Individual investors represented 90% of the asset management industry’s net new flows in 2014, and will account for nearly 120% going forward, as annual organic growth rates shrink below 2% by 2020.

Individual investors will change the asset management industry in four profound ways:

- **Products**: a focus on outcomes will help fuel more than $3 trillion of demand between now and 2020 for multi-asset and benchmark-agnostic strategies worldwide, partly funded by redeeming active benchmark-oriented products.
- **Services**: at least 70% of U.S. financial advisors want more investment-oriented, resource-intensive advice from asset managers, a sentiment reflected globally.
- **Productivity**: distributing to individuals is at least one-third less efficient than selling to institutions, reducing industry leverage.
- **Regulation**: policymakers worldwide will call for objective and discretely priced investment advice, re-arranging economics for asset managers.

Individual investors will encourage disintermediation, an opportunity and threat for asset managers: assets under fully integrated investment advice have grown nearly twice as fast as traditionally intermediated assets since 2008.

Rivalry over individual investors has intensified, reducing fee rates 8% since 2012:

- Nearly 20% more asset managers supply the industry, yet less than half are gathering new assets.
- Wealth managers, banks and insurers secured 75% of new wealth created since year-end 2012.

To win individual investors, the industry’s most powerful players will need to compete differently by embracing any of four new competitive differentiators, potentially as innovative technologies:

- Product development
- Brand
- Specialist engagement
- Risk management

Differentiated firms that keep growing will become more valuable, as shareholders attribute more than 70% of an asset manager’s franchise value to expectations regarding its future organic growth.
Table of Contents

Introduction ..........................................................2

Shifting Opportunities:
How Individual Investors Reshape Demand ...3

New Industry Dynamics:
A Transformed Operating Environment ..........9

Cutthroat Competition:
Internal and External Rivalries .......................17

Success Strategies:
Competing Differently .....................................20

Conclusion ..........................................................32

Authorship

Authors:
Benjamin F. Phillips, Investment Management
Lead Strategist - Consulting
Jeffrey A. Levi, Principal
Michael G. McConville, Senior Consultant

Contributors:
Daniel Celeghin, Head of Wealth Management
Strategy Asia-Pacific
Yariv Itah, Casey Quirk Global Practice Leader
Kevin P. Quirk, Principal
Amanda K. Walters, Senior Manager
Peter Chambers, formerly a Senior Advisor at
Casey Quirk

Supporting Team:
Vlad V. Oncescu, Consultant
Trevor E. Horton, Consultant

CaseyQuirk by Deloitte.

Casey Quirk by Deloitte helps clients develop broad
business growth strategies, improve investment/
product appeal and growth prospects, evaluate new
market and product opportunities, and enhance
incentive alignment structures. Our unparalleled
industry knowledge and experience, detailed
proprietary data, and global network of relationships
make Casey Quirk by Deloitte a leading advisor to the
owners and senior executives of investment
management firms in the world.
Introduction

Asset management remains a vibrant, lucrative financial services industry, but it already shows signs of maturing, including more fee pressure and less operating leverage. Increasingly the same competitive dynamics that shape other financial services industries will affect asset managers: intensifying rivalry among too many players with similar value propositions, resulting in consolidation and disruption.

Winning asset managers will adapt to compete effectively in this environment, using scale and skill to attract attention from the industry's new source of organic growth: individual investors. This white paper explains four key conclusions about the asset management industry's future:

• Individual investors increasingly represent the bulk of organic growth, reshaping opportunity.

• Individual investors also redistribute the industry's economics, transforming the operating environment.

• The new operating environment's tougher conditions heighten competition between existing players and new entrants, including other financial services firms.

• Successful asset managers will win with clearly differentiated value propositions, rather than relative outperformance.
**Shifting Opportunities: How Individual Investors Reshape Demand**

The asset management industry’s economics remain highly attractive. Revenues and operating profit margins touched all-time highs in 2014, and despite market volatility should remain favorable in 2015.

Exhibit 1

**Global Asset Management Industry Revenues (US$Billions)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenues</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>$248</td>
</tr>
<tr>
<td>2011</td>
<td>$262</td>
</tr>
<tr>
<td>2012</td>
<td>$278</td>
</tr>
<tr>
<td>2013</td>
<td>$300</td>
</tr>
<tr>
<td>2014</td>
<td>$319</td>
</tr>
</tbody>
</table>

Exhibit 2

**Global Asset Management Industry Operating Profit Margins**

<table>
<thead>
<tr>
<th>Year</th>
<th>Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>28%</td>
</tr>
<tr>
<td>2011</td>
<td>31%</td>
</tr>
<tr>
<td>2012</td>
<td>32%</td>
</tr>
<tr>
<td>2013</td>
<td>32%</td>
</tr>
<tr>
<td>2014</td>
<td>34%</td>
</tr>
</tbody>
</table>

But the industry is maturing. Buoyant capital markets in 2014 provided 78% of revenue expansion. Organic growth—new assets reaching the hands of professional money managers—is receding. Since the beginning of the decade, annual organic growth in industry assets under management has slowed to 2% from more than 6% posted before the global financial crisis of 2008-09. New growth will further diminish before 2020.

