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Gearing up for renewed growth
Asset management industry summary

Key industry findings from 14th Annual Global CEO Survey

Asset management summary

The global economy is still recovering from the worst economic crisis in 75 years, as many countries grapple with the aftermath of the recession. The PwC 14th Annual Global CEO Survey sets out to uncover how chief executive officers (CEOs) are approaching business growth during a time when sustainable economic growth in many developed markets is far from certain. We surveyed 1,201 business leaders in 69 countries around the globe in the last quarter of 2010.

The cross-sector findings reveal a surprising level of confidence in this environment; chief executives are nearly as confident of growth over this coming year as they were in the boom years before the crisis. The survey also revealed where CEOs see growth coming in 2011, and how they are going to achieve it. In 'Growth reimagined: Prospects in emerging markets', we show how CEO confidence is being driven by targeted investments in particular emerging markets – often far from home.

We also identified three strategic focal points to achieve that growth: innovation, talent and a shared agenda with government. These three business imperatives have always had their place on the CEO agenda. But now, with their worst fears about the crisis behind them and an emerging recovery ahead, CEOs are adopting new attitudes and approaches, tailored to dealing with the issues of the multi-speed global recovery that they hope is underway. To explore the full results from the 14th Annual Global CEO Survey, please visit www.pwc.com/ceosurvey

Gearing up for renewed growth

This is a summary of the findings in the asset management (traditional and alternative funds) sector, drawing on the perspectives of the 31 CEOs from the sector who took part in the survey. While some of the cross-sector themes are reflected in the responses from the asset management CEOs, their perspectives highlight further challenges and opportunities.

Asset management CEOs are among the most optimistic CEOs in our survey, though this confidence is tempered by a keen awareness of the challenges of increasing regulation, competition for talent and evolving investor expectations. Sixty-eight percent are 'very confident' about their company's growth prospects over the next three years, which is higher than in any of the other financial services sectors and some way ahead of the 51% average for the survey population as a whole. The remaining 32% are 'somewhat confident' about the outlook for their companies.

Much of this confidence clearly stems from the huge market potential opened up by an ageing population, not just in the developed world, but in Asia as well. While this potential has been evident for some time, the financial crisis has created further openings for asset managers by accelerating the pressure on defined benefits pension plans and putting even greater strains on already hard-pressed public pension provisions. The result is increasing uncertainty over retirement income and far greater readiness to put money aside. In the US, for example, our analysis suggests that the savings rate could rise to as high as 10% of disposable income, a level not seen since the 1970s. In the years leading up to the financial crisis it was running at below 3%[1].

To encourage workers to invest their growing savings in fund products rather than simply putting them in deposit accounts, asset managers will need to provide investment vehicles that combine reasonably secure income with sufficient yield to pay for longer retirements. They will also have to deal with an increasingly knowledgeable, demanding and empowered client base, which has been made more sceptical and risk-aware by the financial crisis.

Our survey indicates that asset managers are increasing investment in new product development and customer relationship management. Over 80% of asset management CEOs believe that innovations will lead to significant revenue opportunities for their businesses over the coming three years. More than 50% are stepping up product innovation, as well as upgrading their customer profiling and other systems capabilities to support growth initiatives.

One of the key developments within the mainstream retail sector will be the continuing shift from active to passive funds. Some analysts predict that the proportion of global funds managed passively could rise from around 15% to 25% over the next ten years[2]. This development could be especially telling within the pensions sector.

On the active management side, the post-crisis environment is creating valuable opportunities for the alternative investment industry. More than ever, institutional investors are convinced of the need to diversify their portfolios of assets. They recognise that the best alternatives managers offer them the potential to diversify and protect a portion of their assets. As we discuss later, good transparency and governance will be critical in attracting this flow of institutional investment.

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1 'The New Rule of 10%: The coming pension crisis, higher savings rates and fundamental changes in the US financial services industry', PwC (May 2010).
2 'Investment industry set for big shift into passive manegement', *Financial Times*, 27.06.10

Three-quarters of asset management CEOs in our survey believe that emerging markets will drive growth in their companies and that these markets will be more important than developed markets to their organisation's future prosperity. Nearly all expect an increase in revenue from their Asian operations over the next 12 months, and some 80% anticipate growth in the Middle East and Latin America. Asia could provide an especially important source of growth for real estate funds as they seek to contend with the tough market conditions within most developed markets.

