drop in fees after the crisis, as both the product mix and the business mix shifted. Lower-margin products such as fixed-income and passive products grew more quickly, and the institutional share of business grew faster than retail.

In 2013, overall revenues rose by only 0.2 basis points—from 29.2 to 29.4—despite the retail

EXHIBIT 5 | As Traditional Actively Managed Assets Lose Share of the Global AuM Pool and Net Flows ...

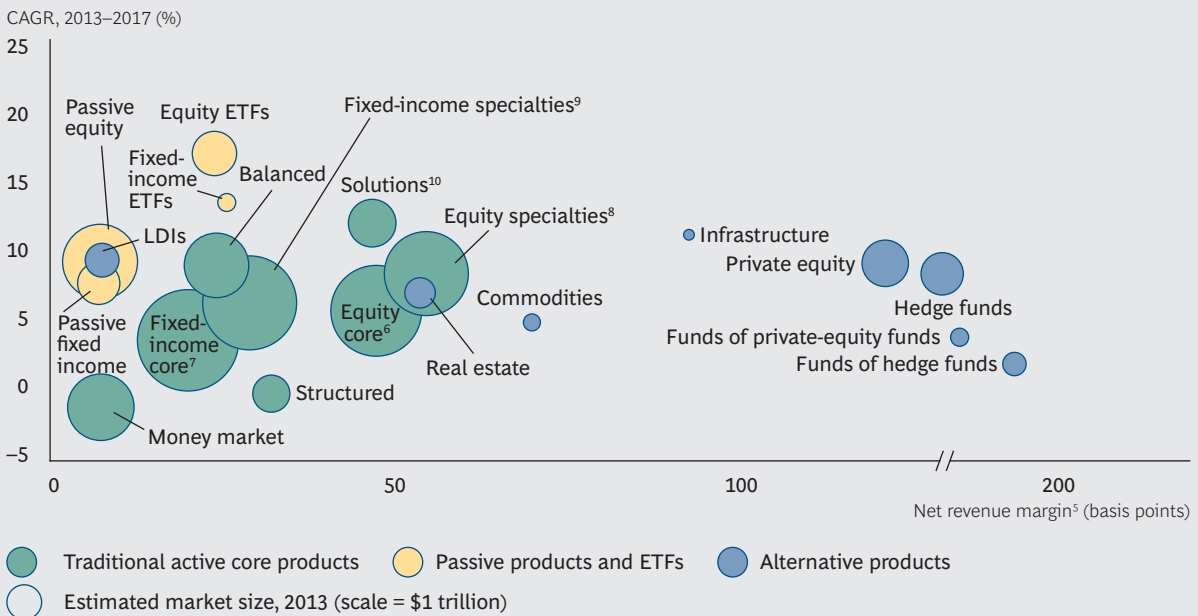
Global AuM, by product (% and \$trillions)



Active core assets are expected to shrink to about 40 percent of global AuM by 2017

○ CAGR

... Traditional Assets and the Managers That Cling to Them Will Continue to Be Squeezed



Sources: BCG Global Asset Management Market Sizing Database, 2014; BCG Global Asset Management Benchmarking Database, 2014; ICI; Prequin; HFR; Strategic Insight; BlackRock ETP report; IMA; OECD; Towers Watson; P&I; Lipper; BCG analysis.

Note: ETF = exchange-traded fund; LDI = liability-driven investment. Any apparent discrepancies in totals are due to rounding.

¹Includes hedge funds, private equity, real estate, and infrastructure and commodity funds.

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

³Includes absolute-return, target date, global asset-allocation, flexible, income, and volatility funds and LDI products.

⁴Includes active domestic large-cap equity, active government fixed-income, money market, and traditional balanced and structured products.

⁵Management fees net of distribution costs.

⁶Includes actively managed domestic large-cap equity.

