

Will the good times keep rolling for Asia's asset managers?

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Introduction

It's no secret that Asian asset management is in hyper-growth mode. For the past ten years, assets under management (AUM) have grown by 9 percent annually, capped by a strong 11 percent figure in 2017. Buoyant capital markets, a shift from deposits to investment solutions, and conducive regulatory regimes have propelled growth across Asia. Double-digit growth attracts attention, and both home-grown and foreign managers are enticed by the prospects. Some firms are moving quickly to capitalize, while others seek to defend their turf.

Barring an unforeseen catastrophe, the good news should continue. We expect that the 2017 revenue pool of \$66 billion will almost double to \$112 billion over the next five years.¹ But the opportunities are by no means evenly distributed. Where can managers hope for the greatest gains? What are the obstacles they must overcome? And what needs to be on the agenda for managers to gain an outsized share of the growth on offer?

We interviewed 25 CEOs and CIOs at 22 of Asia's leading asset managers, probing their views on the market, its prospects, and the management approaches that are working well today. We supplemented these insights with our

decades of experience as well as the most recent findings from Performance Lens, our asset-management research solution. Its key database, the Global Growth Cube, comprises 99 percent of global AUM, and offers highly detailed market sizing for more than 40 countries by client segment and asset class. Additionally, we drew on the 2018 edition of our proprietary Global Asset Management Benchmarking Survey, which covers 60 percent of global AUM. Thirty-five Asian firms, or Asian divisions of multinational firms, participated in the global survey this year. Lastly, 15 firms participated in a survey of asset managers in India.

In this report, we begin with a review of the state of the industry,² highlighting the secular trends that have produced strong growth momentum. We then look at the three greatest growth opportunities in the next five years, through 2022: the expanding China market, the institutional retirement boom in developed markets, and the "new wealth horizon" play to capture burgeoning wealth in developing markets. We conclude with insights about the management approach that the fastest-growing firms have used in recent years, and discuss how those techniques and some new variations can help firms put their growth agenda in motion.

¹ Revenue pools throughout report refer to traditional assets, excluding alternatives.

² Asset managers in Japan, Australia, (mainland) China, Hong Kong special administrative region (SAR), India, Indonesia, Malaysia, Singapore, South Korea, the Taiwan area, and Thailand.

Growth today, growth tomorrow

For the asset management industry in Asia, 2017 was the latest in a string of successes. In this chapter, we will review the industry's economics in 2017, and then look forward to the changes we expect over the next five years.

2017: Record AUM and profits

Asia is the world's fastest-growing asset-management market. The region captured nearly 45 percent of global flows over the past five years. AUM leapt by 11 percent year-on-year to a record \$16 trillion by the end of 2017. Over the past decade, AUM has increased by \$9 trillion. Asia now represents about 18 percent of the global total of \$89 trillion. Revenue pools are currently \$66 billion, up 188 percent from 2007.

Like AUM, profits also grew to record levels in 2017 (Exhibit 1). Revenues expanded not only from growth in AUM, but also from demand for higher-margin multi-asset products and alternative assets.

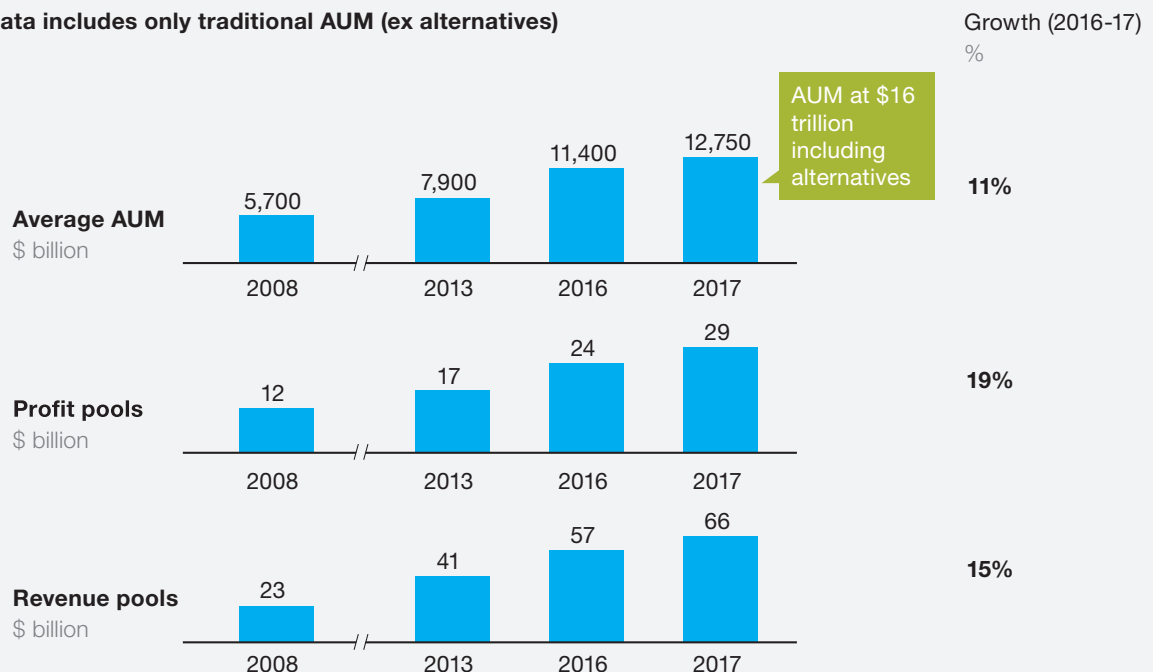
Asian profit margins are also much higher than in Europe and North America. That's another big part of Asia's appeal to multinational firms (Exhibit 2).

The growth in profit margins—driven primarily by higher revenue margins—is exceptional, considering operating cost margins also rose from 28.9 bps in 2016 to 29.3 bps in 2017. While firms believe cost margins are contained given the higher AUM growth, we believe the industry

Exhibit 1

Asset management profits and AUM in Asia reached record highs in 2017.