Emerging market growth

Further opportunities stem from the increasing level of affluence in China, India and other emerging markets. Our analysis indicates that while New York will remain one of the leading 'clusters' for asset management business over the next 20 years, Singapore could overtake today's other top three centres, London and Boston, by 2025[3]. Hong Kong, Beijing and other regional centres are also likely to see strong and rapid growth.

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More than 30% of asset management CEOs are looking to make a cross-border acquisition to support their growth plans over the coming year. Emerging markets feature strongly in the target regions for M&As, with 40% planning an acquisition in Eastern Europe and 30% looking to buy a business in Asia and Latin America.

Contending with regulation

Our survey reveals that asset management CEOs see over-regulation as the greatest threat to growth (see Figure 1). There are clearly challenges in implementing a wave of new directives, including the US Dodd-Frank Act, European Union Alternative Investment Fund Managers Directive (AIFMD) and the latest update of the Undertakings for Collective Investments in Transferable Securities (UCITS IV). Asset managers also face wider legislative developments such as the US Foreign Account Tax Compliance Act (FATCA), as well as the potential fallout from moves to control systemic risk within the banking sector.

It will be important to take account of national and regional differences in regulation and the impact of potential conflicts between the various regulatory developments. It will also be important to assess and address the strategic implications in key areas such as choice of domicile, product design, distribution and pricing. We believe M&As will form an important element of the resulting strategic realignment and restructuring, providing further impetus for the growing wave of acquisition, divestment and consolidation within the asset management sector. Regulatory changes could also lead to a more conservative risk appetite among many institutional investors, despite their broader need for alpha based on demographics and pension shortfalls, which will present asset managers with an even tougher challenge in balancing return maximisation and risk minimisation.

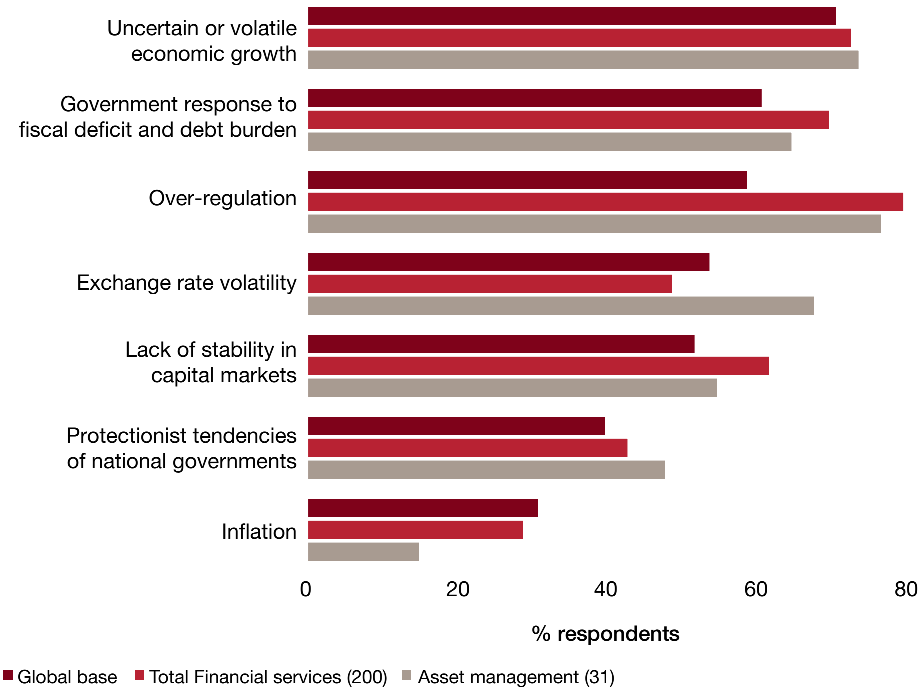
3 'Economic views: Future industry clusters', PwC (September 2010).

At the same time, many of these regulatory developments open up competitive opportunities. This includes rationalising operations and improving tax and capital efficiency. The new requirements on governance and disclosure could also provide the catalyst for enhancing transparency and trust. More than 70% of asset management CEOs plan to increase their company's financial transparency and focus more on strengthening their company's reputation and rebuilding trust over the coming year.

A recent PwC report looked at how greater openness could be especially important in helping alternative funds such as hedge, real estate and private equity funds to strengthen market confidence and attract more institutional investment[4]. Transparency is essential in sustaining investors' trust and reassuring them that there are appropriate controls across the fund value chain – including the fund board, manager, administrator and prime broker. More broadly, alternative funds are going to face increasing pressure from institutional investors to develop a more robust infrastructure of regulatory compliance and tax management.

