

Report
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The new Great Game in North American asset management

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The competitive landscape is being reset by a small group of visionary asset managers jockeying to deliver distinctive propositions at scale.

The North American asset-management industry is undergoing a major shift in competitive dynamics. Even as the secular tailwinds of demographic change, wealth creation, and financial deepening continue to bolster the industry's long-term attractiveness, a set of countervailing trends in product demand, fee compression, and regulation are creating new challenges for asset managers.

Amid these shifts, a number of forward-thinking firms are making bold moves to grow their share in ways that are fundamentally reshaping the market. Pricing is being deployed as a strategic lever to attack new markets, product innovation is unlocking new categories of demand, technology is being leveraged at scale to turbocharge core investment and distribution activities, vertically integrated business models are supporting new client value propositions, and acquisitions are being used to accelerate capability building and deliver efficiencies.

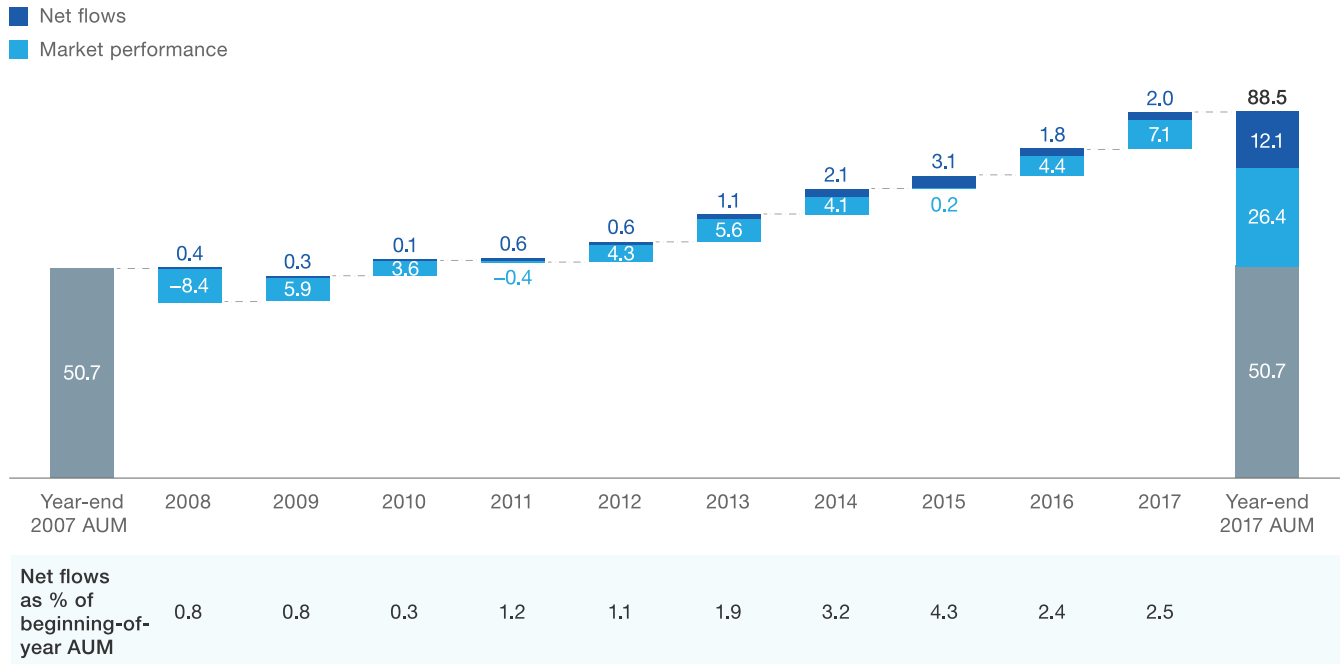
The rules of the game, in short, are being rewritten. Akin to the original geopolitical "Great Game" of the 19th century, a complex strategic ballet that saw two great powers, Britain and Russia, wrestling for control of Central Asia amid a constantly shifting array of regional alliances and proxy wars, the competitive landscape of the asset-management industry is being reset by a small group of visionary firms. These competitors are jockeying to deliver distinctive propositions at meaningful scale, whether low-cost manufacturing, scalable alpha generation, or end-to-end delivery of client needs.