Data includes only traditional AUM (ex alternatives)

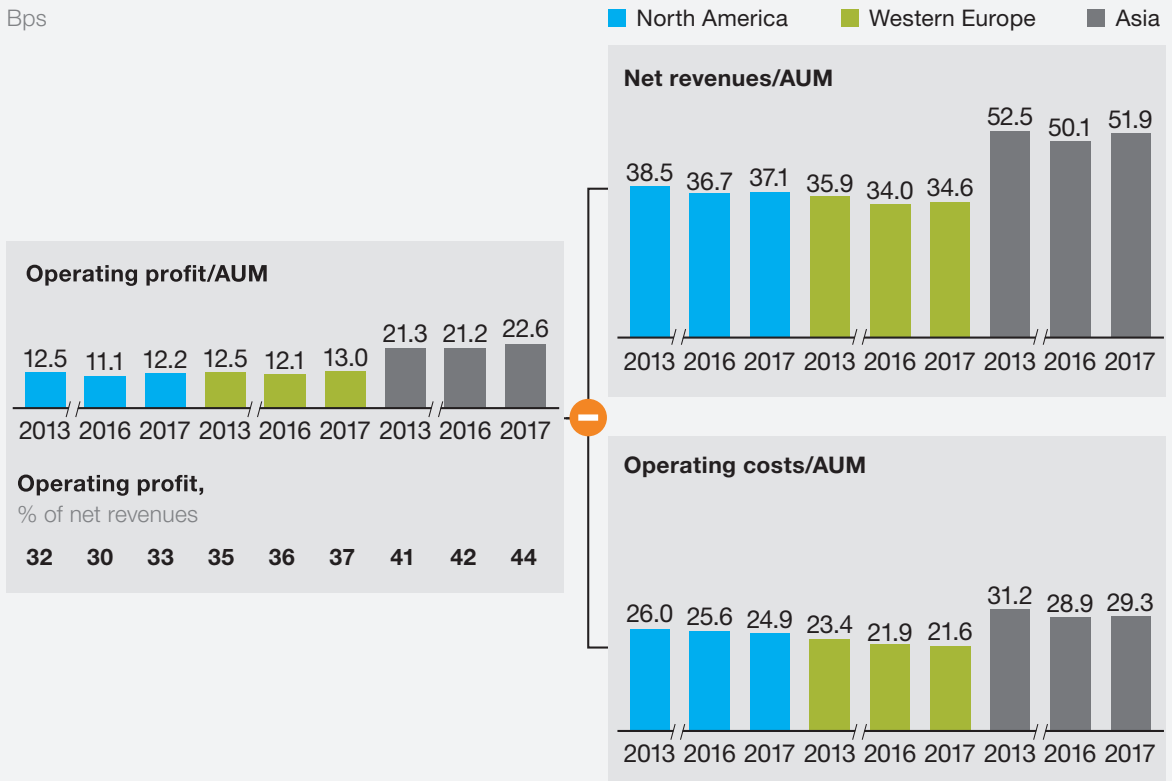


Source: McKinsey Global Asset Management Survey

Exhibit 2

Asset management profit margins in Asia are higher than those in other geographies.

Bps



Source: McKinsey Global Asset Management Survey

lacks efficiency of scale, a prime reason why absolute cost pools rose by 13 percent in 2017. We expect this trend to continue, given the fact that Asia’s asset managers will need to make investments in digitization, compliance, and especially onshore China, keeping cost pressures high in the next three to five years.

Emerging Asia and retail lead the way

Naturally, rates of growth differ across countries (Exhibit 3). Emerging markets, especially mainland China, India, and Malaysia, registered the highest flows over the past four years.

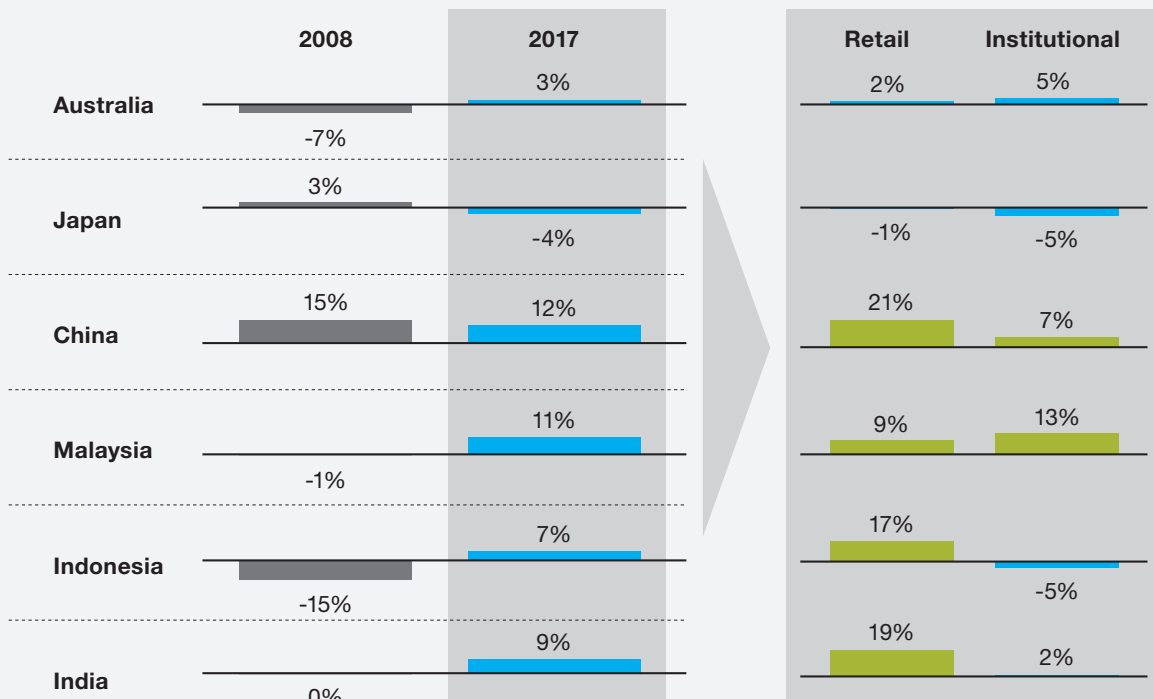
Client segments also powered ahead at different speeds. Retail grew faster on the back of the wealth effect across Emerging Asia. The number of high net-worth (HNW) households has grown by double digits (21 percent from 2008 to 2017), as has their wealth.

On the other hand, institutional (which expanded annually by 11 percent from 2007-17) is concentrated primarily in the more developed markets (Japan, Australia, and the Taiwan area held almost 50 percent of institutional AUM in 2017) followed by South Korea and Mainland

Exhibit 3

Emerging Asian markets have seen the highest asset flows.

Net flows as percent of beginning-of-year AUM



Source: McKinsey Global Asset Management Survey

China. Pension funds and insurers are the largest customers, with about 65 percent of total Asian institutional assets. Institutional business is growing in a few other countries such as Malaysia, backed by the need to solve for the growing asset-liability mismatch at pension systems and insurers, as well as regulatory liberalization.

From a product perspective, growth in 2017 was a story of alternatives and multi-assets.³ True, retail investors in emerging Asia and elsewhere also bought into fixed income (26 percent of the

portfolio mix in 2017). However, alternatives and multi-assets grew the fastest across Asia, driven mainly by wealth customers in search of hedged and asset-allocation strategies. Even on the institutional side, demand for multi-assets and alternatives has grown. Almost 70 percent of institutional mandates in 2017 were multi-asset and alternatives investments.