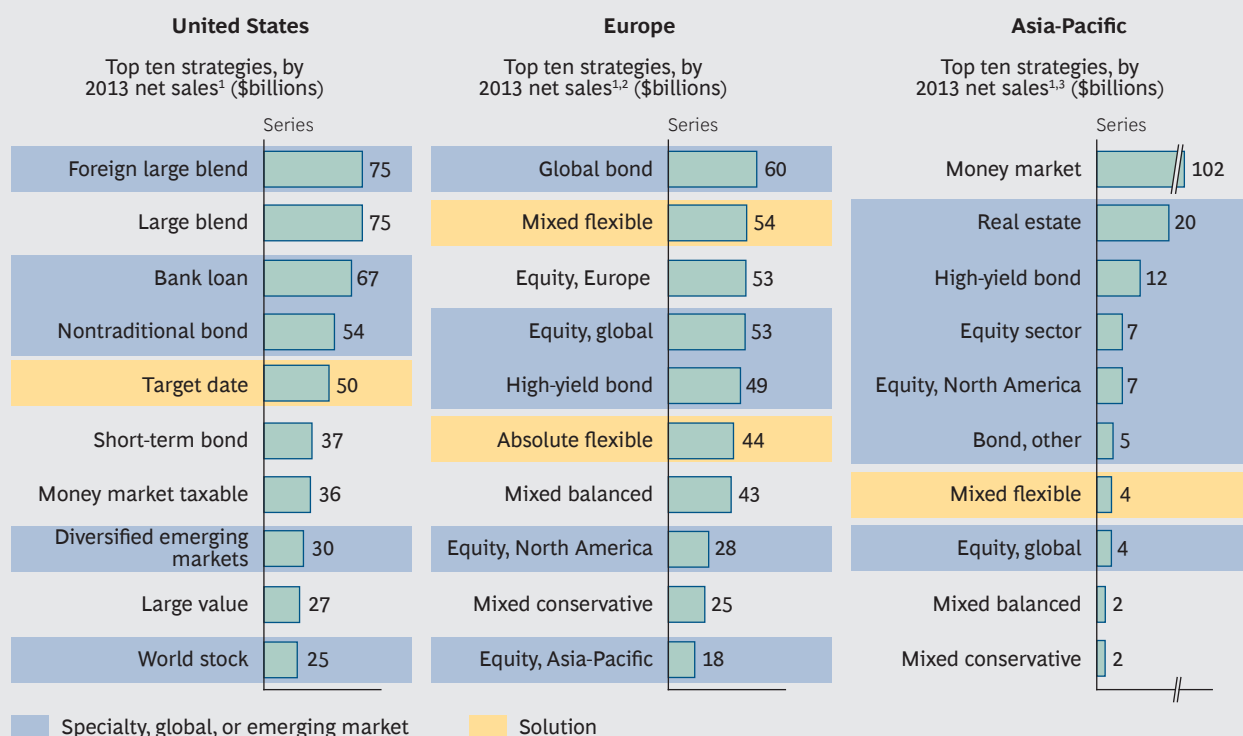
⁷Includes actively managed domestic government debt.

⁸Includes foreign, global, and emerging-market equities; small and mid caps; and sectors.

⁹Includes credit, emerging-market and global debt, high-yield bonds, and convertibles.

¹⁰Includes absolute-return, target date, global asset-allocation, flexible, income, and volatility funds.

EXHIBIT 6 | Specialties and Solutions Continued to Dominate Net Flows



Sources: Strategic Insight; BCG analysis.

¹Based on mutual funds and exchange-traded funds, excluding, for instance, assets of mandates.

²Of 28 strategies defined by the Simfund database.

³Of 27 strategies defined by the Simfund database.

EXHIBIT 7 | The Winner-Takes-All Trend Slowed in the United States and Europe

Top ten asset managers, on the basis of flows in the United States				Top ten asset managers, on the basis of flows in Europe			
Asset manager	2013 net flows (\$billions)	Cumulative share of total market net flows (%)	Cumulative share of net flows of players with positive net flows (%)	Asset manager	2013 net flows (\$billions)	Cumulative share of total market net flows (%)	Cumulative share of net flows of players with positive net flows (%)
Vanguard	129	29	21	BlackRock	51	12	9
BlackRock	51	41	29	JPMorgan Chase	33	19	14
State Street Global Advisors	24	46	33	Standard Life	15	23	17
Dimensional Fund Advisors	23	51	37	Franklin Templeton	15	26	20
JPMorgan Chase	22	56	41	M&G Investments	14	29	22
MFS Investment Management	17	60	44	Nordea	12	32	24
Goldman Sachs	15	64	46	Schroders	12	35	26
New York Life Insurance	14	67	48	Vanguard	12	38	28
MassMutual	14	70	51	Pioneer Investments	10	40	30
Affiliated Managers Group	14	73	53	Allianz GI-Pimco	8	42	31
Total market	441			Total market	436		

In 2013, as in 2012, five U.S. managers were among the top ten in Europe

The top-ten manager tables changed relatively little in 2013

Xx = New player in top-ten ranking in 2013, compared with 2012 rankings

Sources: Strategic Insight; BCG analysis.

Note: The analysis excludes money market funds.

segment's slightly faster growth than the institutional segment, the strong market impact in equity rather than the negative impact overall in fixed income, and strong net flows in product categories such as specialties. Examining fee evolution by product and client segment, we observe some fee decrease in equity (both active and passive), money market, and structured products and also alternatives (especially hedge funds). Fee pressure will not abate as a result of the regulatory push toward more transparency and bans on commissions, as well as increasing power and concentration in distribution.

New Competitors Providing Nontraditional Assets. A structural shift in products is under way, to the detriment of traditional managers. More and more, providers of nontraditional assets are serving traditional clients. Most hedge-fund, private-equity, infrastructure, and private-debt business is still provided by specialized alternative managers. Traditional managers are now investing in and slowly building the specific capabilities required for these new product categories. But building those capabilities will take time. Meanwhile, the alternative-product providers are expanding into products historically provided by traditional asset managers—for example, specialties—and taking advantage of the relationships and reputation they have built in alternatives.

