Coalition Greenwich
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# The Evolving Asset Management Landscape: Only the Fittest Will Thrive

NORTHERN TRUST

**CONTENTS**




*Stephen Bruel is a Senior Analyst on the Market Structure & Technology team covering topics including ESG, derivatives and FX.*


**METHODOLOGY**

Between February and April 2023, Coalition Greenwich conducted interviews with 151 senior asset management professionals in North America, Europe and Asia-Pacific with assets under management ranging from $250 million to over $150 billion. Respondents included leaders from operations, trading, portfolio management, and other key lines of business. Questions focused on the challenges and opportunities within traditional, long-only asset management with an emphasis on how the design of an operating model can support strategic growth priorities. It identified the issues that have grabbed asset managers' attention, and areas that may not be getting the focus they deserve. This paper was created in partnership with Northern Trust.

**57%** of asset managers cite volatility as the top industry challenge, but **82%** say it has not impacted their growth plans

**Cost** of maintaining their current platform is the top factor leading asset managers to increase outsourcing

# Executive Summary

The investment management industry is managing through tumultuous times. The list of challenges is extensive, ranging from regulation to rapidly rising interest rates to market volatility. In addition, as the needs of end clients change, investment approaches change as well. These issues are all connected, so asset managers must respond across their enterprise—technology, product, sales, and operations will all need to evolve.

Against this backdrop, it is vital to understand how asset managers will adapt. The senior investment management professionals involved in this research have an appreciation of the depth of current and future challenges, yet many take the view that they will remain on their current path: looking to make improvements in areas such as technology and operations, but not implement larger scale redesigns.

While many asset managers expect to stay on their growth course, our research indicates that there is a gap between how firms ought to be preparing and the actual level of preparation. Significant changes are coming, and these changes should create a sense of urgency within the asset management community.

There are many ways to address change, and one avenue investment firms will benefit from is a further focus on their operating models—the people, processes and technologies that support the investment life cycle. There is a need to take a holistic view of how to be more efficient, and building that efficiency in a way that is sustainable through different market dynamics, geographies and asset classes. Outsourcing some or all processes can be an integral part of that strategy. More deeply integrating the front, middle and back office yields benefits and will support the business environment of tomorrow. The industry is anticipating growth, so there needs to be a significant focus on preparing for it, and the asset managers that are best prepared for the future stand a better chance to thrive in the new environment.

# Introduction

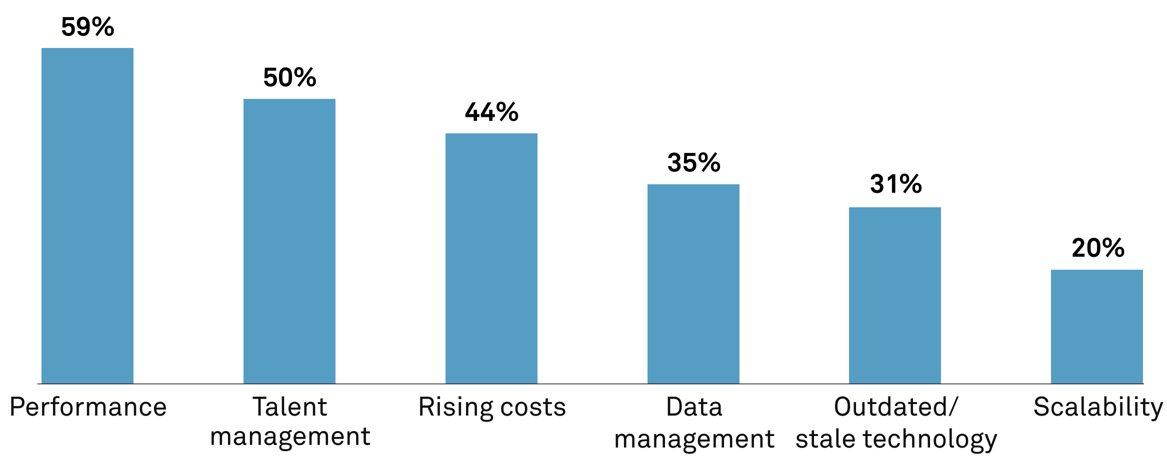
Asset management is a multi-asset class, global business characterized by constant change and evolving challenges. Traditional managers, especially active ones, are under pressure from passive investing, other long-only firms and substitute competitors such as private equity and hedge funds. This ought to provoke a sense of urgency as firms prepare to not only protect their existing franchise but develop and implement strategies that ensure growth.