Active investing is still in favor in Asia, largely because alpha generation opportunities abound in the inefficient markets found in many parts of Asia, unlike their Western counterparts. The

³ Multi-assets includes traditional balanced, target date and target risk strategies, GTAA and retirement income strategies; alternatives include investments in infrastructure, real estate, hedge funds, and private equity.

Exhibit 4

Active strategies dominate in Asia.

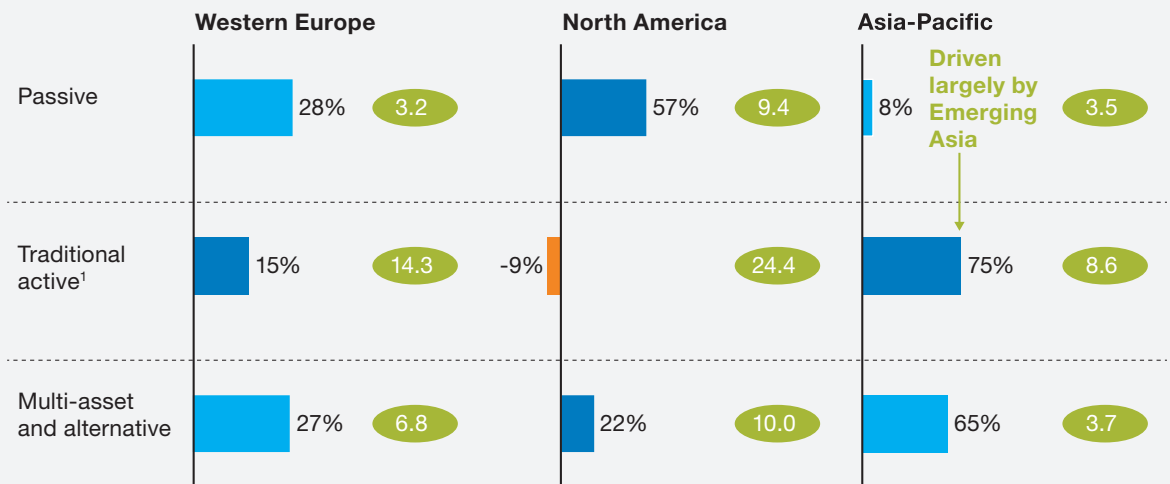
Cumulative net flows by region, 2013-17, as a share of 2012 AUM

%

Total net flows as as share of AUM

■ Strong ■ Moderate ■ Negative

xx AUM 2017, \$ billion



¹ Includes equity, foreign exchange, and money market.
Source: McKinsey Global Asset Management Survey

distribution architecture and commission structures in Asia also slow down the adoption of passive products. Asian investors are comfortable with active products, accustomed to high returns, and thus less sensitive to active fees, while in Europe and US passives are gaining significant share (Exhibit 4).

The next five years

Revenue pools are \$66 billion today, and we expect them to nearly double to \$112 billion by 2022. A large part of that pick-up will likely come from some of the currently undermanaged assets shifting to third-party professional managers. Nearly 90 percent of total financial assets in Asia—or about \$110 trillion—are outside the

asset management industry (Exhibit 5). That compares to about 60 percent in the US and about 70 percent in Europe.

With trillions of dollars on the move, it's not surprising that the CEOs and CIOs we spoke with made a case for a great many opportunities. Just to name a few examples of the investment cases they are considering:

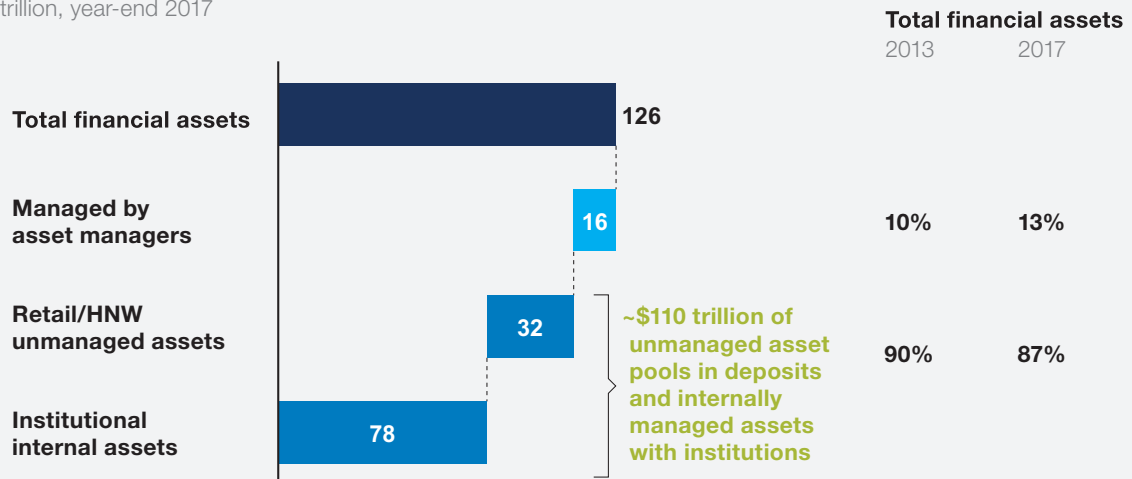
- Use the Asian investment platform to go global
- Tap into un-invested retail assets in Japan
- Emulate the growth of digital platforms like WeChat

Exhibit 5

Nearly 90 percent of total financial assets in Asia are outside the asset management industry.

Breakdown of APAC¹ financial assets

\$ trillion, year-end 2017



¹ Includes Japan, Australia, China, Hong Kong, Taiwan, Thailand, Indonesia, Malaysia, Korea, Singapore, India.

Source: McKinsey Performance Lens Global Growth Cube

- Capture the rise of the millennials
- Take large mandates from insurers

Obviously, no one firm can respond adequately to this assortment. To add to that, Asia is a complex assortment of countries at different stages of investment maturity, with widely varying regulatory nuances and unique local client characteristics. Despite many firms' ambitions, a true pan-Asian strategy, and a true pan-Asian firm, have not yet taken shape. In our view, given there is no compelling pan-Asian strategy, three macro plays stand out for the potential flows they offer, the accessibility of their markets, and conducive regulation (Exhibit 6):

- **The institutional retirement boom** especially in mature markets, like Japan, Australia, and the Taiwan area, where rapidly

aging societies and aggressive pension reforms are creating significant opportunity for third-party asset managers. In the next three years alone, we expect at least \$1.2 trillion of new inflows will become available to Asia's managers.

- **The great wall of Chinese capital.** As the nation creates a more vibrant investment market and opens up to foreign asset managers, we estimate that over \$6 trillion in additional assets will become available to asset managers. (Note: We see volatility in the growth outlook due to the uncertain timing of expected regulatory moves, market volatility, and policy shifts across Asian markets, particularly in China.)
- **The "new wealth horizon" play** to capture the growing wealth effect driving demand for

Exhibit 6

There are three key opportunities to capture growth in Asia.

