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Trends in asset management: A comparison of the industry in China and India

The asset management industries in both China and India are young. Since the 1990s, the industry in those countries has been characterized by significant growth and a huge amount of change and dynamism.

While the global economic downturn has caused a pause in the industry's growth, demographic trends in both markets point to significant growth in investable assets in the long term. Asset management firms, meanwhile, will increase their investments in these markets as mature markets underperform. In light of the opportunity and talent challenges they present, Spencer Stuart's Financial Services Practice looked at the development of the asset management industries in China and India, the opportunities for the future and what firms can be doing today to create competitive advantage in these markets as the world emerges from the downturn.

Background and market overview: Different paths to growth

China

China's investment management industry is by any measure very young, having developed essentially over the past 10 years. The industry consists of a rapidly growing retail mutual funds market and an institutional investment market still in its infancy, including pension funds, qualified domestic institutional investors (QDII) and qualified foreign institutional investors (QFII).

The ceiling on foreign holdings has been gradually increased, allowing for additional foreign influence and knowledge sharing.

Asset managers in China initially were established by domestic investment, trust and securities companies, and therefore the market veterans are wholly owned domestic enterprises. Since 2002, joint ventures between domestic Chinese and foreign partners have been permitted, and more recently bank-linked and/or insurance company-linked fund managers have been created. Sovereign wealth institutions in China also have emerged as active investment entities and there is a growing role played by the unregulated market or "grey funds" in China, which can include private equity and private wealth/family office/collective investment schemes.

While the Chinese market is still dominated by domestic fund management companies (FMCs), foreign financial services institutions with joint venture FMCs have made significant inroads over the last seven years, now numbering 29 firms that manage approximately 30 percent of the total assets under management. The ceiling on foreign holdings has been gradually increased, allowing for additional foreign influence and knowledge sharing. Foreign

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firms that were early movers in establishing joint ventures have in some sense gained a head start through access to a wide choice of partners and distribution outlets. However, the rapid pace of development in the investment management market continues to create new opportunities for foreign entrants, either through build or buy strategies. The global financial crisis, for example, will create vacuums in certain joint ventures that will need to be filled by new foreign partners.

The largest portion of the asset management industry in China, the mutual funds market, is still very small in comparison to mature markets on a global scale. By year end 2008, the net asset value (NAV) of 477 mutual funds in the country was CNY1.939 trillion or roughly US$284 billion, representing a 40 percent decline from 2007. By comparison, the total mutual funds market in the United States as of March 2009 was US$9.249 trillion.[1] Within Asia, Japan boasts the largest asset management market, with personal financial assets in Japan now totalling about US$13 trillion, compared to China's US$2 trillion.[2]

India

The asset management industry in India is a prime example of the success of free competition in the country. From an industry that had one dominant player in the early 1990s, there are now over 30 active players, reflecting how the world of asset management in India has changed. Today, it is an industry of choice for customers and employees, with a range of products available, the presence of almost every large global player and a growing focus on investor education.

The primary driver of this growth has been deregulation, coupled with free competition. The world's best brands were given an entry ticket with majority ownership if they so wanted, the result of which was the creation of a high-quality industry that incorporated global best practices. Regulatory support in the initial crucial years was also exceptional, with a focus on continuous dialogue and openness to change.

A big driver of growth in the late 1990s was institutional business, which has grown to become a major contributor to profit margins of mutual fund companies as well as playing a large role in product innovation and growth of AUM. Most recently, financial advisory and retail distribution have attracted the attention of the sector and retail distribution remains a huge opportunity. Only about 5 percent of household assets are in mutual funds, and the top eight cities in terms of households penetrated account for 75 percent of retail AUM.

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Opportunities and challenges ahead

China

Despite its still modest size, China is regarded globally as a primary market for long-term double-digit growth in investment management for many years to come. An October 2007 McKinsey & Company study estimated AUM in China would increase at a rate of 24 percent annually for the next decade, making it the fastest-growing segment of financial services in China — and the world. Though these growth projections may be dampened by the financial crisis in the short term, observers point to several key drivers of asset management growth over the long term:

- Chinese savings rates as a portion of GDP remain very high, with estimates at 50 percent or higher, and roughly 75 percent of this savings is held in low-yielding bank accounts. As China's population ages, the investment, retirement and insurance needs of its increasingly affluent consumers will drive the retail market. Investors will demand broader portfolio diversification in terms of product and geography.