Nothing reveals problems like a good, old fashioned market rout combined with geopolitical uncertainty. Extreme events tend to reveal shortcomings in processes and strategies, providing asset managers with a keen sense of what needs to be improved and what trends will drive decision-making and investment spend. Surviving recent market events is an accomplishment but not sufficient—how firms respond now will determine their success in the future.

# Looking Both Inward and Outward

Our interviews highlight the diverse set of internal challenges facing asset managers, all of which require immediate attention.

## Top Internal Challenges in Next Three Years




Note: Based on 147 respondents.
Source: Coalition Greenwich 2023 Asset Management Outsourcing Study

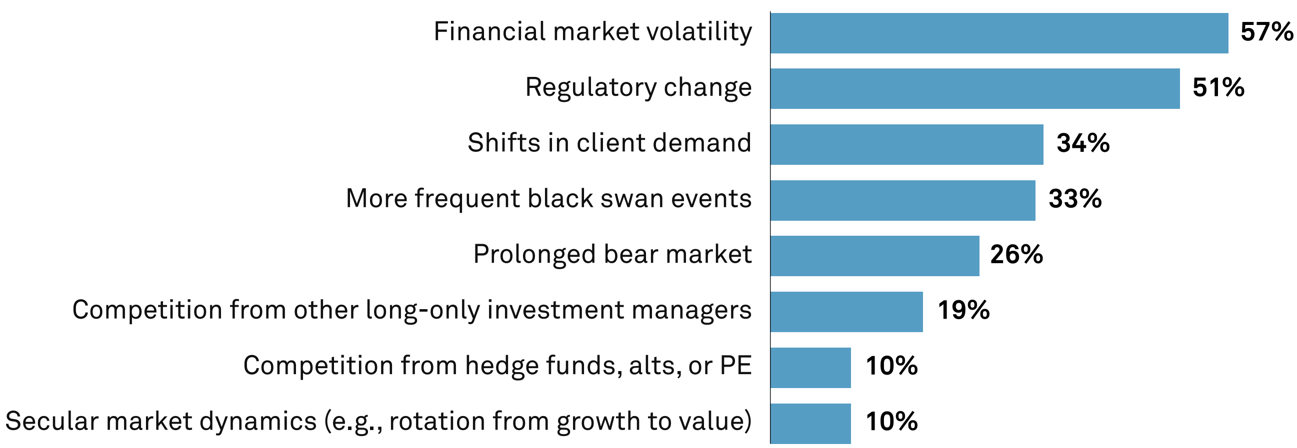
The most pressing concern is performance, which is not surprising given the recent volatility across many asset classes. How firms respond to the performance challenge will be vital for the ability to manage funds in the future. In response to this concern, our research indicates that managers appear ready to double down on existing strategies. Forty-seven percent state that to achieve alpha, they will implement a more disciplined investment process, and 41% will focus on high-conviction ideas. The last few years certainly had unusual events, but it is noteworthy that managers do not plan to make significant strategy changes to address performance concerns.

Beyond performance, the industry is concerned about talent and rising costs, which are less about the investment process itself and more about the environment in which managers operate.

