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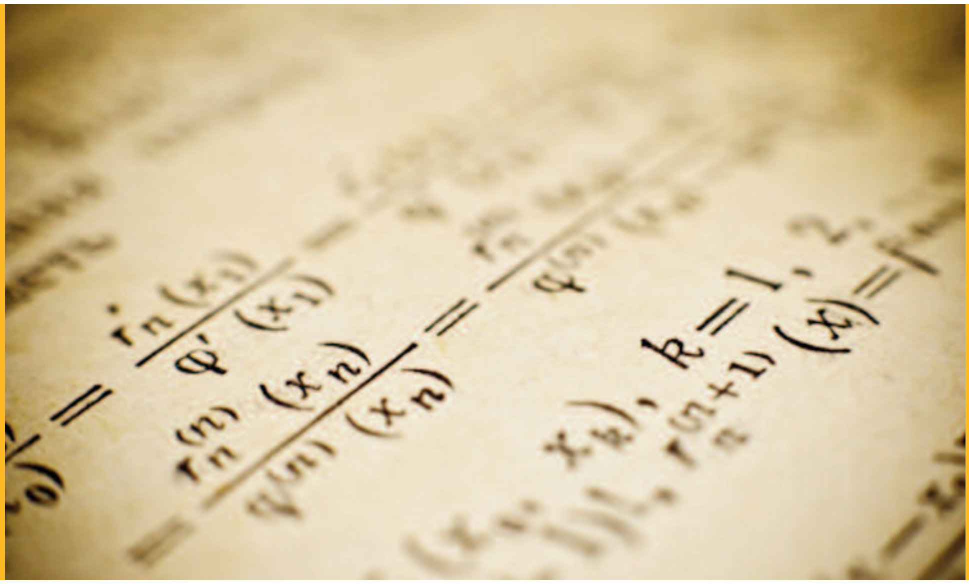

Blending Science with Art To Capture Growth in U.S. Retail Asset Management

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Executive Sum

With more than $15 trillion in assets, U.S. retail continues to reign as the world's largest asset management market, accounting for about 50 percent of all externally managed assets in North America and 25 percent globally. That dominance will continue as the massive wave of IRA rollovers from retiring baby boomers—the primary driver of new retail flows—continues to accelerate. McKinsey estimates that net flows in the U.S. retail market will grow at an average annual pace of 1 to 2 percent over the next five years, almost double the pace of the institutional market.

Not surprisingly, the significant opportunities that this enormous and growing market offers asset managers are accompanied by fierce competition. Moreover, flows are concentrating among leading firms: the top 10 asset managers are now capturing about 80 percent of mutual fund net flows. But McKinsey research also indicates that success in the U.S. retail market can be extremely short-lived. In fact, four of the top ten asset managers during the 2004-2008 time frame fell off the leaderboard entirely over the subsequent five years, as they collectively experienced total net outflows of more than $200 billion.

The often rapid turnover of asset managers within the leadership ranks of the U.S. retail market is directly connected to the inability of many firms to execute well on all three of the key pillars required for sustainable growth: investment performance, market positioning and distribution excellence. In particular, McKinsey research shows that firms concentrating on investment performance and not enough on market positioning and distribution excellence tend to attract strong net flows over the short run, but are the most likely to fall out of the leadership group over the longer term. Zeroing in on the two key pillars of market positioning and distribution excellence, five imperatives for protecting and growing share in the U.S. retail market emerge: carefully pick spots in which to compete, as growth will be concentrated in specific asset classes and vehicles; be at the forefront of product innovation; re-invent the sales process, by utilizing data rather than intuition; win the distribution talent race with a scientific approach; and finally, embrace the new wave of distributors.

Firms concentrating on investment performance and not enough on market positioning and distribution excellence tend to attract strong net flows over the short run, but are the most likely to fall out of the leadership group over the longer term.

In the area of sales and distribution, in particular, the vast majority of asset managers have much ground to make up. Despite how critical distribution is to a firm's success, practices across the industry have barely evolved over the past decade, leaving asset management far behind other industries in sophistication. In a world where retailers can accurately predict their customers' next purchases using big data and algorithms, and where Twitter has made thought leadership possible in 140 characters or less, asset managers appear stuck using 20th century tactics to drive flows. To succeed going forward, firms must accelerate the pace of change as the industry catches up on new trends and capabilities that are creating both opportunities and significant challenges for asset managers.

These findings are based on McKinsey's most recent annual benchmarking study of North America-based asset managers, which surveyed more than 100 firms representing $18 trillion (roughly 70 percent) of AUM, and on interviews with dozens of industry leaders. They also incorporate insights from McKinsey's proprietary Global Asset Management Growth Cube, which dissects growth and profitability trends by regions and countries, client segments and asset classes.

The U.S. retail market will continue to offer one of the most dynamic and attractive growth opportunities for asset managers over the next five years. But to successfully capture that growth going forward, firms must step up their efforts across the key areas of product focus, product innovation, reinventing the sales process, winning the distribution talent race and embracing new distributors. This includes taking a more scientific and analytical approach in these areas to identify and prioritize the most meaningful and impactful opportunities. Asset managers have the ability to move from art to science by building capabilities in these key areas. The alternative is to maintain the status quo—and get left behind.

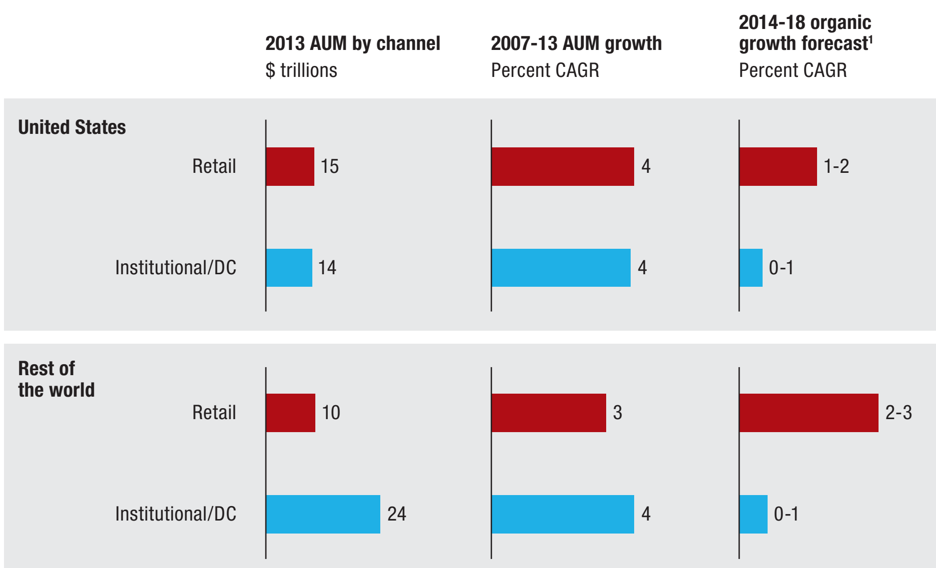
U.S. Retail: The World's Largest Asset Management Market—Where Success Is Often Short-Lived

At more than $15 trillion in assets, U.S. retail is the largest and one of the most robust asset management markets in the world. As demographics continue to drive a massive wave of IRA rollovers—the primary source of new flows into the U.S. retail market—McKinsey projects that net flows will grow at an average annual pace of 1 to 2 percent of assets over the next five years, almost double the pace of the institutional market (Exhibit 1, page 6).