Opportunity	Segments	Current size ³	Expected growth
		2017 AUM, \$ billion	2018-22
The institutional retirement boom	Defined contribution	1,500	13%
	Insurance	2,800	13%
	Defined benefits	2,400	13%
The great wall of Chinese capital	Offshore ¹	~1,100	
	Offshore to onshore ²	200	17%
	Onshore	~1,700	
The new wealth horizon play	Private banks	1,500	14%
	Retail intermediaries	5,250	

¹ Includes Qualified Foreign Institutional Investor (QFII) and Renminbi Qualified Foreign Institutional Investor (RQFII).

² Includes Qualified Domestic Institutional Investor (QDII).

³ Opportunity for institutional retirement and new wealth horizon excludes China.

Source: McKinsey analysis

investments, especially in India and South-East Asia. We expect over \$2 trillion of new inflows from this opportunity.

The institutional retirement boom

The institutional business represents \$11 trillion of AUM in Asia and is expected to grow at double digits over the next five years. Retirement is a big part of that, and clients consist primarily of pension funds (both defined benefit [DB] and defined contribution [DC]) and insurance. If we compare the ratio of AUM from retirement to GDP in Asia, it is only 29 percent, compared to 84 percent in Europe and 96 percent in the US. This is also the fastest-growing institutional segment due in large measure to regulations in many countries to create new retirement programs. The opportunity is opening in both

developed and emerging Asia. Currently North Asian institutions dominate with 80 percent of the total institutional market.

Within retirement, the fastest growth in the past five years has been in DC, at 23 percent, and in insurance, at 17 percent. DB has been losing prominence: its contribution to total institutional AUM has dropped from 32 percent to 23 percent.

Naturally, institutional needs for retirement products vary considerably across client segments:

- **Defined contribution** is rapidly growing as companies across Asia discontinue their DB plans, particularly in developed markets like Australia, Japan, and the Taiwan area (where institutions are in search of yield and liability-

matching, thus looking outside their walls for help from external managers). Many institutional-led asset managers are focused on these three markets.

- **Insurance** is the next fastest-growing segment, especially in the Taiwan area, Korea and emerging markets including mainland China and South-East Asia. The insurance segment in Asia has traditionally been underserved, and is now making it to the top of many institutional sales agendas of asset managers.
- **Defined benefits** still have a place in some markets but are only really continuing to grow in South Korea, where the government is targeting mandatory pension plans at all companies by 2022.

At its root, the pension boom is of course the result of an aging population, especially in developed Asia, which will force institutions to seek higher risk-adjusted returns to serve their rising liabilities. Other factors are also at work. Institutions are outsourcing more of their investment management as they seek to diversify their investments and fill the gaps in their in-house capabilities. This trend to outsource includes expanding the geographic remit as well as expanding into newer strategies such as global and regional equities and fixed income, multi-asset, absolute return, and alternatives. Large pension funds in North Asia, like Japan's Government Pension Investment Fund (GPIF) and South Korea's National Pension Service (NPS), are becoming more expansive in their asset allocation, adding more global products along with alternatives and solutions. For example, GPIF has increased its foreign asset allocation by 5 percentage points in the past two years. Finally, a third factor is the constraints on talent that institutional investors face. Intense competition,

regional shortages in many cases, and institutional challenges associated with compensation mean that institutions are outsourcing more of their investment management.

The great wall of Chinese capital

China is uppermost on the minds of almost all the executives we speak to. That's hardly surprising, as China represents 37 percent of Asian AUM today and more than 41 percent of revenues. On top of that, AUM in China is expected to grow at over 17 percent annually for the next five years.

Growth in China is a result of the significant wealth effect in more recent years, demographics driving higher demand for retirement solutions, as well as a regulatory push towards development of a "real" asset management industry. Institutions like insurers and commercial banks are growing the fastest, but lack active investment capabilities, especially in equity-related assets. They are outsourcing much more to professional managers. Digital financial services companies have transformed the retail market, initially through online sales of money-market instruments, and now by adding a bouquet of active funds as well. Regulators have fast-tracked growth in asset management by clamping down on the shadow banking sector and its wealth products, reopening quotas for offshore products, and opening doors for more foreign players to enter the market.

The three discrete ways that managers can access China's vast assets are:

- **The offshore opportunity.** Managers can serve financial institutions, primarily sovereign wealth funds (SWFs) such as China Investment Corporation and State Administration of Foreign Exchange (SAFE), that invest in offshore products denominated in US dollars or

other foreign currencies. Most global managers start here since there are few regulatory restrictions on serving these SWFs. This segment is accessed either directly by asset managers of size or indirectly through asset consultants. China Investment Corporation continues to outsource a significant portion of its \$940 billion in assets with external managers. SAFE has placed about 16 percent of its \$3.14 trillion with third parties. Today, total externally managed assets are over \$1 trillion. We estimate that this total should grow by 20 percent over the next five years.

■ **The offshore-to-onshore opportunity.**

Many other Chinese financial institutions seek offshore products in which to invest. These flows are regulated through quotas like the QDII (Qualified Domestic Institutional Investors), which are reset at intervals by the regulator. In early 2018 (two years after the last reset), a new quota of about \$103 billion was awarded to a handful of managers. Some managers with JVs in China have benefited from both their own quota allotment and that of their JV partners. Other offshore-to-onshore vehicles include mutual recognition of funds (MRF) schemes, QDLPs (Qualified Domestic Limited Partnerships) for alternative investments, and the equity, fixed-income, and ETF “stock connects” between mainland China and the Hong Kong special administrative region. Stock-connect investments currently stand at about \$90 billion. Many CEOs expect significant relaxation of the QDII quotas in the next couple of years, though timing is uncertain, making it a sizable opportunity.

- **The onshore opportunity.** The biggest opportunity is the chance to serve Chinese investors through an onshore presence. While minority-owned JVs had long been the only

way to do this, the recent introduction of majority ownership in JVs and wholly owned foreign entity (WFOE) licenses have attracted a slew of foreign managers into China. This is not surprising given that the Chinese mutual-fund market has quadrupled over the past five years to \$1.7 trillion and is expected to reach close to \$3.2 trillion by 2022. Even then, mutual funds would hold only 8 percent of personal financial assets in China. Nor is that all. We expect a sizable chunk of the \$4.5 trillion of capital currently in shadow banking products will also be looking for a home over the next couple of years, as regulators limit these products.