**Sources:** Casey Quirk by Deloitte/Institutional Investor Institute/McLagan Performance Intelligence, Casey Quirk by Deloitte Global Demand Model, Casey Quirk by Deloitte Analysis
Two major secular trends will slow the industry's organic growth:

- *The end of a 30-year moderation in interest rates.* Higher risk-free rates will make substitute fixed-interest savings vehicles—such as deposits and annuities—more attractive. Regardless of when (or if) rates rise again, in most developed asset management markets they cannot sink much lower.

- *Shifting demographics.* The number of retirees in developed markets will continue to surge, forcing pension funds and other retirement savings vehicles to de-risk and shift from accumulation strategies to income provision.

More importantly, changing demand factors are redistributing organic growth opportunities within asset management. The most tectonic change has been the shift in demand to individual from institutional investors worldwide. In 2014, individuals represented more than 90% of net organic growth; for the rest of the decade, they will account for all of it, absorbing a significant amount of net redemptions from institutions.
The catalysts for this shift are also secular and powerful:

- **Retirement.** As baby boomers in developed markets enter retirement, retirees are withdrawing their accumulated savings from institutional investors. The global rollover marketplace will shift most investment decisions back to individuals.

- **Sovereign fund dynamics.** The post-crisis capital shifts that created sovereign funds in emerging markets have stabilized, and the falling price of oil has shrunk petrodollar-driven state investment pools.

- **Insourcing.** The cost-benefit of third-party asset management has become less obvious to very large asset owners, many of which can hire their own portfolio managers and install systems to run passive portfolios in-house. Insourced assets among institutional investors globally will grow more than three times the overall industry growth rate.

The shift in power from institutional to individual investors reorients the long-term distribution priorities of asset managers. But it also has deeper impact on the industry's economics: asset-gathering becomes more expensive. While defined benefit plans and sovereign funds may now be slower-growing, they are all members of a club of sophisticated investors seeking opportunities worldwide. Consequently, they largely evaluate and purchase asset management products and services similarly. But the best sources of organic growth among institutional investors for the near future—insurance portfolios and defined-contribution retirement systems—have different buying dynamics, demanding more expensive regulatory compliance and detailed reporting.
More importantly, individual investor demand is more fragmented, eroding the industry's scalability—a principal driver of its favorable economics. For asset managers, creating leverage in acquiring and servicing individual investors worldwide is elusive, given how local customs and regulations shape demand differently by region. European and Asia-Pacific individual investors—currently the world's fastest-growing customer bases for asset management—represent particular opportunities and challenges.

Exhibit 5

Global Revenue Opportunity by Client Segment, 2016-2020E

Note: Revenue opportunity = fees from net flow and manager turnover. Source: Casey Quirk by Deloitte Global Demand Model
Europe: Continental Opportunity

After China, Continental Europe currently comprises the world’s fastest-growing asset management marketplace, clocking a 4% organic growth rate in 2014 and relatively similar expansion this year. Below-zero interest rates have forced Europe’s aging individual investors to seek yield from investment funds instead of deposits. Multi-asset products have been the best-selling yield replacement vehicles throughout the Continent.

The widescale shift into funds has accelerated regulatory change at the local and supranational levels, with policymakers eliminating inducements, promoting transparency and seeking pre-emptive approval of products. Distribution dynamics will change profoundly as a result, particularly after the second iteration of the Markets in Financial Instruments Directive (MiFID II). As regulators seek clarity regarding inducements, hybrid architecture systems blending proprietary and third-party product will attract scrutiny. Advice delivery will become more expensive, encouraging banks to maintain profits by offering simplified guidance digitally. And compliance costs will rise as asset managers structure their products to pass suitability tests.

MiFID II’s dawn will expand opportunities for asset managers, leading intermediaries to seek a wider range of third-party subadvisors. It will encourage single-priced allocation funds with embedded advice, rather than leave product decisions in advisors’ hands. It also will reshape competition among asset managers on the Continent. Brand will become more important, scale will become more useful in offsetting rising compliance costs, and wholesaling to external gatekeepers will further professionalize.

Exhibit 6

European Organic Growth by Market Segment, 2014

<table>
<thead>
<tr>
<th>Segment</th>
<th>Europe</th>
<th>North America</th>
<th>Europe</th>
<th>North America</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active Equity</td>
<td>-5%</td>
<td>1%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Active Fixed Income</td>
<td>4%</td>
<td>5%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Passive</td>
<td>5%</td>
<td>5%</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>Alternatives</td>
<td>3%</td>
<td>3%</td>
<td>4%</td>
<td>4%</td>
</tr>
<tr>
<td>MACS</td>
<td>9%</td>
<td>9%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: Casey Quirk by Deloitte Analysis
Note: Organic growth = flows as % of beginning of period AUM
**Asia-Pacific: China Ascendant**

Individual investors worldwide will reshape the industry, but those resident in China will have an outsized impact. Chinese mutual fund investors could purchase more than $1 trillion of mutual fund shares between now and 2019, representing an organic growth rate of more than 15% per annum. This year’s painful market correction will fail to interrupt secular trends, including the China Securities Regulatory Commission’s reform agenda, driving Chinese individuals from deposits to investments.