- **Talent** – Talent management and retention is a concern across many industries. In investment management, this has led to employee-friendly policies, such as hybrid work, and some firms have gone so far as to relocate to more desirable locations. Talent is key to scaling to demand, but hiring and retaining is difficult.
- **Rising costs** – Inflation and rising interest rates have driven costs up, while investors demand ever lower fees. And as pressure on fees increases, managers must keep tight control of their own costs to remain competitive. Costs are more top of mind for managers under $10 billion, as the largest managers have a greater ability to scale.

Solving for internal challenges must be managed hand-in-hand with external challenges. Regulation is always a top-of-mind challenge given the constant flow of new rules, but recent market events have shifted the focus.

## Top Industry Challenges in Next Three Years




Note: Based on 148 respondents.
Source: Coalition Greenwich 2023 Asset Management Outsourcing Study

Fifty-seven percent of respondents stated that financial market volatility is the top challenge in the industry, with regulation noted as the second most impactful challenge. While extreme volatility will hopefully diminish, the reality is that regulation and shifting client demand (the third-most-mentioned challenge) will lead to more lasting structural changes that could affect the ability to grow assets, performance and client expectations.

Traditional active managers have not only had to respond to passive investing, but they also need to focus on other forms of competition, such as hedge funds and private equity strategies. Only 10% of respondents highlighted competition from these types of structures as a challenge. Alternative funds will compete fiercely for assets, and this competition could have a long-lasting effect on fundraising.

When combined with only 19% of respondents also acknowledging competition from other long-only managers, the relative lack of attention on competition could lead to some surprises down the road, as convincing asset owners to stay in long-only funds may become more difficult. Competition will continue to increase, and firms will need to differentiate their offerings from both traditional and non-traditional strategies.

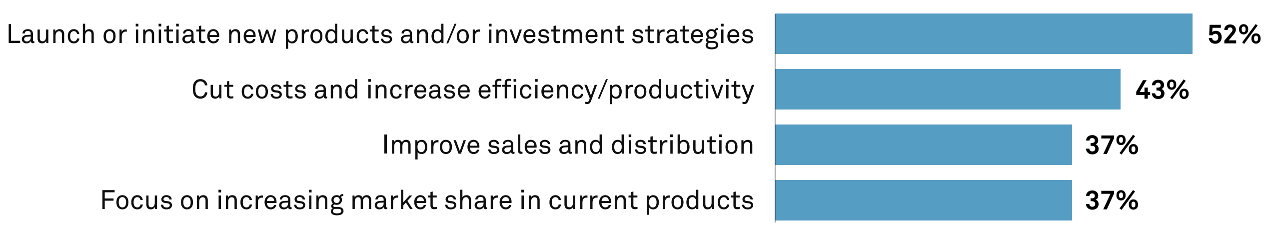
As such, the confidence asset managers have in their status quo may be misguided. The depth and breadth of structural shifts in the investment landscape that have been somewhat obscured by market chaos suggest the status quo won't work for much longer. Retooling or at least reexamining current operating models is increasingly key to keeping up with (and staying ahead of) peers.

# Priorities for 2023 and Beyond

Respondents were asked to identify how they would attempt to generate alpha in the current environment; 42% of asset managers stated that to do so, they will tactically optimize yield on invested cash. This will, of course, help in the short term. To take advantage of the shifting landscape, however, asset managers need to think longer term to develop and support broader strategic priorities to enhance performance and support growth in assets under management (AUM).

While the asset management community was frequently forced into firefighting mode over the last three years, a longer-term view must drive strategic planning. The industry continues to face fee pressure, and consolidation continues, while some investment strategies have become commoditized. Asset managers need to ensure they remain differentiated from the crowd and that their strategic plans respond to industry trends and not simply to the news of the day.

