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An industry rearranged

Winning asset manager lessons for the post-pandemic era

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2022—a year characterized by substantially down equity and bond markets (a phenomenon not witnessed in nearly 50 years), inflation levels not reached in 40 years, noticeably heightened geopolitical instability, and a world emerging from a historic pandemic—will almost certainly serve as an inflection point for the asset management industry. Investors will reconsider their decade-long approaches and portfolios in light of their recent experience. For asset managers, that will mean change, opportunities, and challenges.

The last time the industry experienced this kind of disruption was during the Global Financial Crisis of 2007–2009 (GFC). In the decade that followed, we witnessed a critical shift in the competitive landscape that we had not seen before in the asset management industry: a select group of winning firms using the crisis as an opportunity to separate themselves from the pack. Our research suggests that there is much to be learned from this era.

In the decade that followed the GFC, winning firms *separated from the pack*

This paper aims to isolate the strategies that winning firms deployed and provide a useful framework to guide asset management executives today as they look toward the next decade.

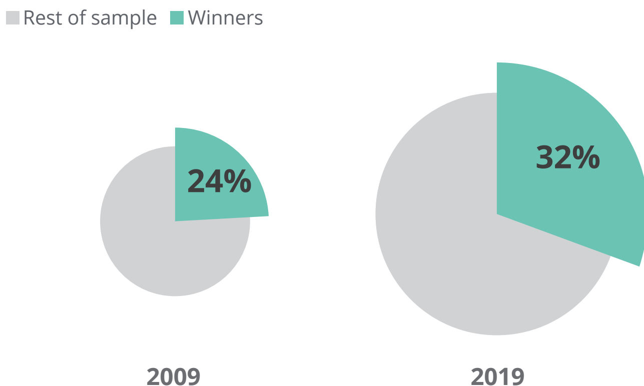
The GFC: An industry inflection point

We analyzed 50 of the largest asset managers globally in the decade following the GFC. This group represented slightly more than 55% of the industry's total revenues as of year-end 2009 and grew to slightly more than 60% by year-end 2019. But an interesting phenomenon, which we did not observe meaningfully in the periods preceding the GFC, emerged clearly in the research: *winning firms represented all of the net consolidation gains and then some*. Winning firms—which we define as those that grew net new revenues (revenues associated with positive net flows) at a rate greater than the industry average for the 10-year period and amounted to about 20 firms in total—grew their total industry revenue share from 24% to 32%. These firms also exhibited superior financial performance in other critical metrics that have helped separate them from the pack—they grew annual dollar profits at a 10% rate (versus 8% for others in the sample) over the 10-year period, exhibited 1.3 times higher productivity (as measured by revenue per full-time equivalent (FTE) as of year-end 2019, and invested 2% more of their revenues each year in technology as of year-end 2021. Interestingly, winning firms varied in size and type—alternatives, passive, fixed income, and solutions-focused firms, for example, were all represented.

FIGURE 1

Winning firm consolidation

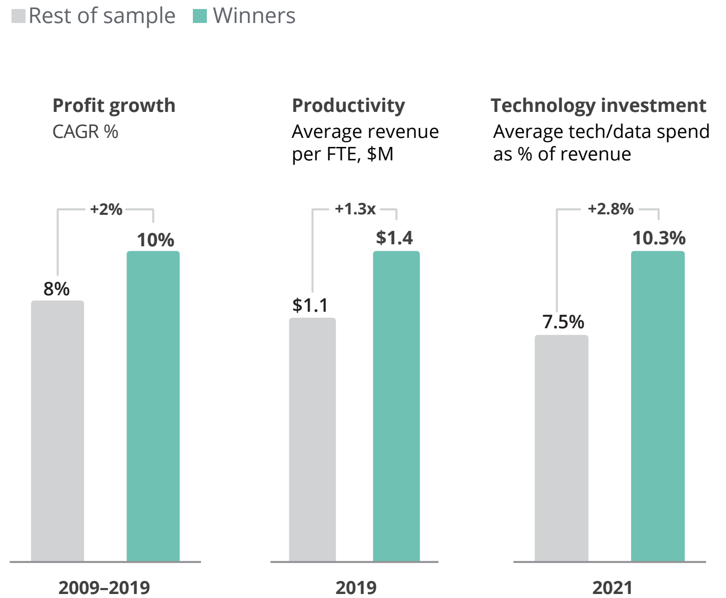
Winning firms' share of industry revenue



Note: Bubble size represents total annual revenues each year for the total sample.

