# Disruptive Trends in the Investment Management Industry

## Abstract

The investment management industry is continuously evolving to adapt to changes in customer demographics, regulations across geographies, disruption from FinTech startups, social media driven analytics, and renewed customer focus on environmental, social, and governance factors. To retain and grow market share in this era of digital disruption, investment management firms are critically examining their technical and operational strategy. This paper explores how asset management firms are adapting to landscape changes to create exponential value for their business as well as customers.

## The Changing Investment Management Landscape

The investment management industry is going through a challenging period on many fronts. With millennials starting to control more wealth, a shift in the investment approach is clearly visible. Investors, who had moved away from high-cost active investments to cheaper, passive investments after the spate of financial crises in the last decade, are now turning to alternative investment options such as private equity, private debt, and real estate products that align with their environment, social, and governance (ESG) values.

New-age asset managers are embracing multi-asset investment models that allow greater agility in responding and adapting to investor needs. For a seamless transition to new business models, firms are leveraging disruptive technologies such as analytics, artificial intelligence (AI), and natural language processing (NLP). While these technologies are key to achieving personalization at scale, most banks and financial services firms are only beginning to tap into the potential that next-gen technologies offer.

## New Investment Strategies: Making the Right Choice

Given the volatility in financial markets worldwide, a prime concern for investors is to ensure their money stays safe, which is why they are focusing on adopting diversified portfolios with a balanced mix of assets. Funds with multi-asset instruments are being preferred over separate funds for bonds and equities as investors strive to achieve higher levels of income and growth for the same level of risk. Diversified portfolios with the right spread of alternative asset classes and fixed income assets are better equipped to weather sudden economic risks. To ensure balanced exposure and better yields, firms are opting for emerging market bonds from Asia, Latin America, Eastern Europe, and Africa. Fixed income asset classes that are subject to floating rates and offer a degree of diversification that cannot be achieved through the old-fashioned mix of bonds and equities are being preferred. Firms are crafting newer investment products with the right mix of assets such as smart beta exchange-traded funds (ETFs) that focus on reducing beta while driving alpha for risk averse investors.

## Alternative Investments are Breaking New Ground

While the decade old financial crisis triggered cautious and somewhat passive investing approaches, the focus on growth has always been there. To that effect, investors are now looking at alternative investments such as private equity and real estate. In the private equity space, limited partners are leveraging the ecosystem – they are collaborating with general partners and turning co-investors in order to reap more benefits and unlock exponential value. In real estate, the focus is shifting to direct investments that involve holding commercial or residential properties for the long term, along with conventional investments through real estate funds and real estate investment trusts (REITs).

While the need to include alternative investment products into investment funds is clear, firms are facing challenges in operationalizing this stream due to human-dependency and limited process automation. To address this, private equity firms must automate functions such as fundraising, deal screening, capital call management, portfolio management, portfolio valuation, performance monitoring, data analytics, limited partner web reporting, financials, bill processing, taxes, and so on. For example, robotic process automation (RPA) techniques along with AI and NLP capabilities can be leveraged to eliminate manual capture of information from financial statements to create valuation reports, which improves operational efficiency of manual business processes.

## Socially Responsible Investing is Gaining Prominence

A growing number of investors are proactively looking for opportunities to generate social and environmental impact through their investments. Few large firms are responding by including stocks of companies that prioritize transparency, have strong governance structures, and focus on positive societal outcomes in their investment funds. They have formed Responsible Investment (RI) committees to establish governance structures based on board-approved RI policies, which are then disseminated across the organization. The RI teams selectively conduct analytics for public equity portfolios and due diligence for private equity funds to determine compatibility with clients' ESG principles while ensuring that sustainability guidelines are followed for real estate and infrastructure investments.

FinTech startups too are designing products that align with investors' ESG principles. In addition, they are also working with industry frameworks such as Global Reporting Initiative (GRI) and Sustainability Accounting Standards Board (SASB) to establish industry-specific standards and metrics to facilitate sustainable investment decisions.

## The FinTech Wave

FinTech startups are reinventing the way people invest and manage their money by augmenting the services provided by mainstream investment management firms through value-adding niche solutions in several areas including investment strategies, distribution channels, investment portfolio management, and risk and compliance.

FinTech firms are also directly targeting end customers. For example, intelligent advisor platforms that initially augmented the advisor community are now growing to grab a significant market share as standalone wealth management solution providers. By leveraging AI platforms for social media sentiment analysis and insights, FinTechs are crafting niche investment products through instruments such as ETF or hedge funds. These firms, however, lack the scale and competencies of incumbent firms to raise the bar and grow.

Social media platforms have emerged as a rich source of data for sentiment analysis and scoring a specific stock, industry, sector, geography, ESG factor, and more, and FinTech firms have been quick to leverage this source. In response, incumbent firms too must adopt analytics solutions that leverage social data and even look at partnering with FinTech firms in this area. Data from multiple unstructured sources can be collated and AI technologies and ML algorithms can be used to create an insights dashboard. Such a dashboard must include sentiment scoring and an analysis of past events and impact on stock performance, which will help build predictive models to forecast future performance. Integrating event analyses with firms' structured data can provide decision insights to portfolio managers. Firms must also look at using social data analytics to identify and redress customer grievances and AI platforms for dynamic customer segmentation. In addition, conversational platforms such as Apple Siri, Amazon Alexa and Echo, Google Home, Microsoft Cortana, Viv and other messaging apps can be leveraged to respond to customer queries in real time.

## Partnering with RegTech to Manage Risk and Compliance

Global investment management firms are subject to a plethora of regulations centered on consumer protection such as MIFID II, UCITS V, GDPR, IORP II, DOL, and PEPP spanning multiple geographies. Mainstream investment firms are collaborating with RegTech firms and leveraging niche solutions for collating and reporting data in required formats to specific regulators.

Firms are also creating centralized transaction hubs powered by big data technologies to facilitate reporting to various stakeholders and leveraging advanced analytics to enable fraud detection and surveillance and identify patterns indicating non-compliance. The use of investment management ontology in data analytics solutions for risk modelling and what-if-analysis is also on the rise. Cloud based portfolio stress testing solutions and scenario analysis tools that focus on factors like market, size, volumes, and external factors are gaining traction in the risk management arena.

## Using Blockchain for Buy-side

Blockchain based solutions help streamline processes and remove reconciliation effort and enable revenue sharing arrangements while facilitating risk mitigation and cost reduction. Many firms have started testing blockchain based solutions in business functions such as fund valuation, transfer agency, private equity contracts and commitments management for a set of customers even as industry standards, tools and methodologies are evolving. There are multiple blockchain consortia or partnerships for specific industries. In the financial services industry, the Corda platform developed by the R3 consortium is widely acclaimed and accepted; other prominent platforms include Ethereum and Hydperledger.

## The Way Forward

Though digital disruption in the investment management sector has been relatively slow, it is now picking up speed, and incumbent firms can ignore it only at their own peril. Adapting business strategies in accordance with the rising disruptive trends will be crucial to capitalizing on emerging opportunities and remaining competitive in the current environment. The way forward lies in revamping the operating model by embracing disruptive digital technologies, expanding capabilities around the people-process-technology triad, and crafting customer-centric products that create exponential value and enhance customer experience.

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