We would be remiss if we did not mention China’s digital disruption at the hands of fintechs and ecosystem players such as Ant Financial, Ping An, and Tencent. So far, their biggest successes have come in money market and deposit products. With regulators discouraging flows into these products, we can expect to see more retail fund offerings on these companies’ mobile apps. In addition, many now offer AI-based robo advisory, which will automatically select funds based on investor profiles and demand. As more assets move from cash to funds, the big fintechs and ecosystem operators are aiding China’s shift to a cashless society. How asset managers position themselves to serve these fintech platforms will be critical, not only in China but also in other Asian markets where fintechs are gaining ground.

The “new wealth horizon” wealth play in South-East Asia

Asia has the fastest growth in number of affluent and high-net worth individuals (HNWI) globally. We expect the wealth market (total personal financial assets, much of it held by banks and insurers) in Asia to more than double by 2025, when it will become the world’s largest with

almost \$30 trillion in personal financial assets, overtaking North America (~\$29 trillion) and Western Europe (~\$15 trillion). In Asia, China is growing the fastest, with India close behind. HNWIs get a lot of credit for this growth, but rapid GDP growth and the entrepreneurial nature of the people in these regions are also producing a strong affluent cohort.

China and India are certainly heavyweights. But South-East Asia is coming on strong. While the

region's main markets in Indonesia, Malaysia, and Thailand are smaller today, at a collective \$600 billion of AUM, they are expected to grow rapidly, and many managers are paying less attention to this opportunity. Changing customer behavior towards investment, a regulatory push towards low-cost advisory models, and the transition of offshore to onshore wealth management with tax and regulatory changes will underpin this opportunity. We expect AUM in these markets to nearly double over the next five years.

A playbook for success

When we reviewed the fastest-growing managers in Asia, both local firms and multinational companies (MNCs), to identify their common characteristics, we found that they shared a few traits. All take a long-term perspective, with a stable management team and strategy. They have all made big bets on China, the foundation of the industry's strong growth. Other moves were more surprising. They have all built programs to develop their people, and generally place a premium on talent management. And they have all invested in new digital and analytical capabilities, primarily for retail marketing and to lower costs.

That was the apparent recipe for success over the past five years. While it is admittedly a small sample of 22 firms, the results square well with our experience of the industry in recent years. The market is certainly changing, but we argue

that those same characteristics will be just as valuable in the years to come. Firms that demonstrate these attributes will be well positioned to capture the macro opportunities our research has revealed.

Five foundations of growth

Since 2013, industry AUM in Asia has grown by 13.8 percent. But our interviews at 22 top firms, which account for almost 30 percent of total industry assets, reveal widely divergent growth patterns (Exhibit 7)—a finding borne out by our work with dozens of firms across the region.

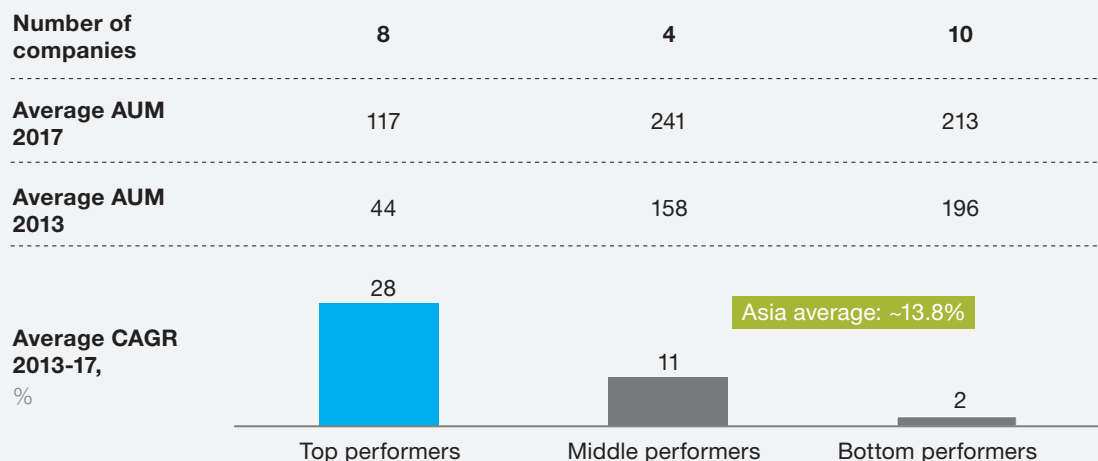
At the top of the growth curve are eight firms that grew 28 percent on average. All had AUM of less than \$100 billion in 2013. But by 2017, six of the eight had vaulted over that threshold. This handful of dynamic firms captured about 10 percent of total AUM growth in Asia.

Exhibit 7

Small firms are growing the fastest; largest players are decelerating.