Over the past decade, many asset managers have focused on global expansion—building a presence in the European cross-border market, investing in fast-growing emerging markets like China and Brazil, and prioritizing high-growth client segments like sovereign wealth funds, for example. But while building a diversified, global presence remains an important component of a healthy asset management franchise (especially in light of slowed structural economic

Exhibit 1

The retail asset management channel is expected to grow faster than the institutional channel over the next 3 to 5 years



[1] Excludes market performance

Source: McKinsey Global Asset Management Growth Cube

growth in developed countries) asset managers cannot afford to lose focus on crucial core markets like the U.S., which still comprises the largest share of the world's asset management assets and revenues. Indeed, over the next five years, McKinsey expects the U.S. retail market, alone, to generate $3 billion to $6 billion in net new revenue opportunities, excluding the impact of market performance.

Flows are concentrated among top firms, but the leaderboard can change quickly

Not surprisingly, the U.S. retail market is also fiercely competitive, with thousands of fund wholesalers,[1] representing more than 1,000 fund families, vying for the attention of intermediary platforms and over 300,000 financial advisors. At the same time, retail flows are concentrated among leading firms: the top 10 asset managers are capturing 80 percent of net flows. But success in the U.S. retail market can also be fleeting. Indeed, four of the top ten asset managers from 2004 through 2008 fell off the leaderboard over the next five years, collectively experiencing more than $200 billion in net outflows (Exhibit 2).

Three major pillars drive sustainable growth

As firms seek to grow within the intensively competitive U.S. retail market, three factors are crucial. Investment performance is clearly an important driver of flows, but it is not enough. McKinsey research shows that it accounts for only

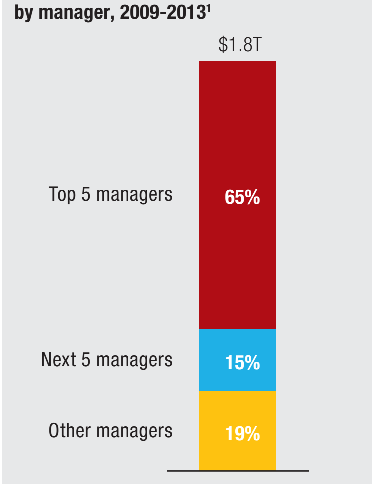
[1] Over 2,000 external wholesalers among the top 40 managers alone.

Exhibit 2

U.S. retail flows are heavily concentrated among top firms — but success can be short-lived

Top 10 managers control 80% of retail flows

Cumulative mutual fund and ETF flows by manager, 2009-2013[1]



But firms can quickly fall from the leaderboard

By long-term, open-end mutual fund and ETF flows[1]

Cumulative net flows
$ billions

Managers falling out of Top 10 in 2009-13 (highlighted in green in the original: American Funds, Dodge & Cox, ProFunds, John Hancock Investments)

	2004-2008	2009-2013
Vanguard	305	559
American Funds	295	(233)
BlackRock	236	241
PIMCO	64	206
Dodge & Cox	58	(17)
T. Rowe Price	57	63
Dimensional Fund Advisors	55	69
State Street Global Advisors	42	74
ProFunds	24	18
John Hancock Investments	23	25

[1] Excluding money market funds

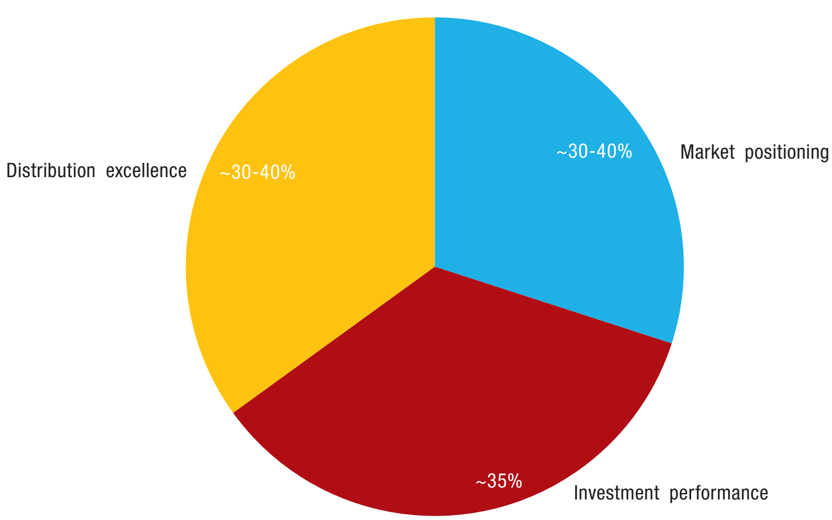
Source: Morningstar; Strategic Insight Simfund MF database

Exhibit 3

Growth at the firm level can be attributed to market positioning, investment performance and distribution excellence

Drivers of growth

Regression-based decomposition of net flows; U.S.-domiciled, long-term open-end funds excluding ETFs



Source: McKinsey Global Wealth & Asset Management Practice

one-third of growth at the firm level (Exhibit 3, page 7). Decisions about market positioning (the geographies, channels and products in which firms choose to compete) are equally material—driving 30 to 40 percent of growth at the firm level. Distribution excellence accounts for the remaining one-third of firm growth.

The U.S. retail market continues to evolve quickly along all of these key dimensions. Asset managers must understand the specific drivers of growth in the retail market over the next five years and use that information to shape strategic decisions on how to compete.