## Top Four Strategic Priorities in Next Three Years




Note: Based on 145 respondents.
Source: Coalition Greenwich 2023 Asset Management Outsourcing Study

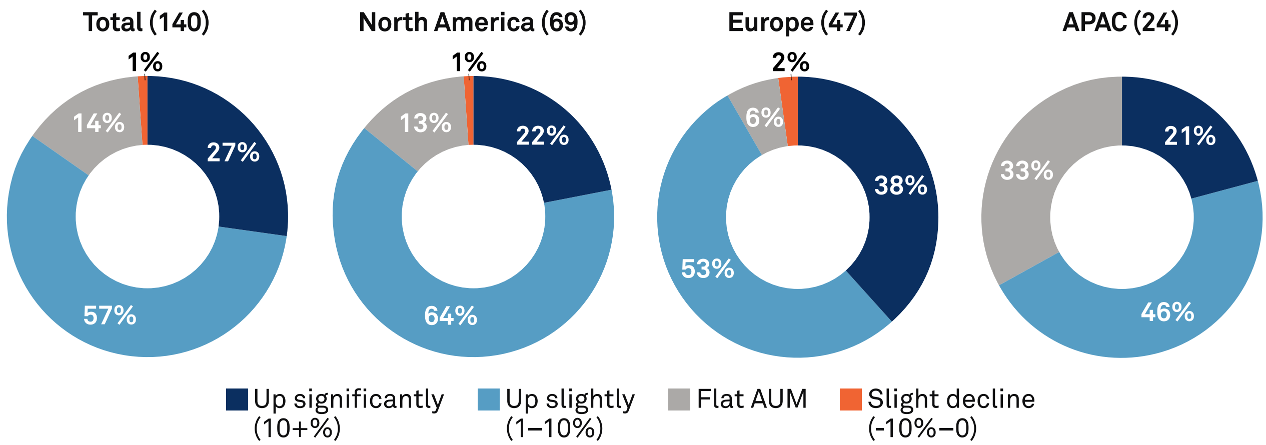
Three of the top four asset manager priorities are centered on growth, either through the launching of new products and investment strategies or battling for market share in existing strategies. Increasing AUM via improved sales, new products or growth in existing products will be managed alongside the other top strategic priority: cost-cutting. This prioritization mostly holds true across region and firm size; however, managers under $10 billion stated that they will focus more on cost-cutting than new products.

The volatility that has rattled markets and was cited as the top industry concern has not rattled the core strategic plans of asset managers—82% stated that the volatility experienced over the past 12–18 months has not led to a significant rethink of their growth plans. This paradox may indicate a blind spot in investment manager planning, and is a risk to their upbeat forecasts for AUM:

- 84% expect AUM to grow independent of changes in market valuation
- 27% anticipate AUM increasing more than 10% in the next 12–18 months
- Only 1% globally expect contraction in AUM

These are quite optimistic outlooks overall and, perhaps, are further indications that competition is underappreciated.

## Expectations of AUM Growth




Note: Numbers in parentheses represent number of respondents. May not total 100% due to rounding.
Source: Coalition Greenwich 2023 Asset Management Outsourcing Study

These rosy views somewhat hold across region, although asset managers in Asia are a bit more pessimistic as 33% believe that AUM will be flat, compared to 13% in the U.S. and 6% in Europe.

Achieving this growth will not be easy, and to try to do so, 50% of asset managers in Asia will focus on new products, whereas over a third of managers in both the U.S. and Europe will focus on expanded sales efforts in existing channels. Managers will invest in the sales organization, with 42% saying they expect to increase sales headcount.

Can these initiatives result in growth given the cost constraints the industry may implement? This multifaceted focus on growth and cost-cutting could initially create tension. After all, cutting costs precisely when a new platform is needed to handle the anticipated new assets, products and volumes is difficult. Depending on the type of growth, new processes and new technologies may be required. For example, to help diversify their product set, 46% of those that plan to launch new investment products to generate AUM growth plan to enter new asset classes; however, this could increase risk, complexity and costs.