22 interviewed firms by Asia-Pacific AUM

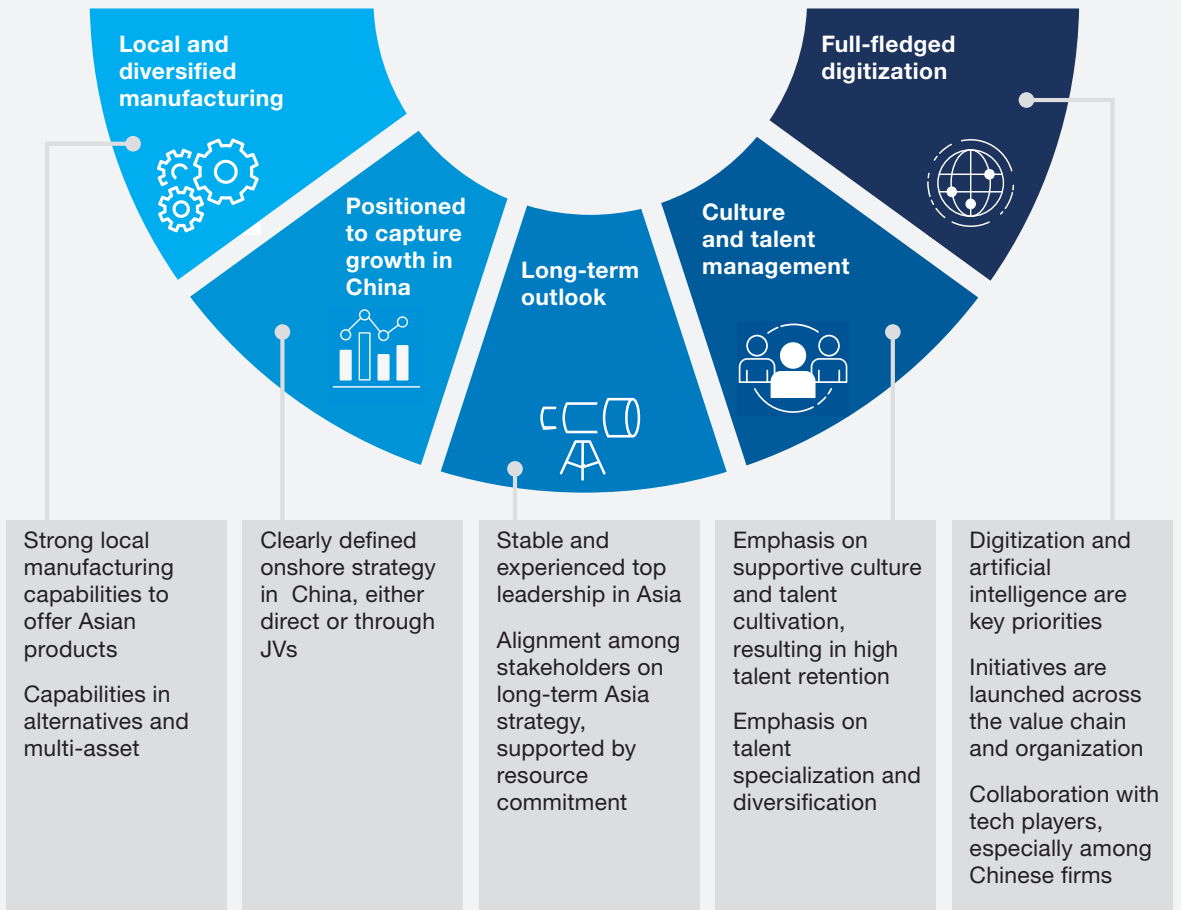
\$ billion



Source: McKinsey Performance Lens Global Growth Cube

Exhibit 8

Five factors have characterized growth leaders in past five years.



Source: McKinsey analysis

In the middle are four firms that grew at 11 percent—a fair bit under the average of almost 14 percent across all Asian firms. These are medium and large firms; all had more than \$100 billion in assets in 2017.

And at the bottom of the growth curve are ten firms that managed only 2 percent annual growth, well below the industry average. At a couple of these firms AUM actually dropped from 2013 to 2017.

Those in the top bracket share the following five common characteristics, which we think will

continue to stand them in good stead in coming years, particularly as they pursue the three macro opportunities (Exhibit 8).

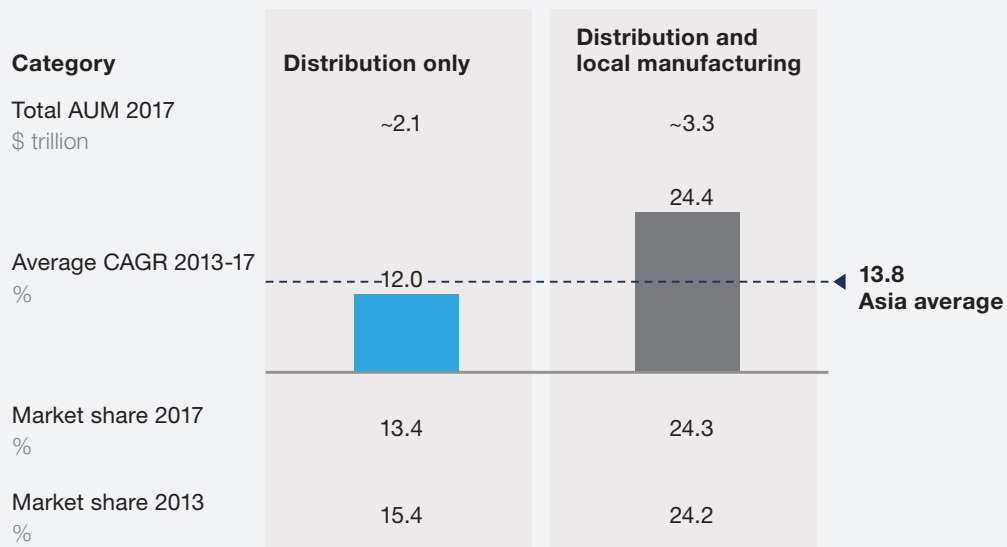
Local and diversified manufacturing

These firms believe in a strong local capability to offer Asian products. They are building additional skills in multi-assets and alternatives through new hires and partnerships or acquisitions. “The secret” to great local manufacturing, says one CEO, is “allowing the boutiques to have autonomy on investments, while looking for ways to help them with shared services.”

Exhibit 9

Firms with manufacturing capabilities have grown twice as fast as those that only distribute.

Top 30 asset managers by Asia-Pacific AUM



Source: McKinsey analysis

Our research also unearthed an important consideration about manufacturing for MNCs. Firms that have built distribution-only capabilities in the region (i.e., they only sell their globally produced products in Asia) have registered lower-than-average growth, and some have also lost market share. Firms that have also established local manufacturing capabilities, either direct or through partnerships/acquisitions, have registered 24 percent growth in AUM over the past five years, and gained share of total AUM (Exhibit 9).

As firms build local manufacturing skills as well as new capabilities, they should bear in mind some of the following necessities:

- **Active investing skills** remain in strong demand, as seen across retail distribution as

well as in recent mandates by leading institutions. The inefficiency of Asian markets has allowed for alpha generation and thus been a source of strong returns for Asian investors, who have become used to success. In Asia, even passive manufacturers position themselves as active producers of alpha through thematic and smart beta solutions. We heard one thing from many CEOs, which is further corroborated by our experience: investment performance is key to not only attracting clients but also retaining them in the longer term.

- **Solution-building capabilities.** While active investments proliferate, demand is shifting from traditional equity and fixed-income products towards differentiated sources of alpha provided by the likes of multi-asset,

solutions, alternatives, and more thematic products. Having an extensive bouquet of investment offerings is required to fulfill the varying needs of clients, as well as to serve current clients more fully. Environmental, social and governmental (ESG) issues are gaining ground, and many institutions are seeking ESG-principled products. Leading CEOs are responsive, and spoke with us about aligning production of investment products to ESG principles.

- **Distinctive product offerings.** Asian investors have typically favored local firms for local traditional products. Thus, MNCs need to differentiate their offerings to compete on their own, and even to successfully partner with local managers to leverage each of their capabilities. For example, foreign firms are partnering with local asset managers in Thailand to access retail investors, by offering offshore products. On the institutional side, while MNCs can go directly to most large institutions, partnering with a local asset manager allows for leveraging their relationship for a potentially larger share of mandates, as well as tapping into smaller institutions, especially in countries like Japan and South Korea.