FIGURE 2

Winning firm characteristics

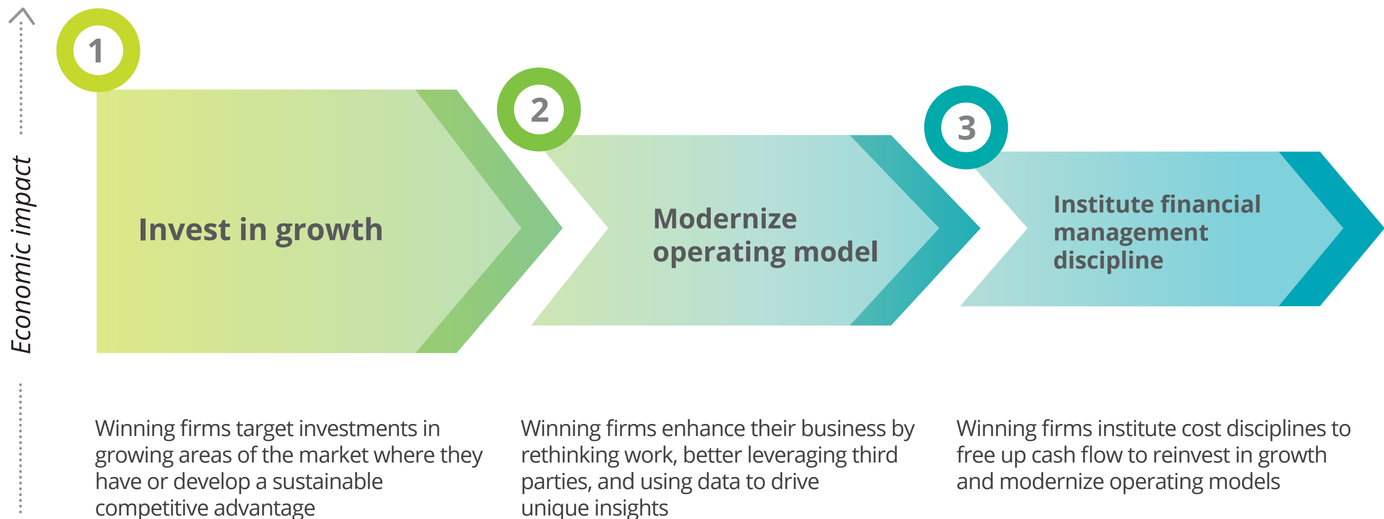


Note: FTE = full-time equivalent

Based on our extensive research and experience working with many of the leading firms over the past several decades, there were *three essential ingredients* that drove separation of the winners from the pack during the decade following the GFC: these firms (1) more effectively **invested in growth**, (2) were better at **modernizing their operating model**, and (3) instituted **better financial disciplines**.

These three ingredients for success will remain largely the same in the coming decade. However, the best playbooks for the next decade will need to account for both the changing competitive landscape that has emerged since the GFC and the unique changes in the current operating environment. We are facing a very different investment environment, and business models are being redefined: cultures are adapting to the emerging hybrid work environment, operating models are being reimagined, and deglobalization and fragmented regulation increasingly challenge firms' legacy models. These changes present an opportunity for managers to recalibrate their strategy and define how they will compete to win in the next decade.

FIGURE 3
Winning strategies



Ingredient No.1: Targeted investment in growth

Naturally, the ability to persistently grow the top line of their businesses was the most important feature of winning firms in the decade following the GFC. But what was the recipe, and does it have application for executives today? Our research points to *four common themes* that have strong application for today's leaders.