The North American industry's performance in 2017 portended a major shift in this direction. Record-setting market performance, spurred by a return of the retail investor and sustained flows from emerging markets, made 2017 a banner year for the industry as a whole. Global assets under management grew to an all-time high of \$88.5 trillion, industry profits increased by 20 percent, and net new money entering the industry rose to \$2.0 trillion (Exhibit 1). North American managers pulled in a record of more than \$683.0 billion in net new flows to managed assets while industry profits, excluding alternatives, grew some 20 percent to \$44.5 billion (Exhibit 2).

Exhibit 1

The global asset-management industry hit an all-time high in terms of assets under management in 2017.

Year-end global¹ assets under management (AUM), \$ trillion²



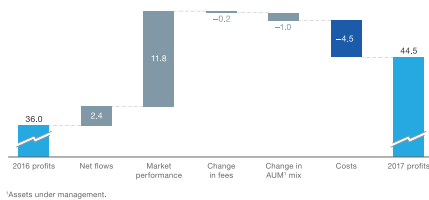
¹Includes 41 countries from Africa, Asia (developed and emerging), Central and Eastern Europe, Gulf Cooperation Council, Latin America, North America, and Western Europe.
²Figures have been rounded.

McKinsey&Company | Source: Global Growth Cube, from Performance Lens by McKinsey

Exhibit 2

The vast majority of growth in industry profit pools was driven by the massive tailwinds of the market.

Traditional (excluding alternatives) asset-management industry profitability in North America, 2016-17, \$ billion



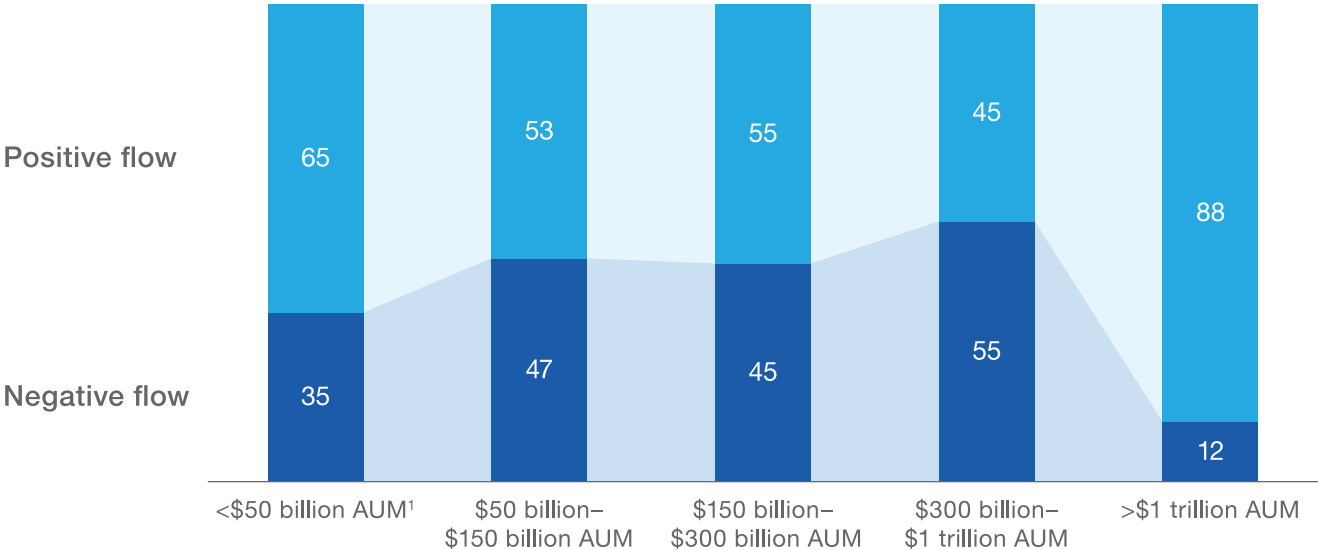
McKinsey&Company | Source: Global Growth Cube, from Performance Lens by McKinsey

