

Innovations, Disruptions & Asset Management: Challenges & Opportunities

The asset management industry has to face three different types of challenges.

The first challenge comes from the new environment which prevails, with the rather new fierce competition between bigger and bigger players, the emergence of new players Sovereign Wealth Funds (SWF), pension funds...), the low rate environment, the changes in regulatory constraints.

The second challenge is in line with the emergence / confirmation of megatrends: how to play (and add returns) demographic challenges, climate change, technological revolution, innovations, how to play social, ethical, and behavioural values...

These two challenges play undoubtedly for a consolidation of the industry, and for new investment processes.

The third challenge is probably more severe: the asset management industry has to cope with a real technological disruption: how will what we can call Watsonisation (the development of cognitive computing), Googlisation (the availability of a greater volume of data), Amazonisation (the power of platforms), Uberisation (hatching new business models) and Twitterisation (doing business in an increasingly connected and collaborative world) ... reshape – or not – the asset management industry? ***How to adapt business models, survive, be efficient and profitable in such a changing environment?***

1. The asset management is in the business of disruption

Tech remains one of the largest sectors in the world economy, but in today's new economy, practically all corporations – small and large – are in technology, directly or indirectly. This challenge can be addressed to any company, of which companies that manages assets and risks: insurance company, pension funds, central bank, endowment, mutual funds, SWF... This situation explains why 73% of American CEOs and 61% of CEOs worldwide think that new competition is going to disrupt their industries in the next five years; according to those surveyed, newcomers (Fintechs for example) will disrupt their activities or preserve their business models but apply new technology to them. Portfolio management will be extensively redefined as cognitive computing and the resulting analyses more extensively use the resulting data and methods.

Artificial intelligence, big data and platforms will impact the business models. The product distribution process will also be significantly impacted by strategies focused on data and online platforms. Big data give asset management companies new opportunities to improve investors' knowledge (risk culture, shared knowledge, better understanding of the business lines), engage more deeply with investors, and understand their ever-evolving preferences. Companies having the capacity to develop infrastructures and invest in innovation will also have competitive advantages that will be hard to counter. As investment activity becomes

more data-driven, because of regulatory and investor requirements, the quality of transactions and trading platforms will also be an increasingly important competitive factor.

“This time is different”... can we find another phrase as overused in the portfolio management business? However, as the asset management world is growing fast, at the same time it is turning upside down with the structural changes that are going on. The demographic, technological, and environmental challenges are in the process of redrawing the financial landscape and redefining business models. Without any doubt, the digital adaptation should reshape the asset management industry, and Fintechs represent only a part of the challenges.

2. Disruption in asset management: the second wave is at play

As many observers, Moody's (2017) considers digital disruption as a major change for the AM industry: *“The **first wave of disruption** in asset management was the adoption of low-cost index funds, which have reduced active asset managers' fees and pressured their business models”*. The two major innovations, the index fund in 1976 and the ETF in 1993, have been hugely transformational. Moody's notes that *“the lack of a good response to this threat (i.e. impact on fees and business models) has weakened the industry and leaves it open to a **second wave of disruption** from new entrants – technology firms”*. (...). *“Barriers to entry are also lower in asset management than in other areas of finance”*. In fact, asset management is globally a low-capital and high margin business, with supposedly low levels of innovation and investment underperformance. All these factors make asset management a target for new entrants (mainly technology-enabled companies), with the continuation of the shift from active to passive products (as long as the perception that asset managers do not add value continues). In such a context, there is a good chance for the rapid growth in **alternative indexing** (i.e. strategic beta strategies) to continue (+25% per year in the past years), should investors and regulators continue to prefer low-cost and rule-driven strategies. In the same way, one can expect **robo-advisors** to increase rapidly in the coming years, representing therefore an additional threat to traditional wealth managers, driving flows away from active strategies to passive ones. According to Deloitte, there should be 7 trillion US dollars in AUM by robo-advisors in 2025 (around \$20 billion in AUM at present). Two types of customers should drive this massive development:

- *Millennials* (persons who were born between 1980 and 2000), who represent one of the main customer base for robo-advisors: they have grown up in the digital age, and are used to going online for any kind of activity;
- The *mass affluent* (investors with \$100,000 to \$1 million in assets), who represent the second main customer base (and target) for robo-advisors.