Achieving Sustainable Growth in the U.S. Retail Asset Management Market

The often rapid turnover of asset managers within the leadership ranks of the U.S. retail market can be directly traced to the inability of many firms to execute well on all three of the three key growth pillars: investment performance, market positioning and distribution excellence. In particular, firms that focus on investment performance (and not enough on the other two pillars) tend to attract strong net flows over the short run, but are the most likely to fall out of the leadership group over the longer term.

Five imperatives drive growth

In the areas of market positioning and distribution excellence, McKinsey research has identified five imperatives for protecting and growing share within the enormous, but intensively competitive, U.S. retail market.

1. Pick spots carefully, as growth will be concentrated in specific asset classes and vehicles.

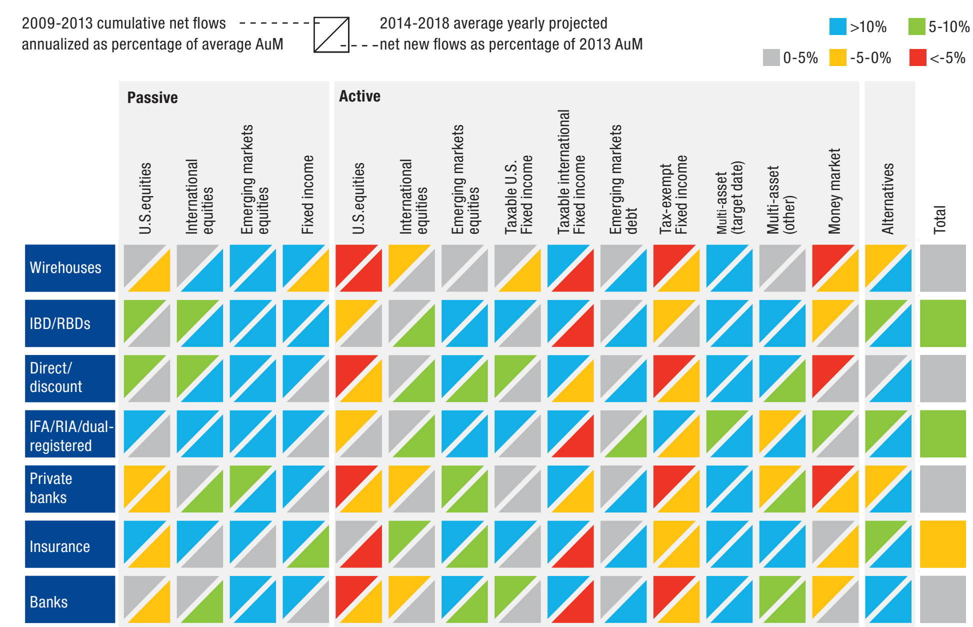
The U.S. retail market currently generates an annual revenue pool of approximately $65 billion (the largest in the world for traditional managers), accounting for about 20 percent of global asset management revenues. Over the next five years, that proportion will likely grow to 25 percent, with annual U.S. retail revenues reaching $80 billion to $90 billion. Up to one-quarter of that revenue growth ($3 billion to $6 billion) will come from net new flows, with the rest coming from expected market appreciation.

While substantial growth opportunities exist, they will be highly concentrated. In fact, 100 percent of overall net new flow growth in the U.S. retail market over the next five years will likely come from four key growth areas: retail alternatives, balanced/multi-asset class, passive strategies and specialized active strategies, with other asset classes experiencing net overall outflows or stagnant growth. For this reason, management teams must consider product and vehicle opportunities at a granular level and pick their spots thoughtfully (Exhibit 4).

Exhibit 4

Asset class opportunities should be assessed at a granular level, as specific pockets of growth vary by channel

U.S. retail trends by distribution channel, asset class and category, illustrative



Source: McKinsey Global Wealth & Asset Management Practice

Retail alternatives will be the most significant driver of U.S. retail asset management growth, accounting for about 50 percent of net new revenues over the next five years. Over the past six years, alternatives have experienced rapid growth, with assets under management more than tripling from $300 billion in 2008 to nearly $1 trillion today. Despite outflows of more than $33 billion in commodities and natural resources, 2013 was a banner year for retail alternatives, which as a group experienced net flows of $113 billion (up from $68 billion in 2012). Growth over the next five years will be fueled by a new wave of demand from high-net-worth individuals as well as from retail investors, who increasingly have access to a broad array of alternative strategies through the proliferation of liquid retail funds. Absolute return, long/short, and multi-alternative strategies should grow disproportionately over the next two to three years.

- **Multi-asset class strategies** will account for about 25 percent of net new retail revenues over the next five years. Target-date funds remain a major driver of growth in the multi-asset product space, due almost entirely to auto-enrollment in small and mid-market defined contribution plans. Other outcome-oriented and multi-asset strategies (e.g., target risk, total/real return, income solutions) should grow by about 10 percent annually on a net flows basis, driven by registered investment advisors (RIAs) and fee-based financial advisors who seek more convenient and cost-efficient asset allocation solutions, particularly for smaller accounts linked to a client household (e.g., educational savings plans). That said, growth will be concentrated among a subset of the advisory population who see value in these solutions, while other advisors will continue to per-

Retail alternatives

Typical investment strategies: precious metals (physical exposure), real estate, commodities, absolute return, energy, natural resources, long/short, leverage, inverse/short bias, options arbitrage, market neutral, currency, multi-alternative, equity options hedging, managed futures, event-driven arbitrage, volatility, infrastructure, and global macro.

Vehicles: '40 Act mutual funds and exchange traded funds.

Typical clients: Individual investors with $250,000 to $10 million in investable assets, who have a relationship with a wirehouse, online/direct brokerage, private bank, retail bank, RIA/IFA, or insurance-owned brokerage.

ceive multi-asset strategies as siphoning away some of their own value proposition to clients.

- **Passive strategies** will comprise about 15 percent of net new revenues (and about 30 percent of net flows), driven by the continued shift among investors from active strategies to passive indexing (especially in equities), as asset allocators utilize more advanced portfolio construction techniques that emphasize strategic asset allocation and exposure management for value creation. ETFs will continue to be a major beneficiary of this trend, with 50 to 60 percent of net new passive flows going into ETFs rather than passive mutual funds.

The aging population will continue driving fixed-income allocations in the U.S. retail market.