Winning firms are *better able to target growth opportunities*. A clear view of structural changes in the investment environment and future buyer demand shifts are central to identifying future opportunities. Coming out of the GFC, some tailwinds appeared more evident than others. Low rates and banks reducing their lending, for example, fueled growth opportunities in active fixed income and private-market strategies. The investing experience during the GFC changed perceptions around the value of active investing, fueled a substantial shift from active to passive investment approaches, and drove the popularity of the exchange-traded fund. The rapid growth in individual-driven markets, including retail, wealth, and retirement, rewarded firms that were best able to pivot their businesses into these segments. Winning firms successfully identified these growth tailwinds early in the cycle to harness superior growth.

Winning firms better target *growth opportunities*

It may appear that future growth tailwinds are more difficult to identify today. However, identifying them today is really no different than it was a decade ago. The dynamic exercise of evaluating growth opportunities and one's competitive differentiators *(see the attached Simple Growth Prioritization Framework)* is an essential strategic discipline for the leaders of any winning asset manager. The dramatic shift in the investment and economic environment we've witnessed in recent years suggests a change in the spectrum of opportunities, while long-term market demographic shifts and demand patterns are even easier to deduce. Secular patterns of the past decade—passive investing, institutional demand for privates, the need for solutions, and the rise of the individual investor, for example—seem certain to continue as important drivers of expansion.

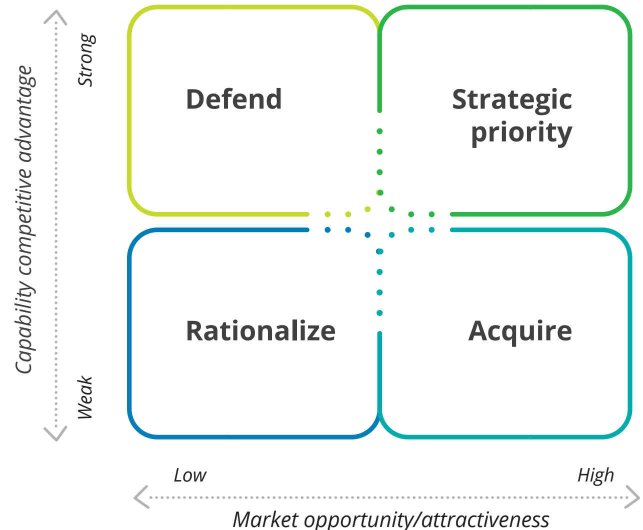
However, growth rates in these areas will slow, and the changing environment (which will have a long-term effect on the investor mindset) will reveal new growth tailwinds. A drastic reset in the rate environment may provide investors with the opportunity to access the fixed income markets in ways they haven't been able to in nearly a generation. The growing individual market is clamoring for the same private investments opportunities that institutional investors have enjoyed. The theme of customization will continue, but new strategies such as direct indexing will likely further transform the way products are delivered to investors. Interestingly, some growth trends that seemed blindingly obvious as recently as a year or two ago, such as the rise in global demand for environmental, social, and governance matters and the rapid opening of the Chinese market, suddenly face headwinds that will cause many to reconsider their approaches. Regardless of the specific opportunity, history has shown a distinct growth advantage to those firms that identify and act on those new tailwinds earlier than their competitors.

Winning firms establish a *differentiated brand of investments excellence*. Following the GFC, winning firms leveraged, and typically broadened, their investments capabilities to differentiate their brand from the investment manager masses. Often the foundation was familiar—clear investment philosophies, proven track records delivered by strong and persistent talent, industrialized investment processes and engines, and deep investment in insight-oriented and risk technology. But winners typically were able to broaden that footprint in different ways—for example, establishing natural investment adjacencies, positioning themselves as investment solutions providers, or establishing scale in commodity-like product areas.

Future winners will need to honestly and objectively evaluate their own capabilities, identify key gaps, and develop capability enhancement plans to determine where to differentiate. New avenues for asset managers to establish their own unique brand of excellence will evolve out of the disruption introduced by the rise of passive, new technologies and quantitative techniques, and the increased use of private investing. Differentiating sustainable proprietary investments will be grounded in processes and investing tools oriented more around data and technology and access/relationships in the future. This will likely include capabilities focused on origination and securitization: technology-, analytics-, and artificial intelligence (AI)-enabled data synthesis; differentiated data acquisition; and index construction.