The structure of the employment market is also expected to change drastically. Manyika and alii (McKinsey (2017)) estimate that in the United States, 5% of jobs are fully automatable while 60% of all occupations have at least 30% of technically automatable activities. All countries are concerned, but to varying degrees. Automation will therefore change many professions - partially automating them, for example - rather than replacing them. In asset management, 40 to 50% of jobs would be totally or partially (at least 30%) automated.

3. Big data and asset management: why is it so important?

As part of the reshaping of asset managers, one should mention the increasing use of **big data**. **Three major aspects to be pointed out:**

- *To improve portfolio returns.* The better the data, the better the analysis, and better the investment processes...
- *To improve knowledge of markets, products, customers' desires, and future trends.* As noted earlier, as many other industries already do, asset managers have started building specific tools to collect and analyse large amounts of mostly unstructured data. These machine-learning approaches allow "instantaneous" analysis of thousands of pages of analyst reports in order to detect relevant and tradable information (see B. Betts and alii (2015)). It allows a better knowledge of clients' requests and employees... employees feedbacks represent an important information on future performance of firms and are essential.
- *To improve product sales:* a better knowledge means additional sales, and sales at lower costs. Instead of monitoring monthly surveys, big data give the possibility to look at real time data, effective data, and very large set of data... As Moody's (2017) mentions, analyzing big data "*will help to better target sales to these distribution channels, enabling to increase sales and to make each sale more profitable*".

All in all, technology's repercussions on asset management activities are very significant and omnipresent:

- **Portfolio management could be extensively redefined** as cognitive computing and the resulting analyses more extensively use the resulting data and methods. Artificial intelligence, big data and platforms will impact the business models.
- **The product distribution process will also be extensively impacted** by strategies focused on data and online platforms.
- **Asset management companies have new opportunities to improve investors' knowledge** (risk culture, shared knowledge, better understanding of the business lines), engage more deeply with investors, and understand their ever-evolving preferences.
- **Companies having the capacity to develop such infrastructures and invest in innovation will undoubtedly have competitive advantages** that will be hard to counter.
- As investment activity becomes more data-driven, because of regulatory and investor requirements, **the quality of transactions and trading platforms** will be an increasingly important competitive factor.
- **Blockchain** in particular will make it possible to automatically enter any online trade and provide full transparency on all transactions: The Economist calls it "*a machine for creating trust, ... a shared, trusted, public ledger that everyone can inspect, but which no single user controls*"). By eliminating intermediaries and providing a reliable, transparent tool, blockchain (PwC 2016) can cut costs (fewer error reconciliations, greater simplicity), accelerate settlement (quicker validation),

increase solidity (little risk of failure or error), and increase transparency (with rapid, simple, efficient, low-cost oversight).

- **The asset management companies will need people who have the right skills** for this new business environment.
- **They also need top-flight data specialists and developers of algorithms** adapted to trends in the business lines.
- **Every asset management company should do an audit on the impact of this new environment**, its capacity to integrate into this environment, and its internal capacity to make the necessary changes to adapt.

In sum, asset managers who adopt and implement big data and predictive analytic tools into their distribution process may have a definitive competitive advantage.... However, gathering large sets of mostly unstructured data, building the analytic tools and revisiting investment processes require large investments (recruitment of data scientists, tools, data...). Asset and risk management is in the business of disruption. But as of now, there is no asset management company (nor any bank for that matter) anywhere in Forbes' annual ranking of the world's 100 most innovative companies.

4. What should asset managers do to be / stay successful?

In such a context, the pursuit of industry consolidation seems inevitable, and all entities should take actions in several areas:

- **Develop strongly customer-centred business models** (diversity, aspirations, flexibility, transparency, platforms, etc.);
- **Be both global and local** (knowledge of the global markets, proximity to local customers);
- **Attain critical size** in order to maintain independence and resiliency;
- **Attain critical size in order to be able to adapt and enter markets quickly and effectively** (entry costs are often very high);
- **Develop partnerships with key clients.** Amundi does this with sovereign funds and other large institutional investors on particular themes like SMART Beta, strategic asset allocation, and risk management.
- **Optimise distribution networks;** forging partnerships with local entities becomes indispensable to really penetrate the local markets: faster saturation of the culture, activation of long-standing networking, an immense reduction in the entry ticket, an immediate strike force that's stronger than the competition who do not have this type of network. Amundi has some twenty partners in different countries, like Korea (NH), China (ABC), Japan (Resona), Germany, the Netherlands, Belgium, Italy, the Czech Republic... solid local partners with, quite often, capitalistic ties, sometimes crossed.
- **Seek out distribution agreements with banking networks.** For example, with every acquisition of an asset management company that is a bank subsidiary, Amundi has negotiated distribution agreements for products and funds (generally for a 10-year

term) with the banks that made the sale: this is the case with Société Générale in France, with Bawag in Austria, more recently with UniCredit in Italy ...

- **Have the capability to sell services** that go beyond savings and cash flow management, such as regulatory reporting, risk management, etc.
- **Develop advisory activities covering any and all areas of potential relevance to the asset management business.** These services are also chargeable.
- **Have the capability to develop simplified operating methods:** enabling lower costs, greater agility and flexibility, etc.
- **Be capable of evaluating the impact of changes in the economic environment at all times.** Today's battle is less about the big and powerful against the small and weak and more about competition between those that are agile and those that aren't. The world is moving very fast, and we must move with it (ahead of it?), and have mastery over its structures and its business model.
- **Be capable of using available data advantageously:** networking, big data, "robo-advisors", etc. for example. Robo-advisors are developed rapidly, including on active management, SMART betas, fund selection.
- **Be quick and innovative, and thus capable of investing;** the network of start-ups (including a number of Fin-techs, Reg-techs and other Insur-techs) that make up, for example, the "Crédit Agricole villages" (in different cities in France and with strong partnership in many countries) is making it possible, in partnership with industrial groups, to select projects, support them, grow them, monitor the existing major trends, detect/participate in innovations... and potentially invest in innovative companies in disruptive themes.
- **Effectively manage risks, regulatory constraints** (which are increasingly numerous, complex and difficult to satisfy without critical size) **and capital.**
- **Becoming an expert in data management is becoming more and more essential. In 2016, SEI experts were reiterating the prerequisites for success:**

— *Ensure better - and different - decision-making.* Adopt an approach based on listening to the experts on data (frequently young persons) rather than following the traditional hierarchical or financial model (the opinion of the highest paid person).

— *Promote Portfolio Management.* Equip portfolio management teams with tools they can use to analyse the data better and seize on trends and relationships between asset classes and assets.

— *Develop smarter distribution networks.* Use CRM system type tools to track and better understand distributors and advisors.

— *Effect targeted sales and marketing.* Develop initiatives and messages based on the record of trades and interactions; use analysis to generate digital campaigns and prioritise prospects.

- **Becoming an expert on Robotic Process Automation (RPA).** Lots of companies recruit actively RPA experts, considering RPA as "an unmissable opportunity to improve back office processes, retrench work previously outsourced, leverage data analytics, and eliminate mundane work" (Prudential Financial). Easy to implement,

with a rapid return on investment, favouring an increase in productivity, increasing the quality of the service to clients, improving the process control, facilitating the compliance monitoring, RPA is largely considered as a cost-cutter and a quality accelerator.

- **Document the product's design better.** Analyse mutual funds and institutional mandates to identify key characteristics.
- **Analyse investors' needs and desires better.** Discover and spotlight hidden factors, which you'll be able to isolate using big data, and which affect behaviours (for example, the influence of others in an investor's social circle); understand the coming needs and preferences.
- **Figure out how to have happier and more productive employees.** Develop "personalised data analyses" that reveal motivation and performance factors. Manage the next generations better: they are more complex in some regards, with different motives and aspirations. It's long been shown that performance and motivation depend on happiness at work. Note that a mass transition to a new generation of asset managers will happen without disruption to the system. The asset manager is disproportionately - compared to other businesses - near retirement age.

Conclusion

All in all, to remain competitive and profit from new opportunities, management companies must think more about their business models and look beyond simple improvements. We are in the business of disruption. This requires new thinking, a conscious shift in mentality and effective leadership on the company and industry levels. These are undoubtedly the keys to future success.

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