- **Specialized active strategies**[2] will account for about 10 percent of net new retail revenues, driven by an appetite for diversification into international developed-market equities, emerging market equities and emerging market debt (at the expense of traditional/core fixed-income products), as investors search for growth opportunities in the face of slower growth in the U.S. and other developed economies. Fixed-income strategies in particular are growing more specialized, as investors seek out sources of higher returns, including in high-yield, credit, multi-sector, global bond and go-anywhere strategies. The aging population in particular will continue driving fixed-income allocations in the U.S. retail market. Leading specialized asset managers are also offering new fixed-income exposures, including direct lending funds that partially disintermediate the capital markets.

Mutual funds will dominate retail revenue pools for the foreseeable future

In addition to setting asset class priorities, managers must carefully consider vehicle design decisions.

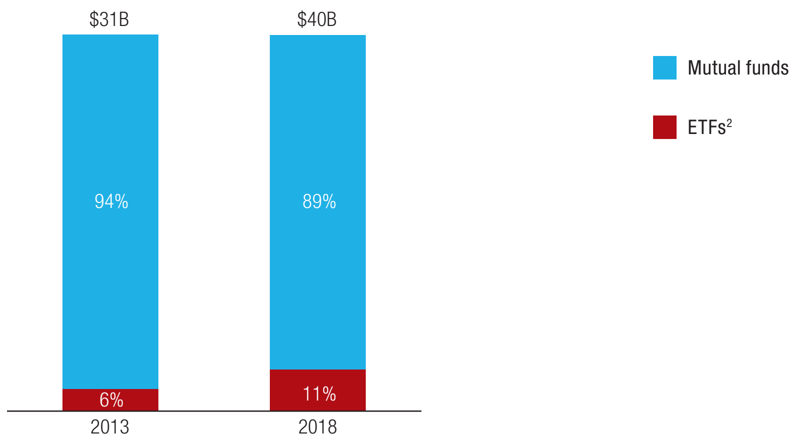
In terms of asset growth, ETFs are expected to experience strong growth (16 to 18 percent annually) over the next five years, driven by the continued adoption of passive indexing among advisors and online direct/multi-brokerage platforms, and their use as sleeves within asset allocation models (including model portfolios in the broker dealer and private banking channels). These models represent a particularly bright spot in terms of ETF growth and economics, although it remains to be seen whether and how much distributors are willing to pay for investment managers to provide asset allocation guidance. With regard to revenues, however, ETFs face ongoing economic pressures (including intense competition, increasing regulatory costs and emerging revenue share agreements from distribution platforms), particularly in passive in-

[2] Strategies beyond the core (e.g., large-cap domestic equities, core fixed income), such as emerging market equities and high-yield bonds.

Exhibit 5

Despite the rising popularity of ETFs, mutual funds will continue to capture the vast majority of retail revenues over the next five years

Estimated U.S. retail mutual fund (open-end) and ETF revenue pools[1]



[1] Excludes annuities, unit-linked insurance, closed-end funds and managed accounts

[2] Includes ETF assets attributable to U.S. retail intermediary channels

Source: McKinsey Global Asset Management Growth Cube

dexing strategies, which comprise about 98 percent of the U.S. ETF market.[3]

As a consequence, mutual funds will continue to dominate retail revenue pools for the foreseeable future, continuing to comprise nearly 90 percent of industry revenues and 70 percent of net new revenue growth over the next five years (Exhibit 5).

2. Be at the forefront of product innovation

New product development remains critical to capturing growth opportunities and market share in the U.S. retail market. Indeed, new mutual fund and ETF launches have captured 25 percent of net flows over the past five years; four of the top ten funds, as ranked by net flows over that same period, were new offerings. While investment performance is clearly an important driver of flows, it is not enough. To be sure, among rated mutual funds, those with “4-star” and “5-star” ratings have brought in significantly greater flows over the past decade than their lower-rated peers, which collectively experienced negative flows. But McKinsey research shows that asset managers’ ability to capture new product opportunities is as important as investment performance. Indeed, net flows into unrated products between 2009 and 2013 totaled $859 billion—almost 80 percent of the amount collected by 4-star and 5-star funds combined (Exhibit 6). Moving forward, consistently high performance in legacy strategies will not be enough; firms must drive flow growth in new products.

Of the funds launched over the past five years, about 80 percent have survived—but only 30 percent have managed to reach $100 million in assets, the threshold that typically defines a successful fund. Reflecting the heavy concentration of re-

[3] Including precious metal and commodities funds.

tail flows among leading firms, the top five asset managers have collected more than one of every three dollars flowing to new funds over the past three years, with the largest share of flows going into active domestic fixed-income and liquid alternative strategies. Overall, new products are capturing a significant share of flows in the fastest-growing asset classes (Exhibit 7).

Moving forward, new products will continue to be critical, as future flows move away from some of today's largest asset classes. Managers should respond with proactive product development and by setting aspirations for category leadership in the highest growth niches. This will require a robust product pipeline aligned with client needs and the ability to monitor market trends and execute quickly to capitalize on market demand. Product innovation and management is much more complex today than a decade ago, with the proliferation of vehicle types and share classes, and growing cross-border/global coordination requiring true leadership, a client-focused approach, and deep understanding of individual product economics and opportunities. To be successful, asset managers must understand retail investors and advisors, including the specific strategic goals of each advisory firm. More than ever, this will require a high degree of specialization, data and depth.

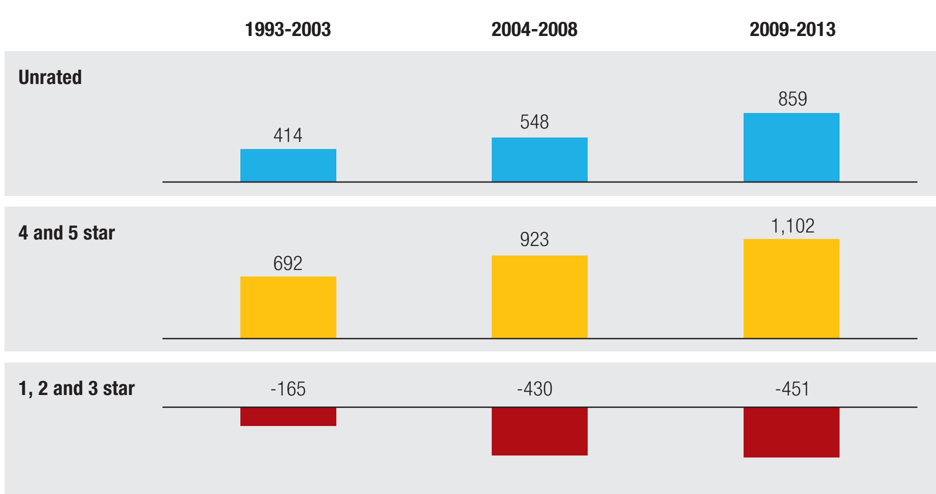
3. Reinvent sales by utilizing data rather than intuition