Even as Beijing relaxes current curbs on global investing, Chinese investors will remain locally focused. Their purchases, supplemented by the eventual addition of Chinese exposure to global equity and fixed income indices, will help create a sustained appetite for Chinese asset management products. Enterprise annuities, the defined contribution plans that will help China navigate its retirement crisis, will grow rapidly, driving demand for Chinese bonds. Mainland investors will hold more than $1 trillion of professionally managed Chinese portfolios by year-end 2019; individuals will account for 80% of the total.

Domestic demand will transform China’s asset managers into some of the world’s largest, and consequently they will face some of the same strategic issues that impact global players. In particular, successful domestic managers will have to address talent-retention issues, and differentiation in an increasingly crowded local marketplace for investment services. They also will secure skills, largely through acquisition, that let them effectively compete for foreign investor allocations to Chinese capital markets.

---

**Exhibit 7**

AUM in Professionally Managed Chinese Equity and Bonds (US$Billions)

![AUM Chart]

Source: Casey Quirk by Deloitte Global Demand Model
New Industry Dynamics: A Transformed Operating Environment

The rise of the individual investor not only changes the size and shape of asset management opportunities worldwide, but also the ways in that asset managers position their value to customers and compete with one another. These changes are the more profound ones, as they will redefine—and redistribute—the industry’s winners and losers during the next decade. Individual investors differ from their institutional counterparts in four significant ways—dramatically reshaping growth strategies for asset managers.

Exhibit 8

Investor Impact on Demand for Asset Managers

<table>
<thead>
<tr>
<th>Institutional Investors</th>
<th>Individual Investors</th>
<th>Industry Impact</th>
<th>Secular Industry Transition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Seeking optimized performance to meet liabilities over long term</td>
<td>Seeking specific cash flows over both short and long term</td>
<td>More Outcome-Oriented</td>
<td>1. A Redistribution of Product Opportunity</td>
</tr>
<tr>
<td>Able to build portfolios from existing strategies</td>
<td>Seeking advice customized to individual needs</td>
<td>More Service-Focused</td>
<td>2. A Shift From Products to Services</td>
</tr>
<tr>
<td>More concentrated, RFP-driven buyer landscape</td>
<td>Fragmented buyer landscape</td>
<td>More Efficient</td>
<td>3. A Challenge to Maintain Operating Leverage</td>
</tr>
<tr>
<td>Accredited investors</td>
<td>Consumer investors</td>
<td>More Regulated</td>
<td>4. A Re-Arranged Value Chain</td>
</tr>
</tbody>
</table>

Source: Casey Quirk by Deloitte

1. Investors will make the asset management industry more outcome-oriented, redistributing product opportunity. Institutional investors historically orient their portfolios around benchmarks; they use active asset managers hoping to generate long-term outperformance relative to an index or peers. This focus on benchmarks has evolved in recent years (our November 2013 white paper Life After Benchmarks explains why), but still shapes much of the industry’s demand and competition. Individuals, conversely, orient portfolios around savings goals, usually future needs for income.

Investors will need strategies that align against their desired outcome rather than an arbitrary market index. Consequently, actively managed strategies will comprise the majority of demand for the foreseeable future, fueled by a transition from beta-plus, low-tracking-error
products to less constrained, multifactor approaches. The largest beneficiaries of this shift will be multi-asset strategies that combine a variety of index-linked or quantitative factor exposures, active bets and dynamic asset allocation in pursuit of specific types of cash flows: income, growth, or downside protection.

Exhibit 9


By combining institutional and individual demand, this chart hides the growing influence of index-oriented investing. Passive assets under management have ballooned 20% in the past five years, driven by interest in exchange-traded funds (ETFs). As institutions insource and de-risk, their indexed portfolios will shrink in size. But in the individual marketplace, beta exposures will play two growing roles:

- **Substitutes for actively managed portfolios.** In highly regulated, fee-sensitive client segments (such as defined contribution schemes or the smaller-balance segment of U.S. and UK retail customers), many allocators will use index-tracking instruments to replace more expensive, low-tracking-error active managers.

- **Inputs to actively managed portfolios.** Indexing also will appear within actively managed allocation and multi-asset products that use ETFs and other vehicles to cost-effectively incorporate more macro-oriented market drivers. Liquid ETFs allow more dynamic asset allocation, and the rise of instruments tracking risk factors and other non-traditional market exposures—“smart” or “strategic” beta—will comprise a growing demand for systematic and indexed strategies in the individual investor marketplace.
2. **Individual investors will further transition asset management from a product to a service industry.** Asset management for institutional investors historically resembled a manufacturing industry: building standardized component parts for relatively sophisticated users adept at evaluating and assembling them, advised by multiple parties. But even this world is changing. Organic growth in the institutional marketplace now pools around fiduciary management, outsourced chief investment officer portfolios, risk overlays and other value-added services where asset managers engage in more customized technical conversations with clients. The benefit of these relationships is they are more persistent and noncompetitive by nature; the downside is they are more expensive to maintain.

