

EVOLUTION IN ASSET MANAGEMENT:

The wealth management industry is changing at an exponential rate. Successful adaptation hinges on understanding the underlying trends and putting a robust and flexible operating system in place.

Propelled forward by the rapid pace of innovation, the business of managing wealth is being reshaped before our eyes.

Five interwoven factors are driving the change; we'll briefly address each over the coming months:

You are here



Fierce competition

Competing effectively may be more complicated than it once was, but the barriers to entry are still relatively low.



Vulnerable economics

Growing competition means benchmarks for excellence are moving targets, and firms are spending more, persistently pushing up costs and pressuring margins.



Emboldened investors

Investors have been conditioned by their experiences outside the industry to expect a more integrated solution that seamlessly caters to their needs.



Complex regulation

The proliferation of regulatory bodies worldwide means firms must contend with an increasingly complex set of rules and rule makers.



Transformational technology

Unstructured and previously inaccessible data sets are now full of promise, and there is little doubt the flood of usable data will continue to grow, sometimes in unpredictable ways.

Introduction

We systematically assessed the state of the asset management industry in our 2014 paper, *Evolving in the New Operational Frontier*. Revisiting the trends and challenges confronting managers, we found the macro themes have been relatively persistent. We noted the rapid pace of change then, but it is nevertheless surprising to observe today that it appears to be accelerating, with the industry now changing at an exponential rate.

Technologies developed in one industry to solve one problem are now being used globally to solve problems people didn't even know existed or at least were considered unsolvable. Convergence is occurring throughout every industry and in different corners of the world. In the investments arena, asset classes are blurring, alternative and traditional product offerings are competing, differentiation between the front-, middle-, and back-office are indistinct, and demand for the same talent from within and external to the industry is increasingly competitive. The result? Clear delineations are tougher to determine, and we are more frequently competing against each other in unexpected ways.

The skill sets needed to perform newly created jobs, let alone drive the business forward in an uncertain future, differ vastly from even a decade ago. Competition for this talent remains robust, not just between asset managers and others in the wealth management ecosystem, but more broadly among fintechs, Silicon Valley technology firms and a variety of startups in other industries.

Adapting to a quickly changing environment is easier said than done in an industry that has often rewarded the methodical and meticulous. At the risk of seeming alarmist, the current pace of change threatens to leave behind any company that is not willing to at least adjust their approach. The implications are many, with every aspect of the organization affected. **Investment processes, sales strategies and talent management alike are ripe for reinvention.** Supporting and enabling every aspect of the business, effective operations will be more critical than ever before.

The most proactive firms are choosing to treat their operational capability as a catalyst for growth rather than a hindrance, leveraging their operational infrastructure for efficiency, flexibility, scalability and insight. Given what we're seeing today—exponential shifts in technology capabilities, the power of data analytics and predictive properties, consumers' desire for customization at the press of a button, and the evolving talent profile—firms that don't address today's reality will soon find that they are playing catch-up, possibly never to recover.



Fierce competition

Trends

The buy-side business has always had a reputation for being more collegial than the more cut-throat sell side.

That may still hold true for cultures within firms, but fierce competition between firms has otherwise rendered this a moot point. Four developments mean that heightened competition is likely to remain a feature of the industry for the foreseeable future: consolidation, new entrants, convergence and globalization.

It is the nature of the business that size begets size. Even without the effect of mergers and acquisitions, market appreciation and compounding mean that firms with the longest track records are often some of the biggest. Surviving over time and being in business longer generally means superior performance, more investors, more infrastructure and institutional characteristics that support additional growth. Size also enables investments in technology and marketing on a scale that is unthinkable for smaller firms, creating a positive feedback loop.

Size is not always a positive attribute, however, as it can lead to diminished nimbleness and saturation of investment opportunities. But its advantages are such that many firms relentlessly pursue growth, in many cases launching new strategies, entering new markets, adding distribution channels, acquiring competitors or lifting out teams. The net result has been a steady consolidation of assets among the largest firms.

It's important to note that industry consolidation has not kept new firms from emerging. A comparable trend unfolded in the banking industry, when M&A and consolidation in the wake of deregulation resulted in a handful of national and super-regional banks. In spite of, or perhaps because of, these megamergers, numerous new local banks sprung up to fill certain niches or meet specific needs. Similarly, despite periodic bouts of retrenching and restructuring, the number of funds continues to rise: regulated investment vehicles worldwide grew 42% over the past decade, resulting in an astonishing 119,000 open-end funds by the end of 2018 (Figure 1). Even hedge funds continue to proliferate despite facing particularly strong headwinds, and investors can now choose from approximately 8,300 different offerings. Other types of alternative investments are heating up too, as institutional investors pour even more capital into private equity and private debt funds.¹

Competing effectively may be more complicated than it once was, but the barriers to entry are still relatively low. Economies of scale may be important, but not any more than a sound strategy. Massive scale is not critical, but critical mass is. This threshold, of course, differs considerably according to asset class and/or strategy.