While distribution excellence and investment performance each account for about one-third of the typical asset manager's growth, "sales alpha" is typically far

Exhibit 6

Unrated mutual funds are capturing heavy flows, as new products challenge existing 4- and 5-star funds for market share

Cumulative net fund flows by Morningstar rating
$ billions (12 months following rating; long-term, open-end mutual funds)



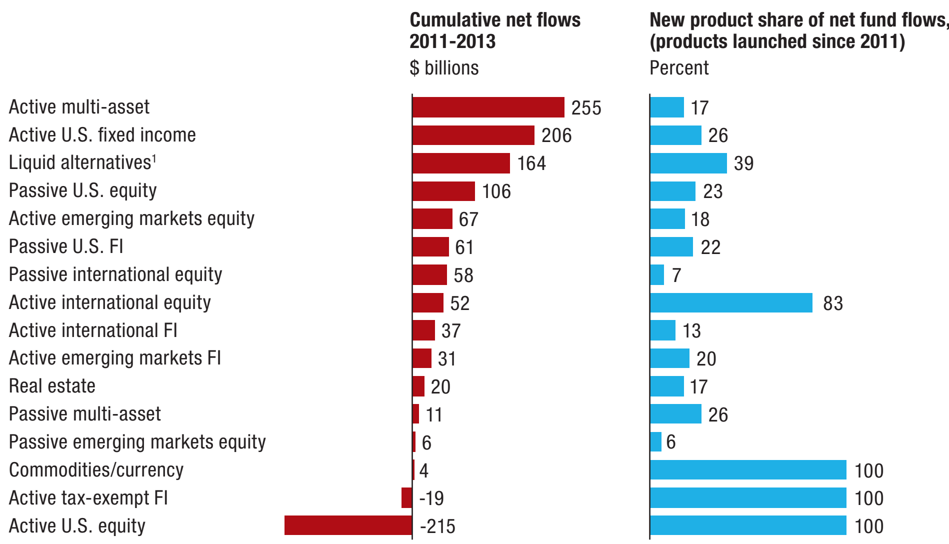
Source: McKinsey Global Asset Management Growth Cube more enduring than investment performance over the long run. That said, asset managers continue to face challenges in improving sales effectiveness, including the concentration of growth in specific channels, continued differentiation in economics and churn by channel, and distributors taking steps to change the nature of their relationships with asset mangers, including aggressively moving to improve their profit margins (which typically lag the asset managers whose products they distribute by 20 to 40 percentage points) and developing preferred partnerships with managers who can provide them with a unique and differentiated offering. At the same time, sales coverage needs and demands are evolving and differentiating by channel, and leading asset managers are increasingly using advanced analytics and data to achieve distribution excellence in a cost-effective manner.

Channel prioritization and sales coverage

According to McKinsey's research, 75 percent of net flows in the U.S. retail market over the next five years will be captured by three channels: independent broker dealers, RIAs/independent financial advisors (IFAs), and multi-platform/direct brokerages. Most of the flow gains in these channels will come at the direct expense of traditional wirehouses, which currently control about 30 percent of managed retail assets. Indeed, moving forward, McKinsey expects wirehouses to capture the lowest share of net new flows. As they increasingly struggle to acquire new customers, wirehouses must also contend with the growing number of

Exhibit 7

New products are capturing a significant share of flows in the fastest-growing asset classes



[1] E.g., hedge fund strategies, absolute return.

Source: Simfund

advisors who are moving to independent broker-dealers or striking out on their own, lured by more generous revenue sharing and compensation.

Despite this changing market dynamic, most asset managers continue to allocate a highly disproportionate share of their wholesaler resources—typically 30 to 40 percent of full-time employees (in some cases, up to 60 percent)—to the wirehouse channel (Exhibit 8).

Moreover, the cost of acquiring wirehouse assets is 15 to 40 percent higher than other channels, with asset churn among the highest of all retail channels (more than 25 percent annually). Consequently, asset managers are underweighting the most important channels and must rethink coverage to maximize their bang for the buck, including prioritizing opportunities at the channel, firm and advisor level and assessing implications for distribution resource allocation and coverage models.

Home office relationships

Home office coverage continues to become more costly and complex, requiring more and different attention from asset managers, including better coordination between home office and field priorities. In the face of fee pressure from competitors and clients and with home offices taking a bigger role, economics will continue to be under pressure for asset managers, as broker-dealers aggressively negotiate revenue-sharing agreements (such as negotiating "finder's fees" for sales of institutional share classes), consolidate relationships through "pay-to-partner" arrangements (e.g., home office and research team meetings, advisor events, conference sponsorships), and identify new ways to monetize asset manager re-

Exhibit 8

Asset managers are over-allocating sales resources to the wirehouse channel at the expense of higher-growth opportunities

Growth by U.S. retail channel[1]

Channels	**Managed AUM** Percent of total	**Share of net flows** 2014-18, projected	**Typical percent wholesaler coverage**
Wirehouses	30%	2%	**30-40%**
Multi-platform/ direct brokerage	25%	28%	
RIA/IFA[2]	10%	28%	**5-10%**
Independent broker-dealers	9%	21%	**10-20%**
Regional broker-dealers	7%	10%	**20-30%**
Private banks	11%	10%	**15-20%** (Private banks and Bank and insurance combined)
Bank and insurance	8%	2%	
Total	**$15.3 trillion**		

1 Includes separately managed accounts, open-end funds, closed-end funds, variable annuities; excludes money market funds, fixed annuities, limited partnerships and collective investment trusts

2 Includes IFAs, dual-registered, and ETF strategists

Source: McKinsey Global Asset Management Growth Cube; Strategic Insight; Investment Company Institute lationships (e.g., charging for data feeds on their advisor network). Distributors with large managed account platforms are also demanding increased manager coverage for their research teams and product committees, such as product and asset class specialists/strategists. As the cost of sales continues to rise due to coverage needs and "pay to play" programs, asset managers need to take a more strategic and disciplined approach toward distribution partnerships. Successful asset managers will focus their efforts (e.g., allocate 60 percent or more of their total distribution spend) on just three or four distributors where their value proposition best resonates, and where they can structure preferred partnerships that provide privileged access and shelf space.

Successful asset managers will focus their efforts on just three or four distributors where their value proposition best resonates, and where they can structure preferred partnerships that provide privileged access and shelf space.