FIGURE 4

Simple growth prioritization framework



Winning firms *invest in an outstanding client experience*. In the decade following the GFC, successful firms made a concerted effort to better understand their clients' motivations, interaction preferences, and behaviors. For example, they invested in data and analytics to identify client retention issues and sales opportunities, senior-facing client professionals that emerged as the "first call" on the biggest issues clients were facing, thought leadership and research to assist clients in their investment decision-making, and CRM systems that served as internal and external communication hubs. These investments have led to a differentiated, and potentially very difficult-to-catch, value proposition in the market contributing to higher growth and better client retention.

Looking forward, leaders in client experience will adapt to three facets that will shape client expectations: shifts in virtual versus in-person preferences, engagement frequency and content, and on-demand preferences. Leading distribution organizations will break down silos among marketing, sales, and client service to deliver a more seamless experience. Additionally, they will leverage distribution technology to deliver more personalized experiences that complement the in-person sales interaction and allow more interactivity and higher-quality touchpoints.

Winning firms better *execute* on business transformation

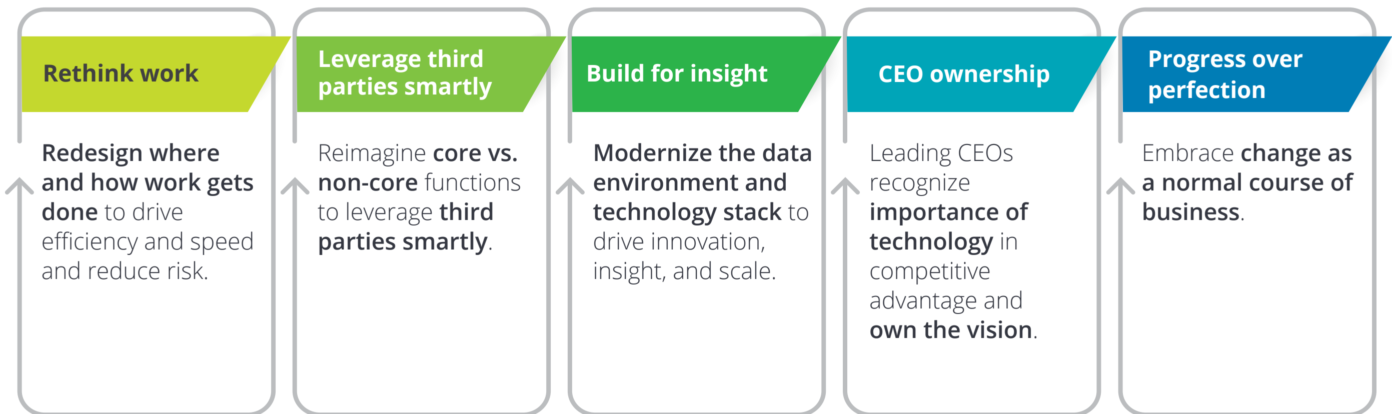
Winning firms are better at *executing on business transformation*. Whether it was better to invest in scale or the client experience, to develop investment capability adjacencies, or to pursue acquisitions, winning firms in the decade following the GFC *executed better*. Executing on change always requires vision and depends on boldness and decisiveness on the part of leadership. Firms that are effective in transforming themselves are led by visionary leadership teams that embrace strategy and innovation as a daily routine and are willing to break down organizational silos to effect change. Leading firms clarify and communicate their vision and long-term goals, prioritize and focus their investments, resource their investments with dedicated project leadership, set reasonable milestones/key performance indicators (KPIs) and hold themselves accountable, align and incent desired behaviors across the organization, and dynamically adjust their transformation strategy by investing behind success and cutting losses when necessary.