Exhibit 10

**Global Institutional Revenue Opportunity by Select Products and Services, 2016-20**

As individual investors gain influence over the asset management industry's economics, they will further focus on services. Already U.S. financial advisors—the most varied and complicated distribution channel in the world—report that two-thirds of their service requirements involve portfolio-related questions: technical conversations about objectives and risk with clients, macro viewpoints, thought leadership and allocation discussions. Similar metrics are likely higher among private bankers in Europe and Asia, where clients and advisors are more sophisticated. Asset managers can differentiate themselves from rivals by meeting these service requirements.
3. **Individual investors will make the asset management industry more inefficient.** Institutional investing has common characteristics globally. Turnover is relatively low. Global investment consulting firms tend to run RFP-driven selection processes built on largely similar criteria and common data exchanges, providing significant leverage to asset-gathering efforts.

In contrast, individual investors are much more difficult, and therefore more expensive, to reach. In addition to the geographic differences described earlier, individual investors are more highly intermediated, at least for now. Asset managers usually need to support at least two layers of access—the head office of the intermediary network, and advisors themselves. Each intermediary organization has different rules, requirements, and data connectivity issues. Homogeneity and quality across an advisor force within a single intermediary organization is rare (particularly in the United States), making segmentation data critical. Manager turnover, importantly, is twice as high as the institutional segment.

This directly impacts the industry’s economics. Distribution efficiency among asset managers already was falling thanks to receding organic growth, especially in the institutional world. Individual investor sales are roughly one-third less efficient than institutional distribution, even today—further reducing the scalability that historically fuels industry margins.
4. Most importantly, policymakers will create more regulations to protect individual investors. Unlike accredited institutional investors, individuals are consumers whom politicians globally will race to protect. The ongoing shift to defined contribution systems worldwide only accelerates this trend. The list of regulatory initiatives is an alphabet soup of acronyms: the U.K.’s Retail Distribution Review, the U.S. Department of Labor’s proposed fiduciary requirements, Australia’s Future of Financial Advice rules and the European Union’s Markets in Financial Instruments Directive. These regulatory initiatives have different sponsors and histories but share two common themes that are reshaping the industry:

- **Objective and outcome-oriented advice.** Citing nearly two decades of registered product mis-selling scandals worldwide and rising investor dissatisfaction, regulators are proposing rules designed to make portfolio advice an objective function, favoring products and services that manage investor expectations. This will reinforce the outcome-oriented demands of individual investors.

- **Discrete pricing in the advice value chain.** Currently internal industry cross-subsidies tangle an individual investor’s fee budget. The legacy system involved investors paying all-in fees that asset managers, intermediary network firms, and individual advisors carved up and paid each other in complicated retrocessions and revenue-sharing. Most proposed or activated regulations encourage or compel separate prices for each investment advice provider.
All four catalysts—of which regulation is likely the most powerful—will re-arrange the advice value chain applied to individual investing, and re-allocate the fee budgets that individuals apply to their portfolios and advisors. Repercussions from this transition impact all investment advice providers: asset managers, financial advisors, and the intermediary platforms that connect them:

- **Advice providers will need to defend their value propositions.** Clearly pricing each element of the advice chain allows consumers to better measure value for money, and applies greater competitive pressure to all advisors—but particularly those easier to measure quantitatively, such as asset managers.

- **Allocation skills**, increasingly priced discretely at the advisor level, become more valuable, especially as allocation across the cycle becomes an important tool for providing outcomes individual investors demand.

- **Advice becomes more complex**, particularly around outcome provision. This will bifurcate advisors into two camps: those comfortable with building more complicated outcome-oriented portfolios, and those who will outsource these tasks, either to asset managers or the home office of their intermediary platforms.

- **Advice becomes more expensive to provide.** More service elements, more technical conversations, and more complicated investment strategies all translate into more, and more expensive, people and systems to deliver. The side effect of much of this regulation will involve significant disenfranchisement of investors with account balances too small to support required advice delivery at a profit, at least within most current intermediated systems. These investors in aggregate, however, control a large pool of assets, and represent a large opportunity for providing advice with disruptive technology and business models such as roboadvisors.

All these changes have two very important, and transformational, changes for asset management firms.

- The first is a threat: *their traditional manufacturing-oriented business model is less effective.* The front end of the advice delivery chain holds the “last mile” to the client, is most in tune with each individual investor’s custom needs, and can control asset allocation central to outcome delivery. In a zero-sum fee budget for advice, asset managers will feel the most pressure.
The second is an opportunity: disintermediation will become an effective disruption strategy. Asset managers able to blend effective outcome-oriented allocation advice with a service model focused on individual investors can compete more effectively. These firms can seize more of an investor’s fee budget and (more importantly) creates a more persistent relationship built on service elements that are tougher to compare between providers. Already, integrated offers to clients that blend delivery, allocation advice and underlying investment strategies—many of which are offered by intermediaries, not yet by asset managers—are growing twice as fast as traditional intermediary-driven advice networks.
Technology will play a critical role in disintermediation, although it remains unlikely that large technology companies will directly provide advice, given their allergies to highly regulated industries. Technology allows asset managers to directly distribute investment advice and products more effectively and profitably; it also can improve the customer experience, critical for client retention in a more service-oriented industry. Successful asset managers will invest in financial technology that makes them more competitive—critical in an industry where rivalry will become even more intense.