Clear positioning in China

An onshore presence in China is a dominant theme. So far it has typically been achieved through joint ventures. One CEO told us, “You don’t need to be the first firm in a given Chinese market, but you can’t be the tenth. We like being the second or third.” For the future, firms are split about whether it is better to have a presence through a WFOE license, or majority ownership of their JVs. What is clear is that a strong distribution partner is necessary for success in China. Beyond that, a few other attributes are also essential:

- **A reconfigured risk appetite.** In several countries, particularly China, managers need a greater risk appetite. Unlike many of the more developed markets, the same risk management restrictions and governance do not apply in the same way to China. Governance needs to allow quick adaptation to evolving regulations and market conditions. For example, some creative product designing will be required to capture shadow banking assets.
- **Quick adaptation to evolving regulations.** While recent changes are promising, the system retains a lot of ambiguity and restrictions. Regulators are intent on opening the financial sector, but real impact will take time. Thus a “wait and see” approach may not work, as it carries a substantial risk of missing the window. Instead, asset managers need to move ahead with a clear plan and an experienced team that understands the regulatory system and can actively engage with local regulators.
- **Get the partnership right.** In China, foreign players must use JVs to serve the public-fund market. Even those that set up a WFOE-PFM (Private Fund Management) still need strategic partnerships with local distributors (banks, securities firms, wealth management companies, and/or digital platforms). Historically, while a few JVs with local majority shareholding have proven successful, we’ve seen more cases in which the foreign entities eventually withdrew from the JV due to poor performance and management conflicts arising from mismatch of goals. It is thus important to get the partnership right at the very beginning: find the right partner, align both parties’ mid-to-long term goals and expectations, agree on roles and responsibilities, and set up a governance structure that can deal with issues that arise.

Long-term outlook

Commitment to the business is a prime ingredient of success. The fastest-growing firms have had their CEOs and management teams in place for a long time. Their strategy is stable, and not subject to passing fads, or the influence of managers who know they will rotate out soon and are intent on leaving their mark. One CIO explained the problem with rapid rotation this way: “A lot of the biggest opportunities, as big and as profitable as they are, are probably going to happen once I’m retired.” Firms have worked to align their stakeholders around a long-term vision, and backed it up with a commitment of resources. As part of this long-term commitment, they have developed a sound regulatory strategy—a sine qua non at a time when regulation is both a headwind and a tailwind (see “Asia is open for business” on page 16).

Three other organizational attributes can profoundly strengthen the long-term commitment:

- **Stakeholder management** is vital, especially for the large MNCs. The biggest fear of a couple of CEOs was being slow to react to disruptive and transformational ideas due to the time taken for stakeholder alignment. Some have found it hard to convince stakeholders of what is required to capture the magnitude of growth in Asia, which has kept them from obtaining the resources they need. As firms develop their growth strategy, they should also think hard about the organizational alignment needed to deliver it. Sometimes the first is clear, but the latter difficult to achieve.
- **Intellectual capital and thought partnership**, according to many CEOs, are essential ingredients to develop long-term relationships with both institutional clients and

distributors. Institutions are looking for solutions to fulfill their needs rather than products to be pitched to them. In addition, institutions are demanding thought partnership in a quest to improve their in-house capabilities. We find that knowledge sharing also helps managers stay top-of-mind as competition intensifies for distributors’ shelf space. CEOs see it as a vital way to sell further into a relationship, so that the asset manager is no longer perceived as a sales person but as a trusted advisor.

- **Local business intelligence.** As assets start to emerge from the \$110 trillion pool, some will be better publicized than others, and can be captured by the traditional fly-in, fly-out model. But others will happen in the background, and managers must keep an ear to the ground to capture some of these mandates. For example, in Japan local ground connectivity is important to tap into new regional institutional opportunities.

Culture and talent management

A fourth common attribute amongst successful firms is a strong culture, made manifest through the approach to talent management. Top firms have carefully nurtured a supportive culture, and cultivated top talent, including local talent, with an emphasis on specialized skills and diversity. As one CEO told us, “It’s not easy to find graduates, even in Singapore. They’re in great demand. And finance is not always the coolest thing to them.” A welcoming culture and a steady series of opportunities can keep talented people from leaving. Local expertise especially has proven critical to better understand nuances of the market and client needs, as well as build better relationships with the regulators. Leading firms have overcome concerns from headquarters about local hires, including investment talent, not being able to meet their global standards.

Regulation: Asia is open for business

Across Asia, regulators are making moves that will aid the development of capital markets and benefit investors. Enhanced transparency is one common theme, and includes disclosure of fees and terms to investors and fiduciary responsibility to advisors and intermediaries. A second thread is creation or improvement of retirement infrastructure, such as new mandatory pension schemes. Another theme is around several countries liberalizing their markets to provide easier access to foreign firms. Here's a brief overview of recent as well as upcoming regulatory moves in Asia's major markets.

- **Australia.** Recently the Australian Securities and Investments Commission (ASIC) reviewed the financial advice on products provided by top banks and wealth managers in Australia and observed that in “75 percent of advice files advisors did not demonstrate compliance with the duty to act in the best interest of their clients.” Despite widespread use of open architecture, the regulator found a clear bias towards in-house products. ASIC is overhauling the system and taking steps to improve its monitoring and supervision processes, including suspending advisors with serious compliance failings. A final report in early 2019 is expected to pave the way for the industry to align itself to the best interests of its customers.
- **China.** A wave of regulatory and liberalization measures is intended to develop a “real” asset management market over the next couple of years. To that end, the regulator has rolled out several initiatives, from creating a level playing field for foreign asset managers to tightening the risk infrastructure. Three are of particular interest to managers. First, the ceiling on foreign stockholding in companies was raised from 49 to 51 percent, enabling majority control, which can be raised to 100 percent ownership in three years. That should lead to increased market activity and thus deepen the publicly traded markets. Second, the recent private fund management (PFM) license has spurred a rush by foreign managers to establish wholly owned entities in China. Finally, in an effort to improve the risk and compliance structure, the regulator has come down heavily on shadow banking and has banned the use of multiple layers of ownership in entities that sell securities, and guarantees on rate of return on some investments.
- **India.** A series of steps over the past three years has improved transparency and expanded the playing field. In 2016, the regulator capped upfront commissions on mutual funds at 100 bps to reduce churn. It also introduced a “direct fund class” that empowers investors to bypass intermediaries and thus reduce their distribution commission. These direct funds are gaining traction; on average direct plans’ lower costs have added about one percent to returns on mutual funds invested in equities. On the institutional side, pension funds and insurance companies are now allowed to invest up to about 15 percent of incremental flows into capital markets through exchange-traded funds, a significant shift.
- **Japan.** As low interest rates persist, the regulator is encouraging retail investors to shift assets from deposits into investments. The Nippon Individual Saving Account (NISA) offers an

exemption from tax on capital gains and dividends. To foster growth in the retail market, the Financial Services Authority (FSA) has released its Principles of Fiduciary Duty, to push distributors away from the traditional commission-driven model toward the provision of advice in “the best interest of clients.”