- China's economic growth story continues to impress. Despite a global financial tsunami, China will likely meet its 2009 GDP goal of 8 percent growth. As of March 2009, the Chinese equities market was already well along in its recovery, and retail investors were beginning to diversify their holdings into other investment products. Throughout the period, the asset management market has continued to grow even in the face of massive losses; despite a loss in total net asset value of 41.5 percent in 2008, Chinese mutual funds still gained inflows, albeit toward the latter part of the year primarily in bonds and money market products.
- The Chinese government readily recognizes a need to boost return in the form of encouragement of more active investment management among both individuals and institutions, and government support of GDP and external investment activity remains solid, although not always politically popular.
- Growth in the institutional investment community is moving beyond the sovereign wealth funds and the banks, and will increasingly include insurance companies, additional pensions and large corporations. In alignment with this growth and the commensurate development of a more sophisticated client base, room now exists beyond the domestic and/or JV mutual fund business model to include product specialists, alternatives and niche managers.

To achieve this dramatic growth, China's asset management industry must overcome a variety of challenges related to distribution, the regulatory framework and investor education.

The vast majority of retail distribution channels in China remain tied to the largest state-owned banks. As the market grows, asset managers will need to focus their efforts on insurance companies, non-SOE banking institutions, the newly licensed wealth managers and their own "bricks" as well as "clicks" efforts to boost their distribution capabilities in China. Meanwhile, the institutional marketplace in China is rapidly evolving, and the capacity for direct mandates from the likes of SAFE and others means that foreign financial services organizations interested in attracting these assets will be better served by having a physical presence in China, though not necessarily a joint venture presence. This is evident in a number of top institutional asset managers creating a separate China strategy that includes relationship managers in Beijing and/or Shanghai as well as Hong Kong and/or Singapore.

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Also important to future growth in China will be the loosening of restrictions related to new product approvals and the ability of investors and institutions to allocate capital outside of China. In addition, the restriction on foreign majority ownership remains a sore point for some non-Chinese financial services institutions. The market may miss out on the opportunity to attract some of the world's best investment management firms to China unless compromises can be reached.

Finally, asset management firms in China will have to continue to invest in investor education. Chinese retail investors are notoriously fickle, creating a high degree of volatility that can quickly erase record fees/profits within an asset management business over the course of a year. Institutional investors are also in need of additional advice, and in light of the general lack of an investment consulting capability in China, asset managers are often in the position to provide significant guidance and education. The market as a whole will need to address these issues to fully capitalize on both retail and institutional business opportunities.

India

In spite of some exits and the current challenging environment, global players still find India an attractive market, and this bodes well for the industry because of its size and potential for growth. According to research by McKinsey, the asset management business has grown 47 percent annually since 2003, taking the total AUM in India in 2008 to US$92 billion. However, there are only about 35 fund "families" in India, as compared to the global numbers like 700-odd fund families in the U.S., 60 fund families in China and around 70 in Japan.

The Indian landscape is highly dynamic and is set to remain so in the near future. While volumes have contracted in the short term, the long-term growth story is intact. While most firms are focused on managing through the current slowdown, plans for the future will have to anticipate a more competitive field. As more companies enter the industry, there is an opportunity to expand the pie, but this expansion will take time and will require the industry and regulators to tackle key issues, such as awareness, education, distribution and product positioning. Furthermore, barriers to entry have increased; Boston Consulting Group estimates that a firm would need at least US$2.5 billion under management to break even now, twice as much as was needed two or three years ago.

Being competitive in India traditionally has been characterized as "being everywhere, doing everything." Although

	China	India
Market Background	Rapidly growing retail mutual funds market; institutional investment market in infancy Asset managers established by domestic players. Joint ventures permitted since 2002	Deregulation and free competition set stage for industry growth; international firms gained access early Institutional business drove growth in 1990s
Opportunity for Growth	Projected annual growth in AUM of 24 percent Savings rates are high Aging population likely to look for new investments, insurance and retirement options	Before current slowdown, asset management industry growth averaged 47 percent annually since 2003 Strong long-term story
Challenges to Address	Need to expand retail distribution channels Restrictions related to new product approvals, foreign majority ownership Investor education	Need for advances in retail distribution and product innovation Investor education
Talent Needs	Scarcity of experienced top management Strong demand for investment, research and sales and marketing executives Few senior fund managers and institutional sales executives	Scarcity of experienced and tested senior leaders Need to globalize the business

no player can afford to neglect any aspect of the business in the current environment, true competitive advantage will be possible only through excellence in three main areas — execution of strategy, distribution and investment performance — and this is where companies will need to focus their efforts.

India's unique demographic and geographic characteristics make distribution a key issue for asset management companies. The industry's expansion commenced only in the last few years and has been driven by advances in distribution. With the enormous potential of the market and the continued entry of new players, one can expect significant change in the way investors are provided for.