Source: Casey Quirk by Deloitte Analysis
Cutthroat Competition: Internal and External Rivalries

As individual investors reshape the operating environment, their demands have further exposed record levels of competition within the asset management industry. Although asset management revenues have reached all-time highs, fee rates—revenue per dollar managed professionally, net of distribution tolls—fell 8% between 2012 and 2014. Our initial estimates indicate the trend continued in 2015. Most importantly, passive investing explains very little of the fee compression, as flows in higher-fee active investment strategies counterbalanced indexing. And most gross redemptions came from lower-fee institutional mandates. Almost all the compression has come from discounting: investors paying less for the same investment strategies.

Exhibit 16

Asset Management Industry Realized Fee Rates Globally (basis points)

As in any industry, fee pressure is a sign of rising competition. The number of asset managers competing in each product category has mushroomed since 2010, and even top-decile equity managers must stand out from as many as two dozen competitors with relatively similar performance in each category. But shrinking organic growth and deteriorating industry economics are removing the insulation that has encouraged vendor proliferation. More than half of the world’s asset managers are now growing only through market appreciation, and will post far weaker financial performance in a prolonged market downturn. Too many similar-looking asset managers are chasing too little organic growth, creating an environment ripe for consolidation.

Note: Realized fees = management and performance fees net of distribution charges divided by AUM. Source: Casey Quirk by Deloitte Analysis.
While asset managers may face profitability and growth challenges, the industry’s relative economics remain more attractive than those in other financial services. A number of non-traditional entrants—from banking, insurance, and particularly wealth management—are augmenting the industry’s oversupply of traditional vendors. Asset managers only secured one-fourth of the wealth created worldwide in 2013 and 2014, despite overseeing nearly half the world’s assets.

Sources: Strategic Insight, eVestment, Casey Quirk by Deloitte Analysis
Banks captured some flows by offering liquidity, and insurers through selling protection. Many investors continued to advise themselves. But intermediaries—particularly full-service brokerages, family offices, private banks and some independent financial advisors—attracted most net new wealth without using asset managers. Realizing individual investors increasingly value the front-end elements of the advice chain—service, customization, and allocation—intermediaries emphasized these elements in their approach to individuals. Often they invested portfolios directly in securities or exchange-traded funds that provide many of the same factors asset managers create in their portfolios.

Asset managers historically built strategies designed to compete with each other. Going forward, they also must consider competing with other financial services, particularly if central banks worldwide start to raise the risk-free rates that banks and insurers can offer without the need for complicated advice. For asset managers, being better than peers is no longer sufficient; true success will come from looking different enough from others to attract the attention of individual investors.
Success Strategies: Competing Differently

Historically, asset managers serving institutional investors and other professional buyers relied on relative outperformance as a competitive advantage. This reflected the industry’s manufacturing model: all providers looked similar and provided similar-looking, if differently-performing, component parts. Most competition to date has focused on three metrics:

- Execution (investment performance)
- Distribution access (revenue-sharing and retrocession payments)
- Price (costs and efficiencies)

But for individual investors, these metrics are insufficient, and in some cases unnecessary. Oversupply blunts the advantage of relative outperformance, regulation eliminates the edge revenue sharing may have provided, and a low-cost strategy simply highlights the capabilities of much larger and more entrenched index-oriented providers. Individual investors and their advisors lack the time, ability or desire to compare multiple similar-looking providers at a granular level. Their decision framework will center on a more complicated, less provable question: who can provide the required outcome?

Consequently, we believe successful asset managers—those capable of strong organic growth—will possess highly differentiated competitive advantages that defy replication and strongly resonate with individual investors. Winning firms will stop struggling to stand out among hundreds of rivals, and start defining themselves as a peer group of one.

There are at least four ways asset managers can differentiate themselves competitively in the changing operating environment: product development, brand, specialized engagement and risk management. All four approaches, however, require at least three time-tested elements of success for any asset manager, in the past or in the future: talent acquisition and retention, efficient data management, and strong corporate development skills.

Successful firms will define themselves as a peer group of one.
Each of the four differentiation strategies requires significant management focus and potential investment:

1. **Product Development.** As outlined in our July 2015 white paper *New Arrows for the Quiver*, more than 60% of net new money worldwide flowed to investment strategies with track records of less than three years. Many of these new portfolios were the outcome-oriented investments sought by individual investors. Yet the asset management industry’s collective product development skills are relatively weak: less than 25% of strategies surpass US$1 billion of assets under management within 10 years. Firms with strong, and adequately resourced, product development and management processes can quickly create new products specifically designed for the changing needs of individuals, as well as rationalize subscale capabilities. This is a significant competitive advantage: firms that invest more in dedicated product development and management resources grow faster than peers.
An asset management firm’s history and skill set influence its product development strategy, but most successful product development processes share six characteristics:

- **Strong governance:** clear accountability and metrics for success
- **Process-oriented:** disciplined and repeatable
- **Control/creativity balance:** supports both innovation and swift execution
- **Cross-functional input:** balances views from investments, distribution, operations and business management
- **Adequately resourced:** including senior talent and seed capital
- **“No sacred cows”:** built to use data, not anecdote, to challenge long-held beliefs

There are multiple competitive benefits from strong product development, including:

- **A more agile product suite** that reflects changing demands of individual investors globally and adapts more quickly to cyclical shifts in sentiment, critical in a high-turnover client segment.