We observed many years ago that barriers between different types of investments were starting to crumble. The trend is widely acknowledged today. Firm identities often used to be tightly integrated with certain types of investment vehicles, but this is increasingly rare. More firms are diversified, and product silos at many of these firms have been relegated to the past. Labels can be deceiving. Certain organizations are still known as private equity firms or hedge funds, for example, despite increasingly managing various investment strategies and structures across multiple asset classes. Even a firm like Vanguard, historically viewed as a leading passive fund provider, now earns a substantial amount from actively managed investments. Some firms are well known as both passive and active managers, offering traditional and alternative investment vehicles for retail and institutional investors, and providing technology infrastructure to boot. Not all things to all people, but specialists in each of the channels in which they operate.

Meanwhile, cross-border operations have become much more common as firms venture abroad in search of opportunities. North American firms have been particularly active, extending their reach not only into the developed markets of Europe and Asia, but also developing economies showing the promise of scale and growth amid demographic changes. Regional expansion by local firms within European and Asian markets is also accelerating. **All of this means that competition is no longer a localized phenomenon, but a global one.** None of these trends exists in a vacuum, and their ultimate effect is likely to extend far beyond their immediate impact. They also interact with one another, sometimes paradoxically. Globalization, for example, amplifies industry consolidation, but it also creates and expands opportunities for emerging managers.

Implications

Hitting the pause button and standing still can be a wise strategy in some fast-moving environments. This is not one of them.

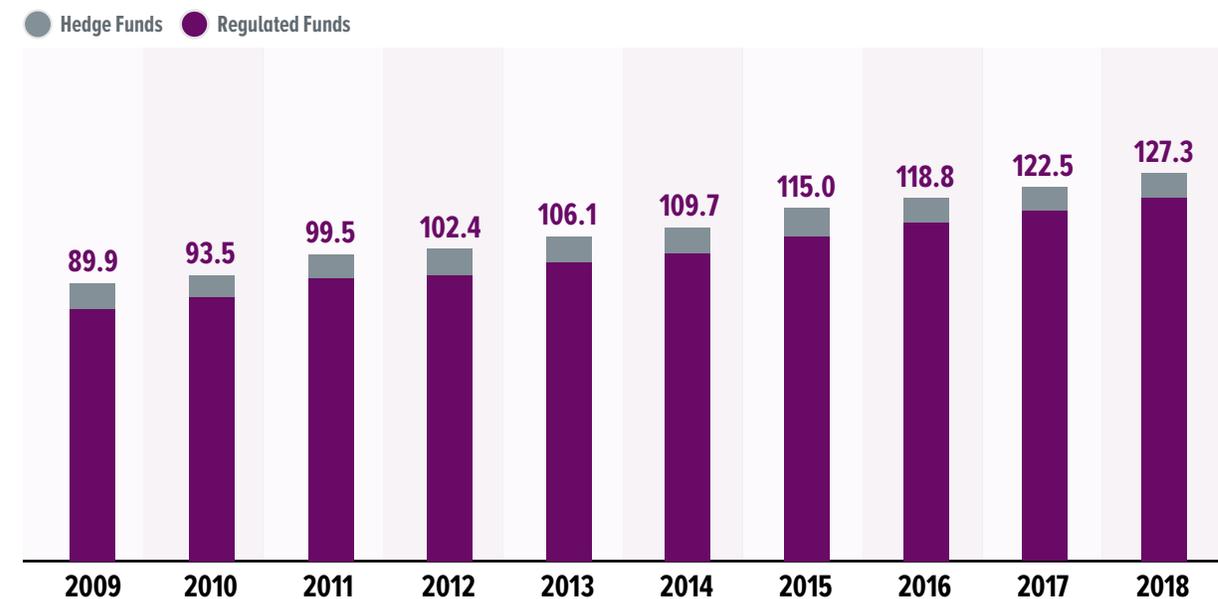
Most firms will need to consider any and all avenues toward growth, whether organically or through strategic partnerships. Assume that no niche is safe.

There is also growing pressure to articulate and deliver concrete value. A poor client experience will no longer be tolerated; to be truly successful in a sea of indistinguishable products, the experience must be distinctive. Superior investment performance is only the price of admission. Attracting new clients and even retaining existing ones will increasingly hinge on additional points of differentiation. The investment strategy might be unique. The quality of service could be extraordinary. Fees will almost certainly need to be competitive. All three would be ideal.

Delivering a distinctive experience will be virtually impossible to accomplish solo. Most firms already work with a variety of service providers, but a more holistic view of a firm's infrastructure focused on quality and differentiation will mean carefully integrating a network of specialists to maximize the value of time, expertise and data.

At a minimum, systems will need to be product-agnostic, support customization and enable improved reporting. Truly forward-thinking firms will abandon legacy systems and processes altogether in favor of a reinvention that leverages technology far more effectively. Operations, systems infrastructure and technology tools can no longer be viewed only as "engine rooms." Rather, they need to be recognized as potent differentiators and catalysts for growth. Indeed, cross-platform collaboration enables both firm-wide transformation and a broader range of customized solutions to be offered to an increasingly demanding customer base.

FIGURE 1 | Number of Funds (thousands)



Note: Excludes funds of funds

Source: HFR, International Investment Funds Association

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¹2018 Global Private Equity & Private Debt Reports, Preqin, 2018.

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