One way for asset managers to manage this conundrum is to implement an operating model that spans pre-trade, trade and post-trade functions. To make such a model successful, managers must focus their internal energy on activities that add demonstrable value to either growth or performance, and to decide as an organization where work is commoditized and not additive to returns. The rest are processes that may be appropriate for outsourcing.

# Getting a Handle on Costs in the Investment Life Cycle

To make informed decisions, asset managers must first look inward to truly understand the current state. By reviewing and optimizing all processes throughout the investment life cycle, asset managers can help ensure every basis point is kept within the fund itself.

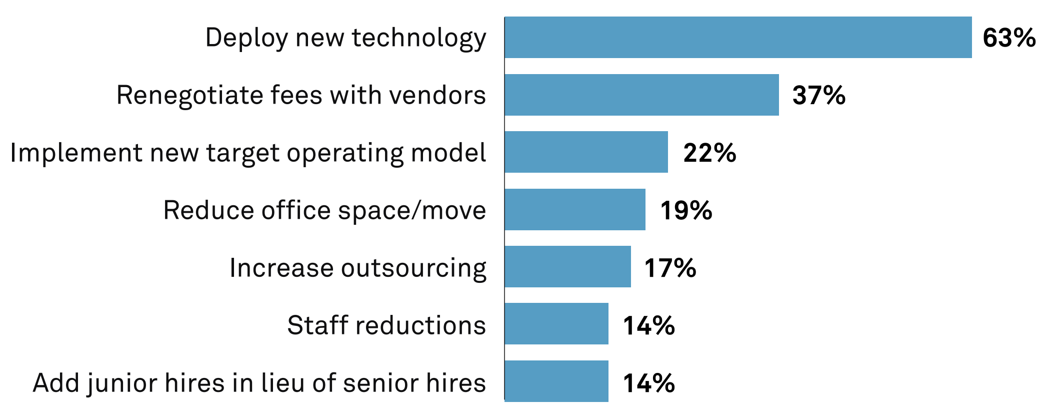
There is a wide range of aptitudes across the asset management community—some managers are highly automated while others still tolerate manual processes. Those on the less efficient end of the spectrum can benefit from the efforts of others by identifying firms that have a keen sense of best practices and have those embedded in their procedures. The ability to increase operational capacity on demand is one way to ensure that business-as-usual operations are maintained when trading becomes unusual.

Of course, sophistication is more than best practice—it is responsiveness as well. This is a key attribute: Operations cannot be a hindrance to front-office decision-making. Should the front office quickly decide to invest in operationally complex instruments such as bank loans, the downstream must adapt.

Similarly, regulation and changing market practice will force change: Failed trade penalties, Central Securities Depositories Regulation (CSDR) buy-ins and the move to T+1 in the U.S. are examples of initiatives that will increase middle- and back-office complexity. The strain on operations will vary from region to region. Managers in the EU and APAC may struggle more with T+1 than those in the U.S., which is concerning given how challenging this may be in the U.S. These market practice changes could necessitate costly upgrades to existing infrastructure and further reinforce the need for a global, responsive operating model.

Though certain firms are still able to charge a premium for their funds, for many asset managers, the industry-wide rollout of low-cost strategies continue to pressure fees, resulting in an emphasis on managing costs. There are a multitude of ways to cuts costs, and our research indicates that the asset manager community is focusing on technology and operations.

## Plans for Efficiencies and Cost Savings




Note: Based on 139 respondents.
Source: Coalition Greenwich 2023 Asset Management Outsourcing Study

It is no surprise that technology is high on the priority list with managers over $50 billion having a greater focus on technology relative to their peers. Often, new technologies are implemented to improve automation, resulting in staff reductions. That is not the case for our study respondents, as only 14% view staff reductions as a way to achieve efficiency and cost savings. The goal of new technology deployments is therefore to make current staff more efficient.