- **More tools for use in multi-asset portfolios,** strengthening allocation propositions and differentiating them from competitors in the marketplace.

- **Effective capacity management** that protects highly active investment processes and ensures maximum fee potential by targeting clients likely to pay a premium for the strategy.
• Elements of an investment leadership brand that closely links the asset management firm's identity with innovation.

2. Brand. Institutional investors, supported by multiple advisors who analyze new or lesser-known boutique fund managers, have been less concerned about a firm's brand identity; in fact, many preferred undiscovered managers from whom they could secure more capacity. Individual investors and their advisors, however, are less adept at such analysis, and use less quantitative criteria. Additionally, individual investors are increasingly skeptical about the asset management industry's ability to add value and therefore will take comfort in more traditional consumer branding elements, such as trust, reliability, and customer satisfaction.

The industry's net flows continue to underscore this point. Asset management firms with strong brand recognition attract flows even with subpar performance. Conversely, competitors with above-median performance but weak brand recognition actually suffer redemptions.

Exhibit 22

Organic Growth by Investment Performance and Brand Recognition, 2012-14

Successful asset management brands share elements with any well-known corporate identity, but there are a few key characteristics unique to the industry:

• Investment leadership. Successful brands in asset management do not simply imply outperformance. They underscore a differentiated view on markets, unique intellectual property or data, an ability to attract the brightest investment talent, and a culture that encourages innovation.
Enterprise-wide. Successful brands no longer focus simply on individual products, portfolio managers, or performance, all of which could be highly variable. Marketing messages for successful brands focus on the firm's entire value proposition for the individual investor, a more sustainable competitive advantage that encourages more direct contact and greater usage within a portfolio.

Service-oriented. Asset managers that position themselves more as a total portfolio advisor, rather than simply a product provider, reduce the risk of turnover and appeal to individual investors seeking a reliable customer experience.

Competitive benefits for asset managers that invest in a strong brand identity include:

- Successful product launches. Investors and even gatekeepers are willing to more quickly examine and use new products launched from asset managers with proven, innovation-focused brands.

- Persistent client relationships that survive longer periods of underperformance, as the buying criteria around the brand comprises more than historical investment returns.

3. Specialized Engagement. Asset managers describe themselves as fiduciaries, but their businesses remain transactional: products are manufactured and sold. Because individual and institutional investors have become more outcome-oriented, they view the purchase of investment advice as a service: customized to their needs and built around an experience that reinforces the advisor's technical expertise.

Supporting these customized, technical conversations profitably and at scale with individuals and their advisors is difficult without using product specialists—the same officers with technical investment expertise that traditionally have provided sales and service leverage in the institutional world.

Firms that have dedicated and well-organized product specialists are better able to support the more service-oriented engagement both individual and institutional investors now seek. Consequently, firms with stronger product specialist groups tend to grow faster than their performance alone would imply.

Additionally, in a low-growth environment, successful engagement models are built not only to gather clients but also retain them. Product specialists and dedicated client service personnel become important for delivering ongoing holistic advice that can keep clients for the long term. Paying them on a more discretionary basis, rather than through gross commissions, helps reinforce client retention goals.

---

Engagement models should retain, as well as attract, clients.
Our May 2014 white paper *Retooling U.S. Intermediary Sales* outlines several elements of specialized engagement models that provide technical advice to individual investors. Key characteristics, applicable not only in the U.S. but increasingly worldwide, include:

- **A unique segmentation approach** that prioritizes advisors by how they build portfolios, rather than by channel or book size. Portfolio assembly characteristics reveal more about the amount and type of advice an advisor seeks.

- **Technical sales resources**, with product specialists or similar resources increasingly deployed within intermediary as well as institutional relationships.

- **Targeted, high-quality thought leadership**, supported by dedicated marketing infrastructure and resources.

- **Redesigned incentive systems**, including compensation packages with larger discretionary elements and rewarding not just gross sales but net flows.

U.S. asset managers that adopt elements of these specialized engagement models realize tangible benefits, especially among individual investors and their advisors: more than 15% more productive distribution at nearly 20% less cost.
4. **Risk Management.** Individual investor demand for multi-asset class and other allocation strategies will orient most product development and distribution around discussions of the entire portfolio. Asset managers that not only understand a client’s entire portfolio, but also use technology to optimize its management, reinforce their value to individual clients. They also appeal to financial advisors who lack access to the sophisticated analytical tools that dissect a portfolio.