Ingredient No. 2: Operating model modernization

The second substantial initiative that winning firms embraced in the decade following the GFC was a willingness to disrupt the status quo of how their businesses operated. These firms embraced new and innovative capabilities that improved their investment processes, product quality, investment returns, client experience, sales productivity, operational efficiency, client tenure, business decision-making, internal controls, and talent experience. Over the past decade, operating model changes were motivated by aspirations around growth, flexibility and business agility, improved scale, reduced cost and risk, and improved M&A integration. Looking forward, leading firms will aggressively seek to further simplify and modernize their operating model and reorient core activities around client preferences, rather than traditional business functions or products.

FIGURE 5

Modernize operating model



Winning firms design *more efficient methods* of performing work

Winning firms *rethink where and how work gets done*. Processes will be dismantled and redefined to reduce manual work, handoffs, duplication, and low-value work being performed by expensive talent. Smart automation will continue to simplify workflows and allow firms to redirect focus to processes that support competitive advantage. Distilling key processes down to their lowest common denominator exposes redundant activities and allows firms to centralize activities, operate with greater scale, and determine primary opportunities for automation. Winning firms will integrate AI into their workflows to enhance the efficiency, productivity, and output quality of their professionals. The redrawing of processes also illuminates options and key considerations to rethink location strategy—more thoughtfully embracing nearshore and offshore talent models, restructuring management and teams globally, and determining how to best embrace emerging virtual and hybrid work environments.

Winning firms *leverage third parties smartly*. The provider ecosystem, inclusive of outsourcing providers, technology vendors, cloud firms, data platforms, and professional services firms, has never been more sophisticated—and many of these firms have built their competitive edge in the exact areas that asset managers lack scale and a clear value proposition. The result is an increased willingness by leading firms to embrace the rapidly evolving ecosystem through new partnerships, alliances, and collaborations—including mergers and acquisitions. This includes leveraging third parties to simplify the tech stack with fewer, deeper, more thoughtful partnerships (with stronger integration across the platform); establish contracts with service providers to fulfill variable talent needs and address key skill gaps; and partner with third parties to innovate across the value chain. Some leading firms are even accessing the broader ecosystem as both a client (using third parties for non-core business needs) *and* a provider (delivering their differentiated intellectual property to competitors through technology, data, and analytical tools) requiring managers to think differently about co-opetition versus competition and how to operate more effectively across the full industry value chain.

Winning firms *build their operating model for insight*. Historically, asset managers designed their operating model for capability enablement, with expansions in product and client strategy that resulted in the incremental additions of people, processes, and technologies needed to support them. This led to extremely complex workflows, highly siloed data, systems that lacked sufficient integration, narrowly defined jobs that limited professionals' impact and increased operational and business risk, and an inability to look across the business to make sound decisions. Leaders will likely shift their operating models from a focus on *hindsight* to a model focused on *insight*—where end-to-end operating model connectivity enables improved data curation, deeper business insight, and a more seamless client experience. Firms will likely eliminate (or at least reduce) their operating model silos and reorganize around the client—improving time to delivery in key client activities, driving more robust reporting, and improving overall client service levels. At the same time, leaders should establish data fluidity across the enterprise through the build-out of data repositories; the establishment of proper data governance, data, and system integration; and the prioritization of business use cases. A key output is flexible, interactive, data-driven dashboards (often supported by advanced analytics) available to key decision-makers to improve decision quality and judgment.

Winning firms *are led by* CEOs who own the technology vision

Winning firms have *CEOs who take ownership of the data and technology vision* of their organization. CEOs who recognized that data and technology were critical to their firms' competitive advantage were able to separate their firms from the pack. These CEOs embraced data and technology as essential to achieving the firm vision, elevated technology (and operations) leadership as equal partners and collaborators with the business, and significantly invested to drive innovation and improve data and technology foundational capabilities. Critically, these CEOs are challenging the core business implications of technological choices and prioritization and, in turn, instilling an enterprisewide culture of innovation and tech fluency.

Winning firms *prioritize progress over perfection* in their evolution. This means embracing change as a normal course of business, where all members of the organization participate in continuous improvement and embrace an agile mindset. At these firms, operating model changes are made iteratively, supported by proactive change management to drive adoption while continually seeking to incorporate lessons learned in near real time to enable further improvement. Leaders instill a culture of smart risk-taking—expecting and embracing failure, and rewarding progress and small victories (versus major milestones) through additional funding and recognition. These firms build agility in their teams and how they approach program execution; are diligent about pausing lagging projects to shift resources toward high-value programs that drive growth, efficiency, simplification, and scale; and are migrating away from waterfall or annual program funding.