There has been a significant shift over the past five years from transaction-based accounts and products to managed or fee-based accounts and products. Since 2008, retail assets in managed account structures have grown from $1.3 trillion to $3.5 trillion, a compound annual growth rate of 22 percent (compared to 9 percent for transaction-based accounts). The home office remains a key influencer in these products, including defining the components of managed and model portfolios, which advisors then use. Upwards of 60 to 70 percent of fund flows on intermediated platforms are likely driven by managed accounts, model portfolios and recommended lists. By 2018, assets in managed account structures should exceed $6 trillion, with unified managed accounts (UMA), representatives as advisors and reps as portfolio managers driving the majority of growth.

Field coverage

Asset managers need to be much more systematic about field deployment to compete effectively; that is, they need to build tight territories and design coverage based on geographies where retail assets are concentrated. Not all advisors are created equal, and managers should prioritize the advisors they proactively cover. Managers can also explore alternative models to balance quality of sales and service with the economics of the channel. The fragmentation of advisors in the independent broker-dealer (IBD) and RIA/IFA channels is challenging asset managers to meet sales and service needs in a scalable and cost-effective way. Building internal and hybrid teams for channels like RIA/IFA and IBD could provide the high-frequency coverage these channels require, while ensuring effective cost management in light of the fragmentation and less attractive per-advisor revenue economics of these channels.

To determine where to play across channels, firms and advisors, and understand the best products to lead with, asset managers must modernize their approach to utilize data to inform decision-making at the most granular level and deploy wholesalers in a more targeted way against the highest potential opportunities.

Advanced analytics and digital marketing

In an era when digital marketers can tailor online ads to consumers' demographic and behavioral patterns and pharmaceutical companies can track prescriptions by physician down to the pill, asset managers are woefully behind the curve in using data and advanced analytics for client insights, sales and service models, and strategic planning.

Asset managers now have the ability to move from art to science by building advanced analytics capabilities for sales attribution, predictive sales analytics and customer lifecycle management.

Legacy barriers and gaps in data availability, ownership and consolidation among manufacturers and distributors are narrowing due to the increasing availability of data from third-party service providers and distributors, as well as consistently improving internal CRM systems and processes (e.g., tracking of wholesaler visits, marketing collateral distributed). Asset managers now have the ability to move from art to science by building advanced analytics capabilities for sales attribution, predictive sales analytics and customer lifecycle management. Tools developed around these analytics, including mobile applications on tablets and smartphones, can help deliver actionable insights to sales teams (e.g., forecasting buying behavior through predictive analytics, advisor demographic/behavioral segmentation, probability of inflows versus outflows given market conditions, impact of product penetration on future flow capture, and new product launch effectiveness). Those asset managers who can quickly and effectively invest to build and deploy such capabilities will be armed with a powerful competitive advantage that could redefine their positioning in the marketplace. Here, firms need not reinvent the wheel, but rather should focus on learning from the best-performing industries in advanced analytics and acquiring talent from them.

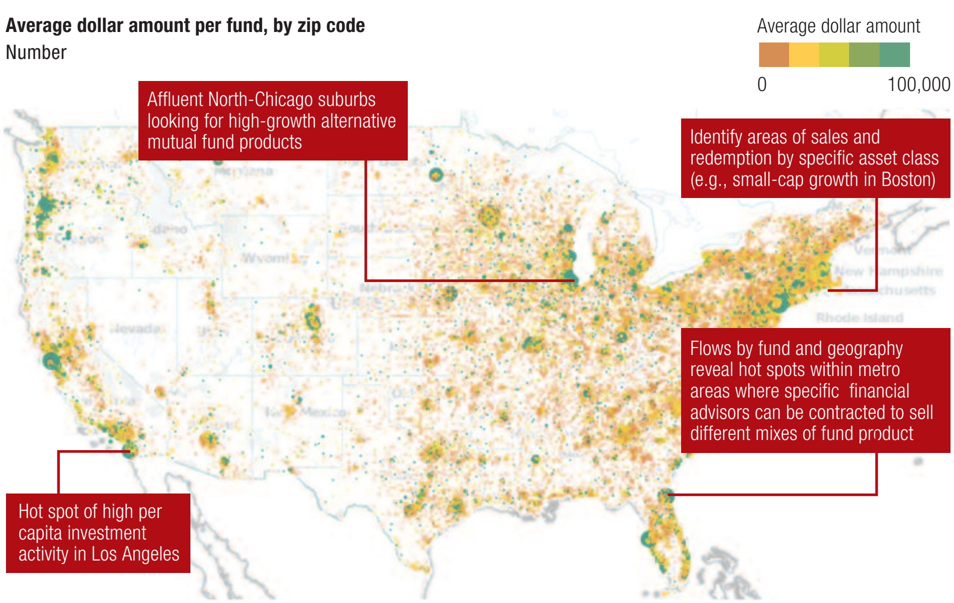
The objectives of a successful advanced analytics strategy for distribution should include a better understanding of where and how to compete based on macro factors, such as geographic market opportunity and competitive intensity, and micro factors, such as advisor preferences and propensity to work with a manager based on that manager's competitive strengths (Exhibit 9). Critical to decoding advisor propensity is understanding the advisor (and platform) decision journey–the process of how and why advisors learn, evaluate, choose and remain loyal to certain funds, wholesalers and managers. Knowing that a certain advisor segment allocates 80 percent of funds to three to five core managers—and that it takes five years of consistent wholesaler visits before that segment will even consider a new manager's funds—can impact how a manager chooses to deploy its wholesalers. In addition, having regularly updated data (e.g., as close to real-time as possible) on the purchasing habits of advisors and understanding how competitors stack up within advisors' portfolios will help wholesalers develop a well-informed perspective and opportunistically take advantage of trends among advisors.

Asset managers should also consider new service delivery formats, especially when targeting younger, more tech-savvy advisors. This could mean moving away from traditional events like full-day, in-person "due diligence" visits that target a few dozen advisors. Asset managers could focus more on using technology-enabled solutions that deliver marketing, thought-leadership and other services more frequently in a small "bite-size," interactive (e.g., videos instead of white papers) and scalable way that will increase advisor engagement at a far lower cost per interaction. Wealth managers themselves are beginning to leverage social media and digital tools to help advisors grow their business both through acquiring new clients and interacting with existing ones (including internal social networks and knowledge-sharing platforms). Asset managers who can partner with wealth managers undertaking this shift could enjoy a real competitive advantage.