Globalization. We see more global competitors and more global products in the new new normal. Demand for greater diversification has helped accelerate globalization, as investors increasingly seek exposure outside their home markets.

U.S. and UK asset managers, in particular, have succeeded in growing significantly beyond their domestic markets. This is especially notable in continental Europe, where strong specialty capabilities have helped U.S. and UK asset managers advance, while local managers have lost market share.

The AuM of continental European managers in 2013 did not regain levels achieved in 2007, even though continental European AuM reached \$13.8 trillion—15 percent above its 2007 level. Meanwhile, UK managers' overall

AuM grew 50 percent while their domestic market grew just 32 percent.

Global competitors also keep investing in developing markets: even if those markets are still small, they offer higher medium- to long-term growth prospects.

Presence in multiple markets—whether through manufacturing or distribution—creates operating-model complexity. Asset managers must adapt their product offerings to local regulations, distributors, and the needs of local investors. We are seeing development of shared-operations platforms across regions with specialization by function: the goals are to achieve scale and enable managers to operate in smaller markets with more promising growth prospects. The global scale and complexity of a multicountry organization require a carefully designed operating model.

A Target Operating Model for the New New Normal

After four years of stalled recovery, the global asset-management industry has finally recorded two consecutive years of solid growth. Global AuM has risen to record levels, profits are strong, and net new flows have achieved solid gains, albeit from a small base.

At the same time, AuM growth for traditional managers has largely been the product of rising equity prices. Net new flows remain a modest part of total AuM, and the lion's share goes to specialists, solution providers, and nontraditional asset managers. The profit pool remains under pressure, as net revenues stay flat and lag below their precrisis peaks.

Meanwhile, as traditional active core assets continue to lose share, navigating a differentiated growth path looks increasingly competitive, complex, costly, and constrained by waves of regulation.

For all these reasons, developing the right target operating model is crucial for asset managers if they are to steer strategically, safely, and efficiently.

DIFFERENTIATION BEGINS WITH A TARGET OPERATING MODEL

ON AVERAGE, ASSET MANAGERS commit more than 25 percent of costs to IT and operations. Yet, in many cases, those functions don't receive even a quarter of the company's time and attention. As a result, most managers' operating models evolve piecemeal, without being explicitly anchored to the company's vision or strategy.

This incremental approach might seem to work for a while, but it leaves managers at increasing risk of being left behind. Clients and products proliferate, new markets are entered, footprints extend globally, and acquisitions bring new technologies that are patched onto legacy systems. In the new normal of regulatory overload, shifting investor preferences, and competitive digitization, such haphazard evolution can quickly morph into a cripplingly complex tangle of systems and processes.

Most asset managers try to get by with such patchwork operating models. But they are light-years from achieving the enormous potential benefits of a strategically conceived target operating model that leading competitors have defined for themselves and are moving toward.

Broadly defined, a target operating model is an overall operations and technology ecosystem that allows a company to chart a path for achieving its strategic vision on the basis of its priorities and starting point. When an op-

erating model becomes a critical part of a manager's strategy, the benefits are tangible and the profound business impact can include the following:

- Shorter time-to-market cycles due to greater agility in launching new businesses and trading new products
- Better ability to ramp up volume quickly at minimum marginal cost
- Increased client satisfaction due to a more transparent and compliant operating model
- Superior investment performance, from focusing investment management resources on priority growth areas and supporting them with tools, data, and insight
- Reduced risk from a more controlled and stable operating environment
- Greater long-term cost-effectiveness

In contrast, managers who fail to act might lag behind as they deploy increasingly greater resources simply to manage the tangle. In many cases, inaction inhibits growth because of the exponential costs of adapting technology and processes to the flow of new regulations; the inability to trade in new asset classes, markets, and locations; and an increased operational risk profile.

Trends Reshaping Asset Management and Its Operating Models

While the new new normal reshapes financial services, managers will find that the five disruptive trends introduced in the previous section provide critical inputs as they define their target operating model. (See Exhibit 8.)

Many asset managers invest insufficient time in defining how they will translate their strategic vision into an operating model that takes into account their starting point, resources, and priorities. The path to achieving that goal begins by creating a target operating model.






The first step in defining the model is to understand the company's strategic vision and priorities for the next five to ten years. The answers to the following questions can help frame the process:

- What is your business strategy—in broad brush and detail?
- What markets, products, and segments will you compete in?
- How do you implement your investment philosophy to win?
- What is your differentiated client value proposition?

Once the company has agreed on its strategic vision, it will need to analyze its operating-model ecosystem in order to define how to achieve the vision. Ecosystems vary by company, location, and asset type.

Our definition of *operating model* is based on three elements: process and technology, work structure, and organization. (See Exhibit 9.)