- **Malaysia.** In recent years the regulator has issued a framework for digital investment management that includes online advisory, tightened cybersecurity standards on financial transactions, and an online standard for complying with KYC rules to speed up and safeguard the customer sign-up process. Most recently it created an online platform for members of the country’s largest pension, Employees Provident Fund, promoting transparency on fund structures to help inform pensioners’ investment decisions.
- **South Korea.** The regulator has taken on the perceived problem of high commissions, a common feature in a country where about 80 percent of retail demand is served by banks and securities companies. It is promoting some low-cost investment channels such as the “Fund Online Korea” platform. As Japan and India have done, South Korea has launched an individual savings account with tax exemptions and benefits to encourage long-term retirement savings, and a mandatory, affordable online class of shares for all new funds.
- **The Taiwan area.** Like its peers, the Financial Supervisory Commission has taken several steps to make its markets friendlier to foreign firms. Most recently, it has raised the cap on offshore funds’ investment in mainland China securities from 10 percent of the fund to 30 percent. This should appeal to Taiwanese investors, many of whom seek some exposure to the Hong Kong and Shanghai exchanges.
- **Thailand.** The regulator has opened the market further to offshore investments, while also pushing for a more open architecture at local banks. In 2016, the Securities and Exchange Commission allowed qualified Thai investors to buy offshore products directly, a departure from the old practice of using local intermediaries. It also increased the upper limit for overseas foreign investment to \$100 billion from \$75 billion, to encourage global fund firms to offer their products to domestic investors. For institutions, a new “mandatory provident fund” is in the works, and will require private sector companies to participate.

Perhaps the most important cultural shift managers should consider is getting closer to the customer. In any business, as relationships grow, some inevitably will stagnate if not constantly nurtured. CEOs consistently told us that customer centricity, as seen in service quality (and knowledge-sharing, as mentioned) are critical to the long-term health of relationships with institutional clients. To stay connected, most CEOs spend considerable time meeting clients to understand their needs and address concerns. Another key step is for marketing teams to

collaborate closely on the messaging to end-customers. To do this well, managers need not only sales and customer service capabilities, but the right talent to drive the innovative platforms and digital solutions that can effectively communicate and yield results. Many CEOs told us that the more local their service teams, the better the results.

Digital and analytics

Finally, leading firms view digital and analytics as a critical priority, though with the caveat that

Digital and analytics: The train is leaving the station

One of the most interesting findings from our interviews, our benchmarking survey, and our experience is the extent to which firms are already digitizing and deploying advanced analytics, including artificial intelligence (AI). Here's an overview of what's happening in each part of the value chain.

- **Manufacturing.** Firms are devoting a large part of their digitization efforts to investment management. Some are using AI to analyze published texts to gauge whether opinion on a company or sector is headed up or down. Others are doing something similar on social media, a technique they call “social listening.” One manager has created a data insight unit charged with gaining “information alpha,” to power its active investments. A few are focused on quantitative products, where they mine non-structured data like text and use the result to shape their investment decisions. One firm has seen sufficient value from the new technologies in their quantitative work that it is considering rolling these out more broadly through its risk management function. Another is finding that even simple applications help, such as automating note-taking from calls and meetings.
- **Distribution.** Some firms are experimenting with customer analytics and targeted digital marketing, a field that most see as very promising. One firm says it now does “very little” in print marketing. Several firms are building shared platforms with distributors, to ease communication. Most see these platforms as good ways to share information with customers and even with their own sales force. A couple are plugging directly into distributors’ platforms and making it easy for them to forward marketing messages to clients and advisers. In some cases, those distributors have the analytical know-how, and can help managers reach the right customer base. One firm we spoke with is building a platform for direct retail sales, designed for smartphones. Robo advisory is of interest to many, especially understanding the algorithms that will position their funds at the top of the selection list. A few firms report that they have built AI into their advisory such that it provides genuine advice, rather than canned formulas on asset allocation.
- **Back office.** From our benchmarking survey and experience in the region, we find this is probably the biggest untapped opportunity for digital and analytics. Robotic process automation is starting to find a home at many of the managers we interact with, in finance, HR, compliance, and elsewhere. One CEO says, “we can take out a huge amount of manual processes” by automating these functions. One Asian firm is also testing the use of blockchain in their back office. Some firms are using automation that resides in the back office to support the front line. One told us about a bot that takes trade orders from portfolio managers through an internal chat system. The manager writes a very short message, and the bot prepares dozens of orders for a specified set of accounts, fulfilling a task that is usually performed by associate portfolio managers, thus freeing up their time for more value-added activities.

“with all the noise around digital, we are concerned that some things will have to go on the back burner.” Most have launched initiatives across the business. All have either struck deals with technology partners, or expressed an interest. One critical challenge that all firms are struggling with is the cost and availability of digital talent and data in Asia. For more on how Asia’s leading managers are building their digital and analytics capabilities, see “The train is leaving the station” on page 18.

Two key drivers as managers think about implementing digital and analytics in the Asian context are as follows:

- **Trust in brands.** In Asia, even more than developed markets, intermediaries and both retail/institutional customers value and trust a known brand. A few global houses have invested for the past couple of decades to build a local presence across emerging Asia and have thus built a local reputation for their global brand. Global firms are finding new ways to make this happen, especially through the adoption of digital marketing. One firm is in the early stages of developing retail brand recognition in China through games and “lucky draw” promotions on WeChat; in Singapore, it has introduced a chatbot on Facebook to educate investors.
- **Relevance to distributors.** Retail intermediaries (including private banks) increasingly value new ideas to win over customers, especially fit-for-purpose solutions. We do not believe that going direct to consumers will be scalable or necessarily feasible in the near term; however there is opportunity on the B2B2C front. Managers need to align with the digital strategy of distributors (banks and advisors), in ways that help distributors advise customers about

asset allocation rather than sell products. Some managers are buying stakes in B2B fintechs and aggregators to support distributor digital strategies.

How will these five essential characteristics play out as firms tackle the three macro opportunities? For China, the key consideration is finding the right distribution partner, irrespective of the choice to enter alone or via joint venture. Depending on the manager’s target client segment, the distribution partner could be traditional (a bank or securities firm) or non-traditional (such as one of the digital/ecosystem companies). In any case, entering China’s onshore market requires a balance between the long-term view and the need for return on investment.

To capture growth from the institutional retirement boom, thought leadership and knowledge sharing are essential to developing deeper relationships. Managers also need a combination of traditional global as well as alternative products, if they are to create solutions that match the liabilities of pension funds, insurers, and other institutional investors.

For the South-East Asia wealth opportunity, we don’t think a single approach is feasible. Rather, managers should take a prioritized market-by-market approach based on unique local requirements. As in China, local partnerships are key to scaling in these markets, as is digital innovation to buoy distributors’ efforts.



Building these five capabilities has been vital for Asia’s leading firms and probably speaks louder than words—but words are also important. A quote that we heard from one executive stuck in our heads: “Asset management is a long game.” To us, that means that firms cannot afford to get

distracted by passing fads, but must pay close attention to the secular forces that will dictate long-term results. We hope that this report helps

in that regard, and offers ideas that will help asset managers build franchises that thrive in the long run.

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