Exhibit 9

Advanced segmentation solutions using big data can identify specific financial intermediaries best suited to distribute asset management products

Average dollar amount per fund, by zip code
Number



Source: McKinsey Global Wealth & Asset Management Practice

4. Attract top sales talent with a scientific approach

Since the financial crisis, the asset management industry has been impacted by several trends that have collectively increased the stakes for finding, developing and retaining top distribution talent. Average wholesaler compensation has risen by 12 percent since 2009, to about $400,000 today, and overall sales and marketing costs as a percentage of total costs have shot up by over 50 percent since 2008 (Exhibit 10).

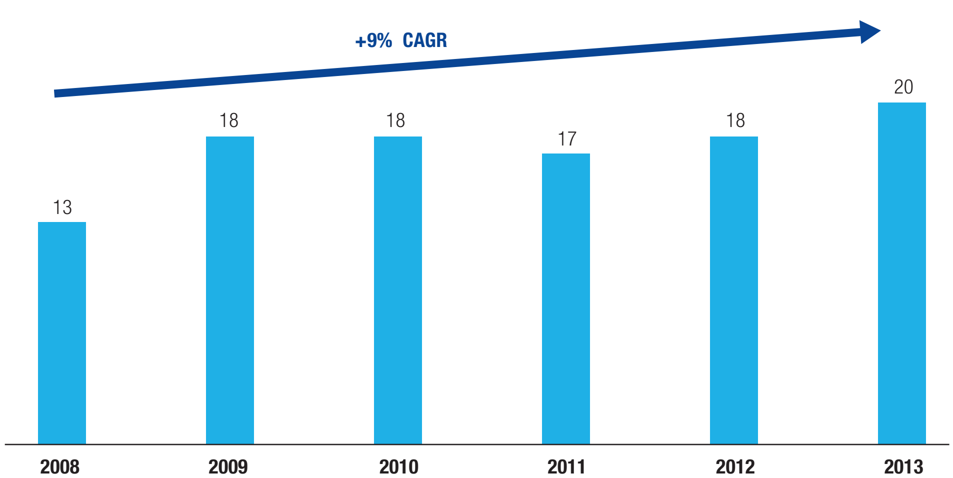
At the same time, churn rates have increased, and passive products have placed additional pricing pressure on traditional offerings. Wholesalers, faced with increasingly complex and sophisticated client needs, must not only be fluent on a much broader range of asset classes, products and vehicles (e.g., alternatives, multi-asset class solutions), but also on how their products fit within their clients' total portfolios. Meeting the demands of different distribution channels and geographies also requires better and more diversified organizational talent (e.g., specialists and enhanced internal wholesalers) to supplement the traditional external wholesaler role. These trends, along with the importance of data and technology, will require a rethink of what the "archetypal" wholesaler should look like and the overall approach to serving advisors (e.g., level of channelization, partnerships with product specialists, using technology to expand reach and relevance).

While many managers have attempted to address these trends by redesigning com-

Exhibit 10

Retail sales and marketing costs as a percentage of total costs have shot up since the financial crisis, compared to moderate net flows

U.S. retail sales and marketing costs as a percentage of total costs[1]
Percent



[1] Excludes revenue-sharing

Source: McKinsey Asset Management Benchmarking survey pensation and by restructuring (e.g., overhauling territories and channels), few have innovated on processes to better evaluate, hire and develop a different type of talent. Hiring remains overly reliant on intuition, with firms typically evaluating potential candidates on personality and "fit." Development typically comes in a one-size-fits-all package anchored around periodic classroom training on products and generic sales capabilities, with little insight into the gaps in skills, capabilities and mindsets that drive performance, including new skills required by the growing role of data.

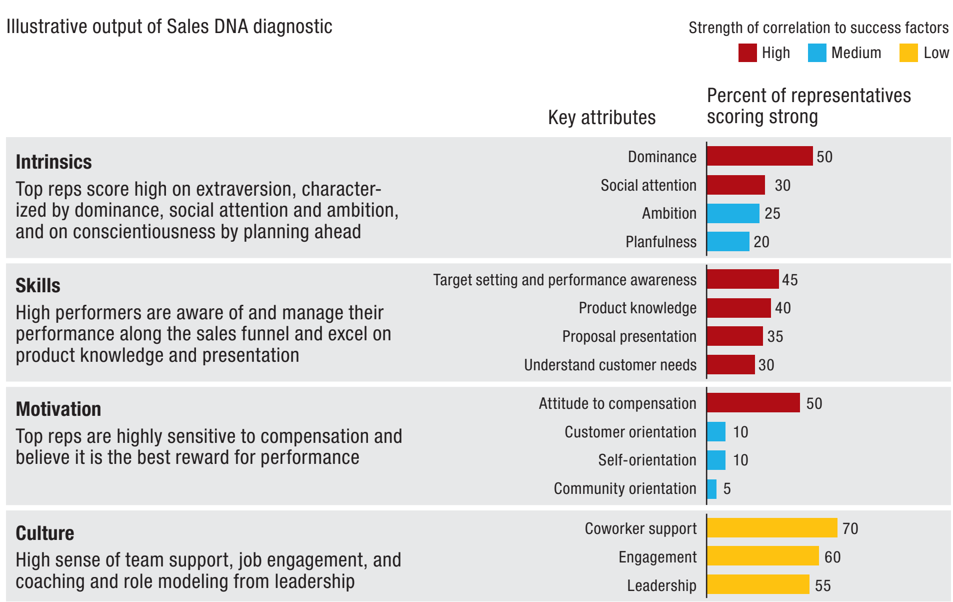
Simply put, the industry needs a new and different set of skills. Adopting a scientific approach to hiring and developing sales talent is a lever that can trigger the productivity gains sought by asset managers today. Developing such an approach begins with understanding those intrinsic characteristics, attitudes and skills—or "sales DNA"—associated with top performers that are not present among their peers. Indeed, McKinsey research shows that sales DNA can drive a sustainable 5 to 20 percent lift in revenue (Exhibit 11).

Defining the ideal sales DNA for particular roles (e.g., internal versus external wholesaler) and the culture of the organization enables managers to evaluate current and potential talent in a scientific manner that supplements traditional hiring and evaluation practices. Sales DNA can also shape an organization's training strategy by highlighting the biggest gaps in the key skills, capabilities and mindsets that have the strongest correlation with performance.