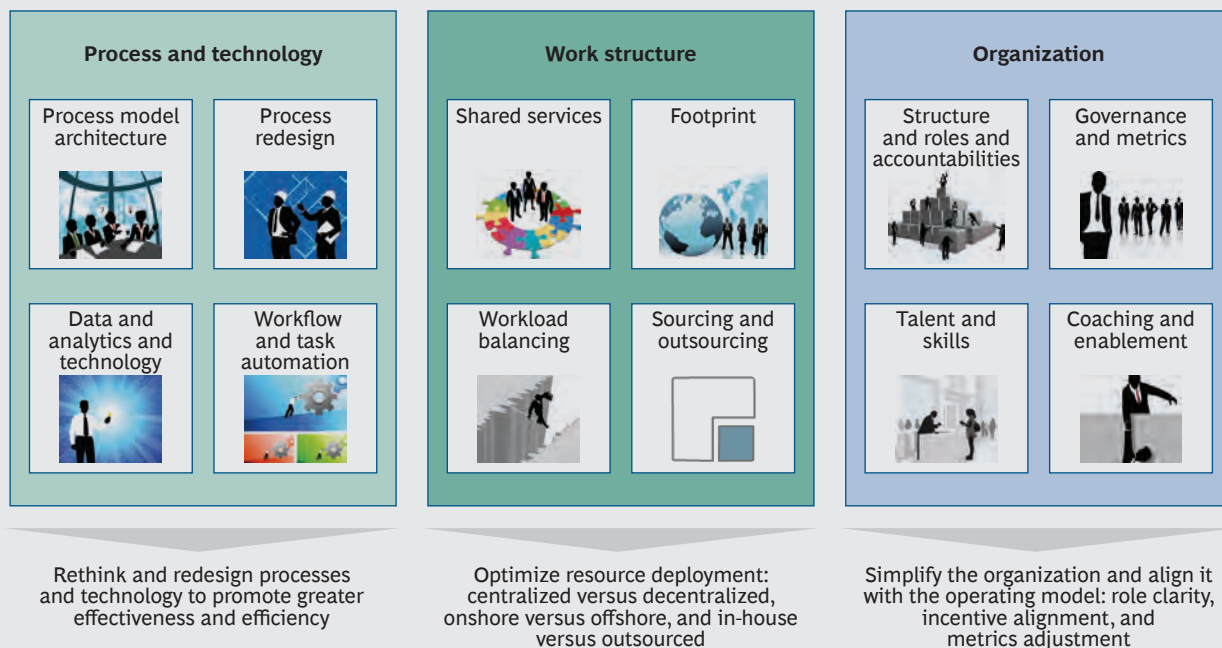
EXHIBIT 8 | Five Disruptive Trends Provide Critical Input for Managers Designing a Target Operating Model

Trend	Description	Implications for a target operating model
 Regulatory change	<ul style="list-style-type: none"> • Regulations (for example, those inspired by Dodd-Frank and the European Market Infrastructure Regulation): increasing impact on the industry worldwide as asset managers become more systemically significant 	<ul style="list-style-type: none"> • Need to be able to build, develop, and scale new functionality (for example, reporting and central clearing) in an accelerated way (months, not years)
 The digital and data revolution	<ul style="list-style-type: none"> • Data proliferation: the explosion of growth in more complex unstructured data and the mounting volume of trading data across multiple systems • Electronification: a growing share of securities already handled electronically 	<ul style="list-style-type: none"> • Need to consider data as a strategic asset and a critical enabler of any target-operating-model transformation • Premium on straight-through processing and flexible connectivity with Wall Street
 More demanding investors with a growing preference for nontraditional assets	<ul style="list-style-type: none"> • Faster growth of solutions, specialty assets, and passive and alternative products • Greater demand for transparency and independence from increasingly sophisticated institutional investors • Scissor effects with pressure on fees while industry evolution is driving costs higher 	<ul style="list-style-type: none"> • Need agility and modularity that enable quick and reliable new-product and asset class introductions • Need for more flexible real-time data and analytics • Need to transform fixed costs to variable costs as much as possible to follow fee and demand trends
 New competitors providing non-traditional assets	<ul style="list-style-type: none"> • Blurring lines between traditional and nontraditional managers 	<ul style="list-style-type: none"> • Need agility and modularity that enable expansion into new business models and investment approaches
 Globalization	<ul style="list-style-type: none"> • Two-speed world with smaller emerging markets that are growing faster than developed markets with higher net flows 	<ul style="list-style-type: none"> • Need an operating model that can be applied globally yet adapted to local specifics

Source: BCG analysis.

EXHIBIT 9 | Three Elements Define the Ecosystem Affecting an Asset Manager's Operating Model

The operating-model ecosystem



Source: BCG analysis.

These three elements translate into a series of far-reaching business questions and decisions for the front office (including the level of sharing across trading platforms), middle- and back-office operations (such as the appropriate degree of outsourcing and centralization), and the enterprise data group (including governance and the level of real-time integration). (See Exhibit 10.)

A World-Class Target Operating Model

There is no single, ideal target operating model that fits all managers. Rather, the design of each company's model will depend on the company's starting point, history, and the optimization goals it has prioritized.

However, agreement on these optimization goals must be explicit and shared at all levels of the organization—not just within the operations and technology silos.