Figure 1: Policy and economic threats

Q: How concerned are you about the following potential economic and policy threats to your business growth prospects?



Respondents who stated 'extremely' or – somewhat concerned'

Base: All respondents (1,201)
Source: PwC 14th Annual Global CEO Survey 2011

Only 21% of asset management CEOs intend to increase the headcount in their risk management teams, only 33% plan to re-examine their capital structures and only 38% plan to adjust their performance incentives to account for risk.

Closer focus on risk

A more systematic approach to risk management will be critical in sustaining investor confidence and complying with new regulatory demands. Nearly 90% of asset management CEOs are modifying their operating models to manage risk more effectively. Over 80% will be focusing more of their senior management's attention on risk management and more than 60% intend to formally incorporate risk scenarios in their strategic planning. Nonetheless, how far many firms are embedding these changes into their day-to-day operations is open to question. Only 21% of asset management CEOs intend to increase the headcount in their risk management teams, only 33% plan to re-examine their capital structures and only 38% plan to adjust their performance incentives to account for risk.

4 'From black box to open book: Hedge fund trust and transparency', PwC (November 2010).

Driving down costs

The renewed focus on fees and charges in the wake of the financial crisis is heightening the pressure on costs, especially within the retail sector. Three-quarters of asset management CEOs – a higher proportion than in any of the other financial services sectors – believe that consumers will focus more on price and value for money. Nearly 70% have responded by initiating or continuing a cost-reduction initiative over the past 12 months. Outsourcing is a significant element of the drive to control costs, with 42% having outsourced a business process over the past year and a further 29% planning to do so over the coming year. A significant proportion will be outsourcing offshore.

In our experience, however, these cost-reduction initiatives often deliver only short-lived savings or, worse still, impede a firm's ability to sustain quality of service, meet its strategic goals and respond to market opportunities. As our survey highlights, outsourcing is a potential case in point. A significant proportion of firms have brought a process in house over the past year or are planning to do so in the next 12 months (16%), suggesting that the arrangements have met with mixed success. If offshoring is managed effectively, it can create significant savings. But it opens up the particular challenges of operating across different time zones, regulatory regimes and long chains of management command.

The difficulties in gaining the anticipated benefits of cost-control initiatives underline the importance of a more sustainable approach to cost management. This seeks to align expenditure with strategic goals rather than relying on arbitrary and potentially damaging cost-reduction targets. It also seeks to make sure that savings can be maintained over the longer term by streamlining operations and improving efficiency. More effective systems and processes will be critical, as many asset management CEOs recognise; over 60% are looking to investments in IT to reduce costs and improve operational efficiency. The underlying requirement is a real understanding of the component costs and drivers of profit to discern the true margins and eliminate uncompetitive expenses in areas such as operational duplication.

The people to succeed

As growth picks up in the sector, so will the competition for talent. Sixty-five percent of asset management CEOs see the availability of key skills as a significant concern and 36% believe that it is the biggest threat to their growth prospects.

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Expansion in emerging markets is opening up a new front in this war for talent. Many asset managers are finding it difficult to secure the people they need to support their growth aspirations. With talent in short supply, competition for recruitment is leading to high staff turnover and escalating salary inflation. Secondment could help to bridge the gaps in the short-term. Forty-five percent of asset management CEOs are planning to deploy more staff on international assignments over the coming year. However, as the numbers needed to fill positions in emerging markets grow, it could prove hard to find enough employees who are willing to relocate. Many firms may also struggle to afford the generous pay and relocation packages that may be needed to encourage their top people to move overseas. It is notable that 35% of asset management CEOs reported difficulties in deploying experienced talent globally.

Is there a way to overcome talent gaps without allowing costs to go through the roof? Asset management is not an industry that necessarily needs people on the ground. Investment in technology would allow asset managers to deploy the talent that is readily available within existing industry clusters without having to fund expensive relocations or salary escalation. This could be combined with a longer-term approach to nurturing local graduates in centres targeted for growth.

Key competitive differentiators

Our survey confirms that asset managers are emerging from the financial crisis with renewed confidence. However, success will be hard won. Customers are becoming savvier and more price-conscious. Regulation is increasing expenses and opening up asset managers to greater investor and market scrutiny.

Technology will be a crucial competitive differentiator, helping to give firms the edge in controlling costs, improving efficiency and responding to evolving investor demands. Greater transparency will also be critical in attracting funds by providing a clear indication of the strategy, risk appetite and performance of the funds and helping to assure investors that the business is properly controlled and governed.

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