At the same time, the fact remains that the Indian asset management industry has grown tremendously over the past few years in spite of not having much constructive regulation on the distribution side. In recent years, one of the most debated issues has been the "tied agency" concept. In many parts of the world where there has been insurance reform — Europe or parts of Asia, for example — there has been a move away from the tied agency channel. For growth to be taken to the next level, such gaps in distribution will need to be addressed.

Challenging market conditions have also brought into focus the need for a long-term growth strategy, especially for new entrants. Given the new valuation expectation, equity buybacks could outstrip the initial commitment made for a venture, especially since a company might need eight to 10 years before it becomes an entity that drives growth in the market. Add in the effects of changes in revenue structure (margins have reduced considerably over the last few years), account inflation and capital expenditure and an effective strategy for the next 10 years becomes imperative.

Another critical component of strategy will have to be product innovation, especially since the asset management industry is now competing with bank deposits, insurance plans and even postal savings for disposable incomes. Creating and marketing the right products for customers that are oriented towards long-term financial planning will be essential. Introducing more internationally oriented products could broaden revenue streams and positioning products effectively will be essential if competitive advantage is to be achieved.

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Finally, given the potential for growing the investor base, the need for investor education becomes critical, more so since a large part of the retail investor population in India still equates mutual funds with equities. Advisory services will need to address customer education in order to be of value. Companies will need to rise above selling their own products to sell asset management products, thus communicating to the investor the benefits of different product categories, whether for retirement, children, family and so on. There needs to be a conscious effort to avoid selling on the basis of day-to-day performance, shifting the focus instead to the long term, be it a three-year, six-year or 10-year horizon — just as the insurance industry is doing.

Financial advisory services also need to be marketed and communicated effectively to the retail investor. In real terms, India needs 1.5 million IFAs (independent financial advisers) who need to take on the mantle of creating awareness among retail investors of the benefits of asset management products. This will be the first step towards creating an industry that has the recognition of the regulators, policymakers and the government. The regulator can also play a role here by, for example, supporting initiatives that include financial services as part of school curriculums.

The industry's talent needs

China

It will come as no surprise that the rapid expansion of the asset management industry in China (notwithstanding the financial services industry as a whole) has resulted in severe talent shortages. In a PriceWaterhouseCoopers April 2009 survey of foreign fund management companies in China, the recruitment and training of personnel remained one of the top three pressing issues for companies surveyed, even though turnover slowed during 2008. Although the financial crisis may have made it easier to retain staff, recruitment remains challenging and, contrary to some other markets, compensation packages have not been reduced. Perhaps reflecting an overall immaturity of the talent market as a whole, base salaries remain the most important element in recruitment and retention of asset management talent in comparison to short-term bonus opportunities, a prestige brand and long-term bonus incentives.

Investment management, sales and marketing, and research executives are expected to continue to be in demand in 2009, as new entrants to the fund management space are created and current organizations expand their distribution strategies and product scope. In particular, experienced senior fund managers and institutional sales executives are precious few in number. The proliferation of new products, the increasing number of fund management companies, and demands by institutional clients for more sophisticated service and relationship management will ensure that these shortages continue.

Exacerbating the problem are regulatory changes, notably new China Securities Regulatory Commission restrictions which prevent portfolio managers who have changed jobs more than twice in the last two years from registering with the Securities Association of China, a registration that is now mandatory.

Perhaps nowhere else is the need for talent within China's asset management industry as evident as among the ranks of top management. Foreign joint venture partnerships continue to wrestle uncomfortably with issues around control, how to pursue the right business model and allocate top talent to the right roles with the right levels of seniority. For their part, domestic houses have yet to demonstrate their ability to successfully internationalize their teams, often buying offshore talent at a high price and ultimately for a temporary fix rather than fully integrating such individuals into their long-term succession plans. The industry's meager history of little more than a decade combined with an incredibly steep growth curve has meant that for many fund houses, 2008 was the first financial crisis they had ever experienced. For boards of directors, CEOs and their direct reports, this opportunity for introspection hopefully means taking a hard look at what has been until now a disturbing trend of over-promotion and under-resourcing of current teams, and a realization that some are unprepared to demonstrate leadership under the duress of volatile markets. In an era of significant enterprise risk, corporate governance and its corollary, succession planning, have also begun to receive much-needed attention.

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India

Critical to success for asset management players in India will be their ability to attract, retain, nurture and employ high-quality talent in a market that is both in transition and has a relatively short supply of experienced senior leaders. Investing in globalizing the business will also be important for both Indian and international players.