We generally look at six possible design choices for a target operating model, and the selection of a particular model depends on

the organization's optimization goals. (See Exhibit 11.)

The relative weight to assign each of these design choices varies by manager and asset type. For example, a manager of passive products would focus on responsiveness, scale, and efficiency. An active asset manager would likely stress a flexible and adaptive model. An asset owner might emphasize the importance of having a single view of performance and risk across investments. Insurance company asset managers, who oversee the world's second-largest asset pool, could be seeking business upside, risk, and efficiency. (See the sidebar "Insurers Begin to Attack the Target-Operating-Model Opportunity.")

Truly world-class operating models will deliver value across multiple elements, reconciling often opposing forces such as scalability and flexibility.

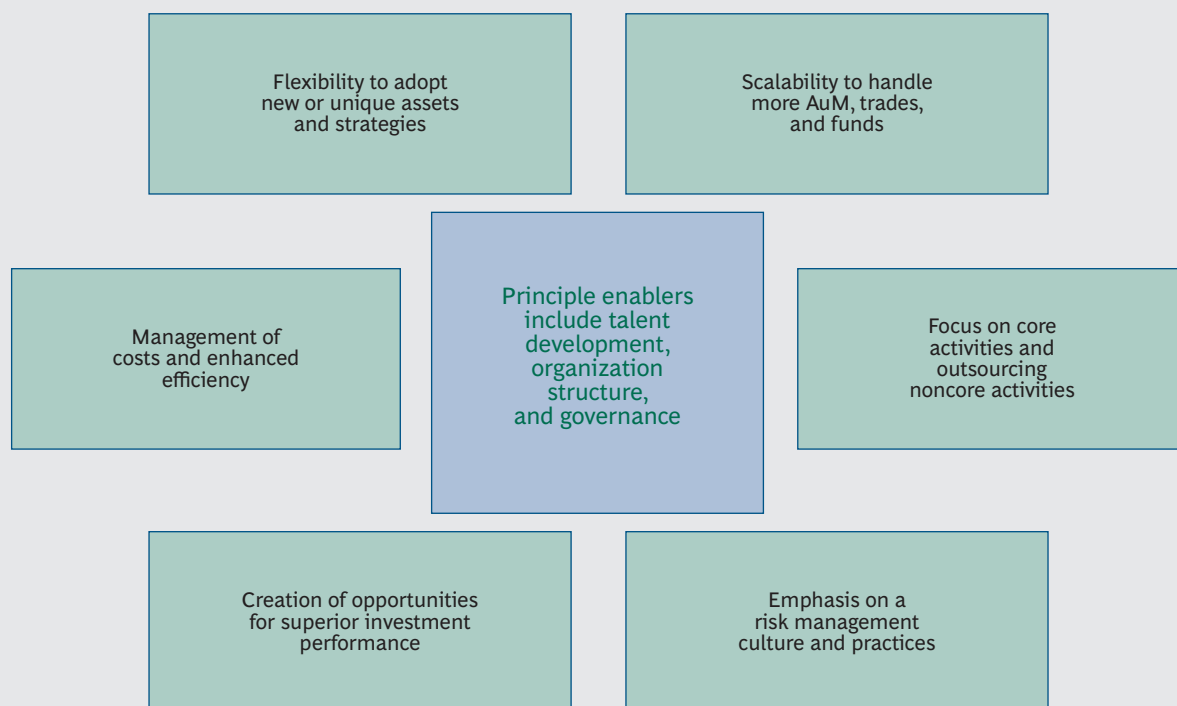
To illustrate, we have selected four operating models that we find particularly interesting and innovative. Although these models must be consistent with the objectives of a particu-

EXHIBIT 10 | Critical Operating-Model Questions and Considerations Across the Asset Management Organization

	Front office: portfolio management and trading	Middle and back offices: operations, accounting, and investor services	Enterprise data group
Process and technology	<ul style="list-style-type: none"> • Are there operational activities in the front office that could be handled in the middle or back office? • Should future technology adopt an integrated or best-of-breed solution; custom-built or packaged solutions? 	<ul style="list-style-type: none"> • How can critical processes (including cash approvals, subscriptions, and redemptions) be simplified? • Can straight-through-processing rates be increased? 	<ul style="list-style-type: none"> • What is the required level of integration across data and technology? • What types of data infrastructure and tools are required?
Work structure	<ul style="list-style-type: none"> • What level of sharing can be achieved across asset classes for critical trading platforms? • How centralized and controlled should critical portfolio-management platforms—including investment and risk analytics and portfolio construction—be? 	<ul style="list-style-type: none"> • What functions should be centralized or shared with adjacent businesses? • How much should be kept in-house, and what should be outsourced? • Where should operations be located? 	<ul style="list-style-type: none"> • What are the best ways to integrate performance and risk metrics and analytics across asset classes, asset types, and locations?
Organization	<ul style="list-style-type: none"> • Are roles and accountabilities clearly delineated between front and back offices? • What operational metrics should be incorporated to evaluate front-office performance; trading-unit costs and error rates? 	<ul style="list-style-type: none"> • How should middle- and back-office roles flex with the changing environment? • What metrics should be used for back-office teams? 	<ul style="list-style-type: none"> • What level of governance needs to be in place? • What roles are required in order to ensure robust data management?