Yet, this rosy picture masked a gap between the haves and have-nots that grows ever wider, particularly when viewed through the prism of organic growth. In 2017, the growth gap between top- and bottom-quartile firms in North America was 21 percentage points, up 6 points from 2016. More strikingly, the industry’s largest firms accounted for a disproportionate share of growth—those with \$1 trillion or more in assets under management were overrepresented among those capturing organic growth (Exhibit 3).

Exhibit 3

Organic growth was particularly scarce for all but the largest firms.

Share of firms with positive vs negative net flows in 2017, by size of firm, %



¹Assets under management.

McKinsey&Company | Source: Global Asset Management Survey, from Performance Lens by McKinsey

The new Great Game of asset management brings with it a new logic of scale. This is not scale in the conventional sense of managing the largest pool of assets, but rather the ability to marshal a set of distinctive capabilities and leverage them across the entire enterprise for competitive advantage, whether by creating massive operating efficiencies, building broad and sustained client access, or generating superior investment insights and consistent outcomes. Size alone does not determine destiny. Trillionaire firms that act like a disparate collection of small firms have not set themselves up for success, while smaller firms that pick their spots, find the right partners, and leverage their competencies are on a winning path.

We expect scale to grow in importance as the broader investment-management ecosystem evolves in the coming years. The vast network of retail intermediaries through which a significant portion of the industry's future growth will funnel is becoming increasingly institutionalized as home offices acquire greater sway over manager selection and portfolio-construction decisions. Institutional clients are increasingly adhering to a credo of “fewer but more strategic relationships,” while demand from the long tail of smaller institutions is concentrating more tightly within a smaller set of consultant relationships and a growing outsourced CIO marketplace.

Regulatory developments (for example, the updated Markets in Financial Instruments Directive, or MiFID II) and the need for scaled investments to take advantage of new data sources and technology are together making a strong case for a more centralized investment research function. Finally, two new sets of at-scale competitors with big ambitions for growth—mega alternatives firms and vertically integrated retail firms—are making a move toward the heart of the industry.

These structural shifts place a new set of demands on asset managers. Firms urgently need to build strategic relationships rooted in a deep understanding of underlying client needs, deliver for clients in a way that cuts across silos, build new data and analytics capabilities to generate both sales and investment alpha, and leverage technology, data, and analytics to forge an integrated, highly scalable end-to-end client experience.

These new demands are turning the longtime dominant operating model of asset management on its head. What was once a predominantly vertical model organized around asset classes and well-defined functions is being transformed horizontally to build greater alignment with the needs of clients, embrace a set of investment opportunities that fall between the lines of traditional asset classes, and take advantage of new technology-enabled capabilities that lead to drastic increases in the effectiveness and efficiency of every function across the enterprise.

Still in its early stages, the new Great Game promises to dramatically reshape the landscape of asset management. A new set of winners will emerge and some existing “great powers” that fail to respond will likely fall by the wayside. This will lead to consolidation within the constellation of smaller firms that, separately, cannot keep up with the pace of change, but at the same time prepare the ground for the rise of innovative insurgents that can either establish more specialized niches or forge productive alliances with the bigger players. The new logic of scale will sustain the wave of industry consolidation and lead to a new wave of partnerships and alliances across regions and industry segments.

Asset managers that want to thrive in this new environment face a set of imperatives, not dissimilar from the choices faced by the great powers in the original Great Game. They will need to make a deliberate set of decisions: to clearly define their role in the ecosystem, to pick their spots (that is, where to compete) in a way that clearly aligns with their strengths, to build strategic alliances in areas where they choose not to compete, to back up their choices with deliberate resource allocation, and to create an operating model that delivers sustainable and scalable economics.

About the author(s)

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