This focuses significant attention on portfolio analytics focused on risk management, especially given the entire asset management industry’s transition toward managing various exposures defined by risk. As views on risk become pillars of a firm’s investment philosophy and process, proprietary risk analytics that measure and reinforce these insights become more important. Several integrated wealth management propositions, including some roboadvisors, are differentiating themselves with risk management analytics. The asset management industry’s investment in risk management capabilities has jumped considerably.

**Exhibit 24**

<table>
<thead>
<tr>
<th>Risk Management Expense Growth, 2012-14</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012: 5%</td>
</tr>
<tr>
<td>2013: 14%</td>
</tr>
<tr>
<td>2014: 17%</td>
</tr>
</tbody>
</table>

*Source: Casey Quirk by Deloitte/Institutional Investor Institute/McLagan Performance Intelligence*

Asset managers offer varying portfolio optimization technologies and tools, but some of the more successful ones share the following characteristics:

- **Institutional-grade risk management philosophies and tools,** enabling the asset manager to extend the credibility and brand of professional-grade risk management capabilities to individual investors.

- **Unbundled applications,** such as investment tools and technology that allow distribution officers to use the analytics in conversations with advisors across their existing portfolios.
• Intuitive and accessible interfaces, often using easy-to-understand graphics and metrics to facilitate using analytics in both advisor and client conversations.

On top of improving investment performance, developing proprietary technology for risk management and portfolio optimization can provide a number of advantages, including:

• Deeper relationships with individual investors and advisors, as risk management analytics not only enhance portfolios but also provide more information for technical discussions about investments. Individuals and institutions are demanding more conversations about risk management.

• Further investment leadership branding, with risk management and other portfolio optimization tools reinforcing cutting-edge approaches to investing, particularly when coupled with thought leadership.

• Information flow, especially from unbundled analytics that can provide further insight into advisor behavior and client portfolios, aiding advisor segmentation strategies.

While the method of competition may change for most asset managers, some elements of achieving success still remain the same:

1. Talent Management. Despite its recent focus on technology, the asset management industry always will be a human capital business. Attracting and keeping the right investment professionals, distribution officers, and business managers will provide competitive advantage. Finding incentives that align a professional’s personal wealth incentives with the firm’s strategic objectives is critical for asset managers to successfully manage talent. Our data on incentive structures and quanta underscore that asset managers with long-term compensation based on organic growth and franchise value fare better than rivals.
Asset managers always have aggressively recruited strong portfolio managers and salespeople. Building more differentiated value propositions to clients, however, requires a wider range of talent. Key functions becoming more important within asset management firms include:

- Information technology
- Operations
- Marketing
- Product development
- Business management
- Strategy

2. **Efficient Data Architecture.** Asset management trails most other financial services firms in using technology to improve operational efficiency. This is partly a function of the industry's rapid growth: building operating leverage took more time than letting rising capital markets inflate asset profit margins. Additionally, the serial mergers and acquisitions that created most of today's larger asset managers resulted in significant front-office integration that remained missing from cobbled-together middle- and back-office infrastructure. Finally, as firms expand geographically, many have struggled to connect regional data repositories, adding to inefficiencies.
But as the industry's primary clients become individuals instead of institutions, inefficient systems will fail to keep up with a larger amount of smaller clients that require greater regulatory compliance. Individual investors focused on outcomes are more complicated, and asset managers will become more complex as a result. Existing data architecture at most asset managers will be woefully insufficient. The impact of strong and weak internal data systems is already evident: firms that invest more in technology have better margins.

Exhibit 26

Operating Margin by Technology Expense, 2014

Information technology infrastructure improvements take a number of forms: application management, cloud computing usage, and automation. Enterprise data management and its integration into management information systems, however, is where asset management firms in particular can create significant competitive advantage. True enterprise data management within an asset management firm links data from multiple locations:

- **Human resources**: incentives, benefits, payroll, and performance reviews
- **Finance**: budget data and key management performance metrics
- **Operations**: risk management, trading data, back-office information
- **Distribution**: customer relationship management (CRM), client and advisor data
- **Business intelligence**: external market data and competitive intelligence

Note: Technology spend defined as % of total costs.
Source: Casey Quirk by Deloitte/Institutional Investor Institute/McLagan Performance Intelligence
Linking these disparate functions lets asset managers not only optimize internal operations, but also mine data for competitive advantages:

- **Customer segmentation data** that precisely targets the most appropriate individuals, advisors and institutions representing the firm's best prospects. Such segmentation is critical for rationing scarce capacity in highly active products as well as the time and bandwidth of technical resources like product specialists.

- **Product management data** that measures long-term growth and profitability prospects at a granular level, prioritizing the most scalable product offers.

- **Talent management data** that provides a more accurate view on how each individual moves the firm's strategy forward, encouraging wider use discretionary incentives that support both quantitative and qualitative progress.

3. **Corporate Development.** Asset managers need new skills to better differentiate themselves, and the ability to secure those new capabilities quickly and smoothly is critical. Mergers and acquisitions, consequently, have become an important method by which asset managers can compete. The number of asset managers expanding inorganically has jumped dramatically during the past five years.