Source: BCG analysis.

EXHIBIT 11 | Six Possible Design Choices for a Target Operating Model



Source: BCG analysis.

INSURERS BEGIN TO ATTACK THE TARGET-OPERATING-MODEL OPPORTUNITY

Insurance company asset managers oversee the world's second-largest asset pool, as they steer their parent companies' general accounts. Despite this financial heft, few of them can boast leading operating models. They have, consequently, left on the table substantial benefits related to business upside, risk, and efficiency.

Intense and persistent cost-cutting pressure is among the chief obstacles inherited from their corporate parents. Needed resources are perpetually shoved to the back burner. Capability development is undermined. In operations and IT, managers face a cost squeeze that makes it difficult to address critical concerns.

Now a few leading insurers are stepping back to revamp their asset-management units and redesign their operating models. They are doing this, in part, to provide support for the core front-office business, including the flexibility to manage new products and tools to help investment professionals perform. Furthermore, they aim to achieve better management of both operational and investment risk. Also, these efforts promote greater cost-effectiveness.

Insurance company assets compose nearly 20 percent of the global total. Insurers' total AuM reached \$13 trillion in 2013. Yet their AuM growth of 7 percent in 2013 was far lower than the overall average 13 percent increase in AuM.

There are several reasons for insurers' slower asset growth. First, most insurers have been affected by slower-growing inflows from the liability-producing insurance side, driving net outflows of 0.5 percent, relative to total market net inflows of 1.6 percent. Second, because insurance companies typically hold a large proportion of fixed-income assets in their portfolios, they did not benefit as much from the

global surge in equity markets. Last, their exposure to high-growth specialties was similarly limited. Insurers must decide which of the following hurdles they need to overcome.

Insurers have lagged behind their asset-management peers in operations and IT capabilities. In the past two years, insurers have reduced operations and IT spending by 4 percent per unit of AuM. In contrast, the broader asset-management industry has increased that spending by 3 percent—despite beginning at a higher overall cost position. Furthermore, many insurers have applied simple across-the-board cost reductions rather than pursuing a well-conceived target operating model.

Organizational impediments have created or sustained asset management inefficiencies. These include regional fragmentation—an artifact of historical organization ties to the insurance company's sources of cash and liability. The asset managers of most insurers operate in regional silos as well as asset class silos, exacerbating fragmentation and complexity.

Structural and role impediments abound. Low transfer pricing, for example, caused by the historically strong political pull of the insurance units, has skewed asset management economics and allowed lower investment levels in managers' capabilities. This bias can lead to a penny-wise-and-pound-foolish approach to investing in front-office resources and capabilities and to supporting talent, operations, and IT. For instance, independent asset managers typically spend more to research an investment than does the insurance company that bears the direct benefit or burden of the investment's outcome.

Insurers struggle to manage new complexity created in expanding their third-party offerings. While insurers' asset managers have not historically focused on profitability

INSURERS BEGIN TO ATTACK THE TARGET-OPERATING-MODEL OPPORTUNITY

(continued)

and growth, they are tempted by the high returns on equity of third-party management. Some managers have built this business to more than a third of their activity and, in doing so, have invested and grown stronger commercially. As a result, they have achieved higher revenue margins and profits—averaging 25 basis points of revenues and 39 percent profitability, compared with 12 basis points and 26 percent, respectively, for mostly captive managers that focus predominantly on the insurer’s general account.

But achieving third-party growth generates new challenges, including greater operational complexity, for insurers’ asset managers. So far, they lag behind independent asset managers in operational efficiency. For instance, they have a signifi-

cantly lower proportion of straight-through processes for both fixed-income and equity products.

Leading managers are actively working to create target operating models that address these challenges. They have moved beyond mechanical cost cutting to focus on creating differentiators, which range from organizational, process, and technology changes to commercialization in order to build scale.

The good news for these forward thinkers is that there is much to gain in efficiency and effectiveness, including higher investment returns and enhanced revenue streams, from the growth of third-party asset management.

lar company, their core characteristics have valuable lessons for other asset managers.

Shadow Outsourcing: Redundancy. Outsourcing core processes and technology has become standard, but in many cases, asset managers decide to keep some aspect of quality control and oversight in-house. Now a small number of innovative asset managers have begun to outsource such “shadow” capabilities. The goals are to focus on core activities and improve risk management culture and practices through increased independence and better quality control. Shadow outsourcing also makes it easier to switch outsourcers. (See the sidebar “Emergence of the Shadow Outsourcer.”)

The Global Operating Model: Global Scale, Local Customization. This model aims to achieve twin objectives: scalability, by taking advantage of an institution’s global scale, and management of cost and efficiency, by, for instance, leveraging lower-cost locations. The global model is also a powerful means of creating a template for future expansion to new regions.