By combining sales DNA analysis with other elements of sales force transforma-

Exhibit 11

Sales DNA identifies the optimal profile to drive targeted capability building and hiring, and can result in a 5 to 20% lift in revenue



Source: McKinsey Marketing and Sales Practice; McKinsey Global Wealth & Asset Management Practice tion, such as manager capability-building, role alignment, compensation, and accountability metrics redesign, asset managers can position their distribution talent to become a long-term, sustainable competitive advantage.

5. Embrace new types of distributors

Investors from Sand Hill Road, the Back Bay and Wall Street alike are betting hundreds of millions of dollars on the "end of the advisor." New players such as Learnvest, Betterment and Wealthfront, in addition to large online brokerages, are aiming to disintermediate traditional advisors, using low-cost managed advisory and portfolio allocation tools that are wrapped in streamlined, easy-to-use online interfaces.

To date, new wealth management platforms aimed at tech-savvy mass market and HNW individuals generally have not reached a critical mass of users or assets, although they have experienced rapid growth from a small base. However, while new models will challenge existing ones and take some share over time, the advisor-driven model will never be truly "dead" due to continued client need for portfolio customization and financial planning, and a preference for face-to-face interactions. Several large brokerage platforms have in fact gone in the opposite direction, making huge investments in brick-and-mortar branches and call-service centers.

That said, advisors will almost certainly be challenged by the emergence of these new models, especially given that the way in which the next generation of investors (Generation Y) will want to interact with their advisors in 10 to 20 years is likely to be fundamentally different from the current experience. Younger affluent consumers are increasingly comfortable with and prefer low-cost, online management offerings. A recent McKinsey survey reveals that affluent investors between the ages of 30 and 39 are three times more likely to apply for or open new investment accounts online, and 20 to 50 percent more amenable to interacting with their financial advisors via virtual meetings and video conferences than other age groups.

Consequently, asset managers must prepare to distribute through new channels by sowing the seeds today. This means helping advisors embrace technologies (e.g., real-time portfolio reporting and analytics) that will give them access to the next wave of affluent investors, communicating through digital channels (e.g., social media, videoconferencing), encouraging knowledge-sharing, and improving asset allocation tools. Asset managers should begin developing a view of emerging platforms and determine whether these new technology-driven solutions are potential disruptors, representing either new opportunities—through distribution agreements/partnerships or even customized products (e.g., model portfolios, managed accounts)—or competitive threats they must learn from and adapt to.

Ensuring Success in an Intensively Competitive Market: Questions for Management

Comparing an asset manager's present position to industry best practices will lead to insights into how well the firm is positioned to thrive in today's market. A diagnostic to assess an asset manager's current state is often the first step in the journey toward defining the strategy required to succeed in a growing but highly competitive market. A good place to start is with a series of questions for management concerning the firm's U.S. retail business across a number of dimensions.

Are we picking our spots and capturing our fair share, or are our products holding us back?

- How do our products map, by asset class and investment strategy, to expected U.S. retail growth opportunities?
- How is our product mix optimized to capture flows from macro shifts and shocks?
- Are our products structured to be friendly to all distribution channels (e.g., share classes, vehicles, naming conventions, alignment to Morningstar style boxes)?
- How strong are our investment capabilities (i.e., investment strategy and process, people and talent, marketability, operations/risk management, and performance)?

How effectively are we developing new products?

- How have our new product launches over the last three to five years performed relative to competitor product launches? Are we capturing our fair share of new product flows?
- How aligned is our product development roadmap with expected U.S. retail flows and growth opportunities?
- To what extent are we dependent on our existing product set to capture share?

How effective is our go-to-market approach in terms of sales coverage and opportunity identification?

- What is our "sales alpha" (based on stock and flow of assets) and what does that tell us about our sales and marketing performance?
- How aligned is our channel and firm coverage (home office and advisors) with expected sources of growth?
- How effective have our home office coverage efforts been (e.g., coverage and platform spend, flows and asset growth, recommended list and model portfolio wins)?
- What is the economic contribution of our distribution efforts by channel and relationship? What implications does this have on our go-to-market approach, and how should we prioritize channels, firms and advisors?
- How effectively are we using analytics to identify home office and field opportunities (e.g., predictive analytics of advisor behaviors, stock and flow of assets at the branch and advisor levels, competitive intensity of products)? What is our organizational readiness to use advanced analytics?
- How are our thought-leadership and market perspectives disseminated today? Do we track where and how these perspectives reach our clients? Are we able to link these actions to sales impact?

Does our sales talent have the right mix of skills and incentives?

- Do we use a variety of quantitative and qualitative measures to assess our talent effectiveness? How does our effectiveness by role compare to our competitors?

- How aligned are our compensation and incentive structures (e.g., relative to competitors, organizational objectives)?
- How well-linked is overall compensation by role to individual performance (e.g., "balance of gross and net flows/revenues"; "incentivizes true 'sales alpha' created"; "does not compensate for asset churn")?
- Do we have a good understanding of what the capabilities and intrinsics are that make our sales people successful?

Are we positioned to capitalize on emerging distribution channels?

- Do we understand the landscape of nontraditional wealth managers? How will emerging channels impact our business across products and distribution?
- As wealth managers struggle to keep pace with client demand for digital capabilities, what investments are we making to meet that demand?
- What are we doing to capture these emerging distribution channels?

■ ■ ■

The U.S. retail market will continue to be one of the most dynamic and attractive growth opportunities for asset managers over the next five years. But to capture that growth, firms must step up their efforts in product focus and innovation, reinvent the sales process, win the distribution talent race and embrace new distributors. They must take a more scientific and analytical approach to all of these areas to identify and prioritize the best opportunities. Asset managers have the ability to move from art to science by building capabilities in these key areas. The alternative is to maintain the status quo—and get left behind.

Pooneh Baghai

Onur Erzan

Céline Dufétel

Kurt MacAlpine

Kevin Cho

Daniel Yeoman

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To learn more about McKinsey & Company's specialized expertise and capabilities related to the asset management industry, or for additional information about this report, please contact:

Pooneh Baghai
Director
pooneh_baghai@mckinsey.com

Onur Erzan
Director
onur_erzan@mckinsey.com

Robert Byrne
Principal
robert_byrne@mckinsey.com

Céline Dufétel
Principal
celine_dufetel@mckinsey.com

Kurt MacAlpine
Principal
kurt_macalpine@mckinsey.com

Fabrice Morin
Principal
fabrice_morin@mckinsey.com

Jill Zucker
Principal
jill_zucker@mckinsey.com

Nancy Szmolyan
Senior Knowledge Expert
nancy_szmolyan@mckinsey.com

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