Turbulent environments are perfect testing grounds for leadership. Successful leaders harvest the benefits of the "highs" but always plan for the "lows." For the asset management industry in India, the biggest challenge continues to be finding mature CEOs. While there are many excellent people operating on the ground, those with the ability to take on leadership roles are few and far between.

Nevertheless, a good management cadre is being created; many universities now offer specific financial planning and wealth management courses and there are some high-quality training programs within organizations. As a result, better talent is coming into the industry and new leaders will emerge from that group. At the present moment, though, broader leadership talent is scarce in India.

This has also had implications for the leadership of these companies, as they strive to maintain bottom lines in times of decreasing revenues and increasing redemptions. An added challenge will be to keep teams and employees motivated, as customer numbers drop. Leaders will also need to focus on identifying new avenues for growth in business, through innovative distribution and product strategies, balancing them with a tighter cost structure.

Addressing talent shortages

While their histories and many of their challenges are different, the asset management industries in China and India face talent shortages. There are no quick fixes to the problem, but a multi-pronged approach that addresses short-term leadership needs while building a strong foundation for the future will be the most effective solution for asset management players in both countries. These include:

In the short term, import key top talent to fill critical gaps from outside the industry and region. Asset management companies in China and India should be open to looking to other geographic markets and outside the asset management industry when recruiting key talent. Senior leadership from more mature investment management markets, whether from elsewhere in Asia or from markets farther afield such as New York or London, are more available in the current environment and can bring valuable expertise. In particular, the financial crisis has encouraged some Chinese nationals to return from Wall Street, but Mandarin-speaking executives from Hong Kong, Singapore and Taiwan will also continue to find opportunities in the industry.

Cultural and sociopolitical dynamics will continue to have an impact on these individuals' ability to be successful, but the past 10 years has demonstrated that with enough support, flexibility and a bit of luck, organizations can achieve significant success with a multinational team in place.

Another way companies can develop their leadership talent pool is by looking outside the asset management industry. And, in fact, other industries that have experienced exponential growth in short periods of time, such as telecommunications and insurance, have successfully recruited people with the right leadership capability and experience from other sectors. The rapid growth of the asset management industry, coupled with the scarcity of talent, suggests that asset management firms could benefit from this strategy as well. For example, in India, banking and other financial services as well as scaled up consumer businesses are being seen as the best "outside" source of talent in present times.

In particular, the financial crisis has afforded the investment management industry a rare opportunity to attract talent from the corporate and investment banking and capital markets communities. For example, where it is becoming increasingly important to have senior institutional sales, marketing and general management executives on the ground in China, this opportunity should not be overlooked. This demand may be met in part by a relatively more seasoned population of bankers and relationship managers already in China and willing to consider other options, although as the market recovers, the window of opportunity to make these hires may already be closing.

Nurture the next generation of leadership. While external recruitment will be an important source of key talent in the short term, companies must maintain their commitment to nurturing talent in-house and establishing retention mechanisms that motivate talented people to stay and provide a path for upward progression.

Given the high levels of turnover within the fund management industry in China and India prior to 2008, firms have been tempted to hire for the short term without regard for career development or retention strategies. However, organizations that choose to invest in their next generation of leadership by offering more than just a higher salary and a more inflated title will ultimately win the day. Multinationals in the region or foreign joint ventures would be well-advised to offer secondment opportunities for key staff to the Asia Pacific hub or, better yet, corporate headquarters to deepen their international expertise.

Providing opportunities in the way of continuing education (CFA certification for example) and broader industry involvement (sponsorship for conferences, symposia and the like) can also demonstrate commitment to high-potential talent while increasing their overall value to the enterprise. For their part, domestic Chinese or Indian fund houses that are setting up subsidiaries outside their home base can acquire overseas perspectives while affording their onshore staff an opportunity for offshore rotations.

While there is no magic formula for developing the right talent in an organization, it takes a combination of empowerment, compensation, excitement about growth, an opportunity for people to widen their horizons, gain overseas exposure and a dynamic working environment.

Conclusion

The leadership challenge in the Chinese and Indian asset management markets will persist for the foreseeable future. However, the ability to innovate profitably and focus on building strong teams and a dynamic culture will be the factors that provide companies with the much needed competitive advantage. Without a doubt, the opportunity is huge. The key to success will be finding the best people and developing high-quality leaders who have the vision to take the industry to new heights.

Footnotes

1. Investment Company Institute. April 2009.
2. McKinsey & Company. "The Asset Management Industry in 2010."

About the authors

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