*Exhibit 27*

**Number of Asset Managers Buying Asset Managers**

![Graph showing the number of asset managers buying asset managers from 2009 to 2014.](image)

*Sources: Pensions & Investments, Casey Quirk by Deloitte Analysis*
Catalysts for mergers and acquisitions in other industries—consolidation, cost efficiencies, financial engineering—are weaker in asset management. Cost synergies rarely materialize in a talent-driven business where personnel retention is critical and comprises most of the middle line. Consolidating market share fails to provide stronger competitive differentiation in a changing industry: two poorly positioned firms add up to a larger, worse-positioned firm. And acquisitions driven by balance sheet advantages are less effective in asset management, which has low capital intensity. The types of mergers and acquisitions that work best in asset management include those that:

- Add new investment skills and capabilities
- Secure access to a new client segment
- Gain innovative technology that can support competitive differentiation

Corporate development teams among successful asset management firms tend to share the following characteristics:

- They are well-informed and strategic, targeting acquisitions based on gap analyses, market intelligence and strategic objectives. Opportunistic acquisitions based on availability and price rarely add substantially to franchise value.

- They are proactive, reaching out directly to target teams and firms to build closer relationships. They consider liftouts, partial acquisitions, incubation strategies and other creative methods of securing needed skills.

- They are experienced in onboarding acquisitions, developing integration processes and goals that minimize execution risk. These processes include compensation alignment, client communication, systems integration and product development.
**Conclusion**

To compete effectively in the evolving operating environment, asset managers must invest in talent, capabilities and systems. All of these are costly in terms of capital, management bandwidth, and opportunity cost. Yet the return on these investments is already evident. Franchise value has become increasingly correlated with elements of organic growth. Asset management firms that keep expanding in a cooling industry are worth more to shareholders of all types.

*Exhibit 28*

**Franchise Value Drivers, 2015**

<table>
<thead>
<tr>
<th>Factor</th>
<th>Correlation to Forward 12-Month P/E</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue Growth</td>
<td>71%</td>
</tr>
<tr>
<td>Organic AUM Growth</td>
<td>49%</td>
</tr>
<tr>
<td>PM Experience</td>
<td>48%</td>
</tr>
<tr>
<td>Above Median Profit Margins</td>
<td>30%</td>
</tr>
<tr>
<td>Investment Performance</td>
<td>24%</td>
</tr>
</tbody>
</table>

Note: Sample includes major publicly traded fund managers worldwide. Source: Casey Quirk by Deloitte Analysis

The rise of the individual investor also will accelerate some longer-term changes in the industry:

- Industry profit margins will remain attractive and in line with historical norms, but the range in profitability between successful and unsuccessful asset managers will widen.

- Global institutional investors will still represent significant revenue opportunity, but gaining assets in a marketplace characterized by turnover instead of growth will require a different product set and a new engagement model.

- Regulatory oversight will prevent technology companies from becoming direct competitors to asset managers, but they increasingly will ally themselves with a range of financial services companies to support advice delivery to individuals.
• Group financial services companies, with bigger brand budgets and more tools with which to provide individuals with the cash flows they desire, will seek to become more effective owners of asset managers, and will spur M&A that may encourage industry concentration.

• Investment performance remains a key ingredient of success, but will become more difficult to report, measure, and compensate (through fees) in an outcome-oriented, individual-driven world—making brand more important.
The Roar of the Crowd:
How Individual Investors Transform Competition in Asset Management

CaseyQuirk by Deloitte

Casey Quirk by Deloitte helps clients develop broad business growth strategies, improve investment/product appeal and growth prospects, evaluate new market and product opportunities, and enhance incentive alignment structures. Our unparalleled industry knowledge and experience, detailed proprietary data, and global network of relationships make Casey Quirk by Deloitte a leading advisor to the owners and senior executives of investment management firms in the world.

To discuss this white paper, please contact:

Benjamin F. Phillips
Investment Management
Lead Strategist - Consulting
New York
bfphillips@deloitte.com
US +1 347 269 1324

Kevin P. Quirk
Principal
Darien
kpquirk@deloitte.com
US +1 203 899 3033

Jeffrey A. Levi
Principal
Darien
jalevi@deloitte.com
US +1 203 899 3035

Daniel Celeghin
Head of Wealth Management Strategy
Asia-Pacific
Hong Kong
dceleghin@deloitte.com
+ 852 3103 1070

Michael G. McConville
Senior Consultant
Darien
mmconville@deloitte.com
US +1 203 899 3026

This publication contains general information only and none of the member firms of Deloitte Touche Tohmatsu Limited or their respective related entities is, by means of this publication, rendering business, financial, investment, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. None of the member firms of Deloitte Touche Tohmatsu Limited or their respective related entities shall be responsible for any loss sustained by any person who relies on this publication.

About Deloitte
Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/about for a detailed description of the legal structure of Deloitte Touche Tohmatsu Limited and its member firms. Please see www.deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2016 Deloitte Development LLC. All rights reserved.
Member of Deloitte Touche Tohmatsu Limited