Ingredient No. 3: Financial management discipline

Asset management remains one of the most financially attractive industries in the world: median profit margins north of 30%, very healthy levels of compensation, revenue growth tied to typically rising capital markets, and high cash-flow-generating/low capital-intensive business models. However, it is these very characteristics that can encourage poorly conceived spending policies.

For winning firms, the decade following the GFC was one of incorporating *more robust financial management disciplines* to improve profitability and free up cash flow for reinvestment. As fixed costs in the industry rose (for example, non-compensation and benefit costs have risen from representing, on average, 22% of revenues during the GFC period to more than 30% of revenues in the past five years), winning firms established a fit-for-purpose operating model, created a culture of financial accountability and stewardship, and provided a robust financial toolkit to arm business leaders to make sound decisions.

Winning firms view financial management discipline *as a means to redirect investment toward growth*

A direct outcome of operating model modernization outlined in the prior section is a *fit-for-purpose operating model* that addresses inefficiencies and optimizes cost structures. Winning firms target increased efficiency across people, process, and technology to achieve these results. The number-one lever firms can pull is tightening people costs, which account for roughly 75% of the typical asset manager's expense structure.

This includes eliminating unnecessary and duplicative roles; thinning out or consolidating management; and employing offshoring, nearshoring, and outsourcing. Levers beyond people costs alone require significant effort to reengineer and simplify processes, decommission systems and redundant tools, and strategically leverage workflow and digital solutions. These simplification efforts can significantly reduce wasteful technology spend, which is the single largest cost area for asset managers after people. Technology costs have risen at an annual rate of 18% over the past three years (roughly double the rate for overall operating expenses). Winning firms have installed practices and teams that periodically review the operating model and organizational structure, assess efficiency and productivity, track costs and benefits, and drive improvement initiatives. These are the firms that regularly realign staffing levels and incentive schemes to rebalance and reduce areas of bloat and refocus on areas of growth.

Firms with *strong financial management disciplines drive financial accountability* across leadership and their teams. Executives lead by example and provide incentives for similar behavior. Employees are incented to act like owners with aligned interests, with appropriately designed performance reviews and opportunities to make an impact on the firm. Functional or program budgeting efforts designed for cost containment leverage a clear prioritization methodology, so critical programs move forward and key growth initiatives are not curtailed. Leading firms create a culture of financial responsibility and an efficiency-driven mindset that permeates all levels of the organization and creates accountability for smart spending decisions. It is also important to note that while cost-cutting is a component of robust financial discipline, cost-cutting by itself is a path to mediocrity in asset management.

Robust financial management discipline requires a deep understanding of business performance, the sources and uses of cash, key operating metrics and KPIs, and the overall health of the business. Leading firms embrace a *robust financial toolkit* to manage and monitor the business, assess profitability, and improve decision-making. Over the past decade, advancements in management information systems have shifted from periodic static reports with standard metrics toward automated self-service dashboards that provide end-to-end views, including total cost of ownership. As firms continue to establish high-quality, trustworthy, centralized data repositories and robust reporting capabilities, significant management value will be created. Cross-functional decision-making will be more data-driven and less anecdotal, driving stronger leadership team alignment. Improved costing methodologies and advanced analytics will enable leaders to derive new insights on the business to promote smarter spend practices, understand business profitability, and manage expectations more effectively.

Capitalizing on disruption

The decade following the GFC permanently rearranged the asset management industry's competitive landscape. A select group of firms demonstrated that acting boldly and decisively was a winning formula. But future success for these same firms is hardly a foregone conclusion—investors' needs change and their search for the best products, solutions, and partners is constant. The firms that best execute on building visions with enduring competitive advantage, investing successfully in targeted growth areas, modernizing their operating models to deliver outstanding client experiences, and leveraging strong financial management disciplines will be the asset management industry's winners in the next decade.

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