This model relies on a global infrastructure comprising core, fully integrated front-to-back systems, single repositories for reference and market data, and common operational processes. The industrialization of systems, repositories, and processes creates scale benefits while accommodating the customization required by individual investment-management teams and regions.

Another benefit is the creation of shared services of critical functions—such as data management, technology, and reconciliations—in lower-cost locations as a way to build scale and reduce unit cost. However, location-dependent functions—such as trading and regulatory reporting—and those needing proximity to portfolio managers or clients remain within local or regional hubs.

The Utility Operating Model: Monetizing the Model. The manager’s premise in this case was to create a customizable, flexible operating model that would allow for the addition of volumes and new products at minimum marginal cost. After investing heavily, the

EMERGENCE OF THE SHADOW OUTSOURCER

Although it has become standard to outsource processing capabilities, many companies keep a “shadow” of such operations in-house for oversight and quality control. Now a small number of hedge funds have begun to outsource this shadow responsibility, using two providers simultaneously. This model merits consideration by traditional asset managers as well.

This dual-outsourcer model is particularly relevant given today’s high premium on transparency, risk management, regulatory compliance, operational risk, and variable costs. It also responds to emerging regulatory requirements in Europe and the U.S. for better business-continuity planning—that is, the ability to substitute a new service provider for one that, for example, fails to perform well or goes out of business.

The outsourcer model is structured so that an execution partner and a shadow partner operate and control, respectively, the middle- and back-office operations. The execution partner is responsible for operating those functions and manages the official books and records. The shadow partner is responsible for replicating critical functions of the middle- and back-office operations, reconciling and resolving differences with the execution partner, and providing an independent quality control of the execution partner’s results.

This model removes the requirement to maintain an internal oversight team and the associated technology and tools required to perform a controlling function for the most critical and risky activities.

Variations of the model range from full shadow to light shadow.

- *Full Shadow.* Both outsourcers operate the full scope of processing and accounting, although only the primary outsourcer interfaces with counterparties. The asset manager achieves full

“switchability”—the ability to move from one outsourcer to the other quickly.

- *Partial Shadow.* The shadow outsourcer duplicates and verifies only the most critical functions—such as valuation and reconciliation—which are typically replicated in-house. This model is less costly and simpler to implement, but it provides limited switchability.

Cost is among the obvious questions about the dual-outsourcer model. The usual, though incorrect, expectation is that two outsourcers cost twice as much as one and, thus, that having two is financially prohibitive. This notion fails to account for the true costs of personnel, technology, maintenance, network hardware, and office space that come with internal shadowing. On the basis of service provider discussions and our modeling, we believe that the dual-provider model can deliver significant additional value of 5 to 25 percent more than the all-in cost of the single-outsourcer model with an in-house shadow operation. In the long run, the cost of maintaining an up-to-date internal shadow function will continue to grow. These rising costs, coupled with the increasing scale of the outsourcers, will likely drive the cost benefit even further.

The value of the dual-outsourcer model is compelling because it provides the following benefits:

- Increased transparency and independence in client-sensitive areas of positions and valuations, whose importance was highlighted by the recent crisis
- Quality assurance that is the result of having two reputable independent outsourcers
- A healthy competitive tension between outsourcers, supporting ongoing service quality

EMERGENCE OF THE SHADOW OUTSOURCER (continued)

- Evolution of internal roles from processing to higher-value and differentiated strategic-partner management
- Elimination or reduction of ongoing technology investments
- Ability to switch providers quickly if an outsourcer does not deliver the expected level of service or goes out of business

The dual-outsourcer model is very new. At this stage, we don't believe that it applies to every asset manager or asset owner. However, we do believe that it has potential appeal for sophisticated managers and asset owners as well as large hedge funds.

manager created world-class middle- and back-office operations that would have value for others and looked for ways to pool future costs and investments and to generate additional revenues.

The solution was to turn the multiyear investment into a service-providing business. The company commercialized select “commoditized” portions of the operating model as a “utility” service for competitors. Two functions that differentiated the company—front office and data—were of course kept off limits.

Data-Centric Operating Model: Real-Time Decision Making. The manager's primary objectives for this model were threefold: to maximize flexibility for new and unique assets and strategies, to improve the risk management culture and practices (for instance, by providing increased transparency and a better risk view across assets), and to create superior investment performance through better use of data in investment decisions.

Delivering on this goal requires a technology-heavy operating model and a real-time data capability feeding a modular technology and operations platform.

This last model reinforces the strategic importance that data occupies in target-operating-model transformation. In many cases, transformations are enabled by data infrastructure. Mature data-management practices

are formidable enablers that allow a high level of automation and near-real-time analytics. (See the sidebar “Recognizing Data as a Strategic Asset.”)

Seizing the Moment

Target-operating-model transformation is a multiyear journey, not a big-bang, do-it-all-now endeavor. Indeed, although transformation must be aggressive, it should entail a series of realistic and achievable steps. Each step should deliver clear and tangible benefits to clients, to the business, and to overall financial results. Several actions are crucial to the success of a target-operating-model transformation program:

- *Lead from the top.* Transformation should rank among a company's top two or three initiatives. It should be championed by the CEO and regularly discussed by the management team. The senior sponsor—typically the CTO or COO—should have a seat at the table.
- *Anchor to business priorities.* Target-operating-model transformation is much more than an IT or an operations transformation. It is a critical enabler for the business, especially for front-office professionals. Their buy-in and engagement throughout the transformation is crucial.
- *Fund the journey.* The transformation will need to deliver tangible results early and have a self-funding business case.

RECOGNIZING DATA AS A STRATEGIC ASSET

Most asset managers have considered improving their data management, but their progress along the data maturity curve has generally been slow.

We classify data maturity into three levels—controlled chaos, managed, and optimized. (See the exhibit below.) In BCG’s Global Asset Management survey, about 60 percent of respondents rated themselves in the lower levels of the data maturity curve. This implies that most managers have not yet embarked on formal data-management programs or that they have done so only with single, localized initiatives.

Nonetheless, managers overwhelmingly recognize the value of improving data management practices. The majority of our respondents were in the lower levels of maturity, but all planned to achieve high levels within three years. For most, this will

mean a step change advance, requiring substantial attention and investment, from where they are today.

Better data management has the potential to enable operating-model improvements in several ways. On the revenue side, data management can create flexibility in investment strategies and improve investment performance—for example, identifying trade opportunities by mining social-media preferences or integrating risk management analysis across locations and asset classes. It can improve customer acquisition through more targeted marketing while supporting a better customer experience through a customized and all-inclusive view of holdings.

On the cost side, leaders in data management can improve efficiency by removing manual processes from data cleaning and consolidation. They can

Data Maturity Is a Crucial Component of an Asset Manager’s Target Operating Model

Data-management maturity level	Description	Implications
Level 1 Controlled chaos: ad hoc and organic data management	Data managed locally in silos: <ul style="list-style-type: none"> • Little to no data sharing • Loose processes • Distributed data solution and infrastructure 	<ul style="list-style-type: none"> • Low levels of automation • No single source of truth; multiple copies of data • Limited or no aggregation capabilities across, for example, asset classes and markets • Long lead times for custom reporting
Level 2 Managed: basic standardization and sharing	Pockets of excellence for critical data sets: <ul style="list-style-type: none"> • Data sharing and standards • Common technology • Standard processes 	<ul style="list-style-type: none"> • Pockets of automation • Centralization for important shared data • Some aggregation capabilities • Select capabilities for custom reporting and analytics
Level 3 Optimized: standardized and controlled	<ul style="list-style-type: none"> • Clear governance and ownership • Controlled and managed architecture • Robust data and analytics tools 	<ul style="list-style-type: none"> • High levels of automation • Single source of truth • Flexible aggregation capabilities • Near-real-time custom reporting and analytics

Source: BCG analysis.

RECOGNIZING DATA AS A STRATEGIC ASSET (continued)

achieve flexibility and scale in navigating market change—including meeting new regulatory reporting requirements, introducing new asset classes, and delivering custom client reporting.

For most organizations, the step change required to extract the most value from data can be achieved only by undertaking a data transformation. Companies embarking on a data transformation face the challenge of balancing investments in both foundational initiatives and improvements that support business needs. In weighing these trade-offs and to achieve success, companies must be sure that data transformations are clearly aligned with business strategy so that foundational initiatives can be traced to a business need.

Successful organizations will capitalize on data improvements and derive significant business benefits. But the road to achieving a state in which data is a strategic asset can be difficult. Data improvement programs risk morphing into multiyear IT-investment projects that are costly but lack clear business benefits. Successful organizations will not achieve data maturity for data maturity's sake: they will clearly understand and articulate the strategic value of their data and make investments appropriate to their situation.

- *Involve the A-team, both internal and external.* A target-operating-model transformation is a large and complex project involving business, operations, IT, and corporate functions. It requires the best talents internally as well as deep partnerships with vendors, including outsourcers, IT vendors, integrators, and strategic advisors.

In a rapidly evolving industry, asset managers that invest the resources to transform their operating model will differentiate themselves among clients, enable superior performance and growth, and capture market leadership.

Now is the time for asset managers to redefine their operating model—from top to bottom. Many have started the journey timidly, focusing only on the back office rather than committing to a complete transformation.

FOR FURTHER READING

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

Global Wealth 2014: Riding a Wave of Growth

A report by The Boston Consulting Group, June 2014

Operational Excellence in Retail Banking 2014: No Compromise; Advocating for Customers, Insisting on Efficiency

A Focus by The Boston Consulting Group, May 2014

The Quest for Revenue Growth: Global Capital Markets 2014

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Global Risk 2013–2014: Breaching the Next Banking Barrier

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Profitable Growth for Life Insurers: From Cash to Capabilities

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Global Asset Management 2013: Capitalizing on the Recovery

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