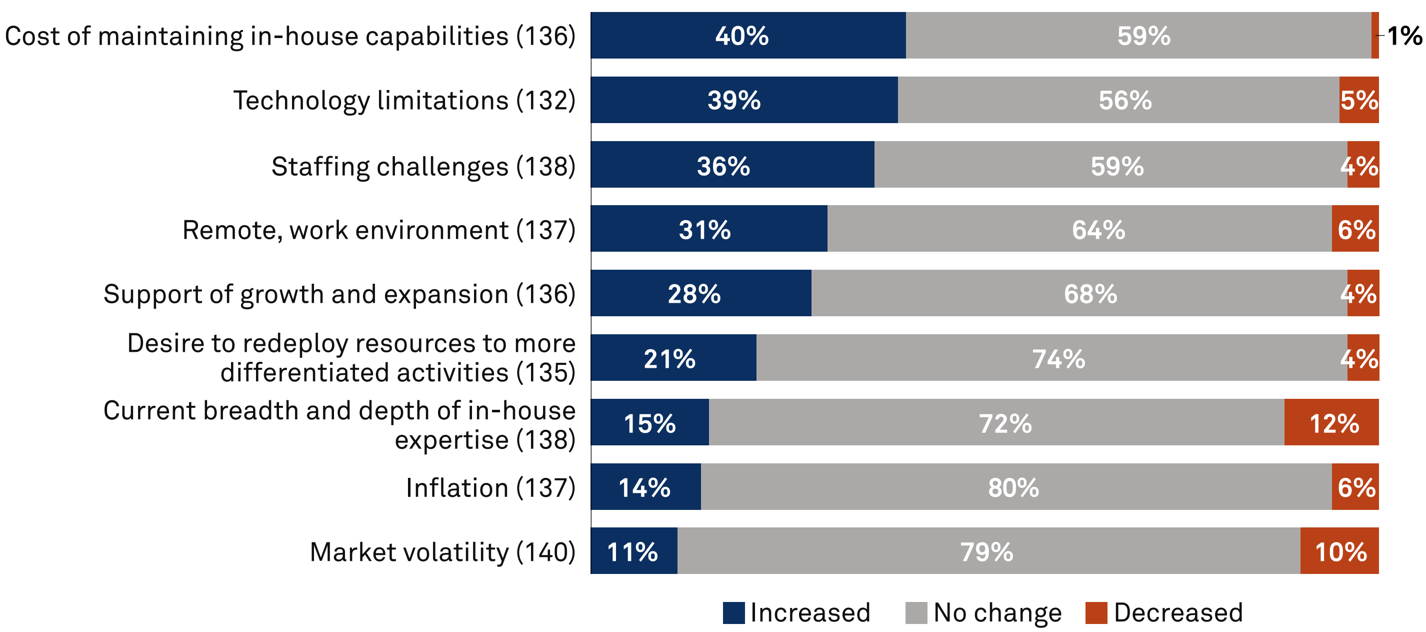
New technology must be implemented in a cost-conscious way. One method, of course, is to negotiate heavily with the vendors, as the buy side will. Yet, technology redesign without an operational redesign can lead to a disjointed outcome and may be insufficient to support strategic aspirations. Therefore, vendors that combine leading-edge technology with industry-leading operational know-how can help alleviate the tension between supporting growth and cutting costs. This combination becomes vital as 22% of respondents are looking toward a new operating model for relief.

Another way to take advantage of new technology without investing heavily in the cost of systems is to outsource to providers that already have leading-edge technology, and17% of asset managers say they will increase outsourcing. Interestingly, European asset managers are more focused on building a new operating model compared to their U.S. and Asia counterparts, who are more inclined to increase outsourcing. This may be because European asset managers already employ an outsourcing strategy, whereas U.S. and Asian managers are in the earlier stages of this move.

# The Role of Outsourcing in an Optimized Operating Model

Preparing for the future requires a rethink of existing systems, processes and talent, and many operating models include outsourcing. And when outsourcing is on the table, it is there because firms need to address these areas.

## Factors that Impact Likelihood of Outsourcing



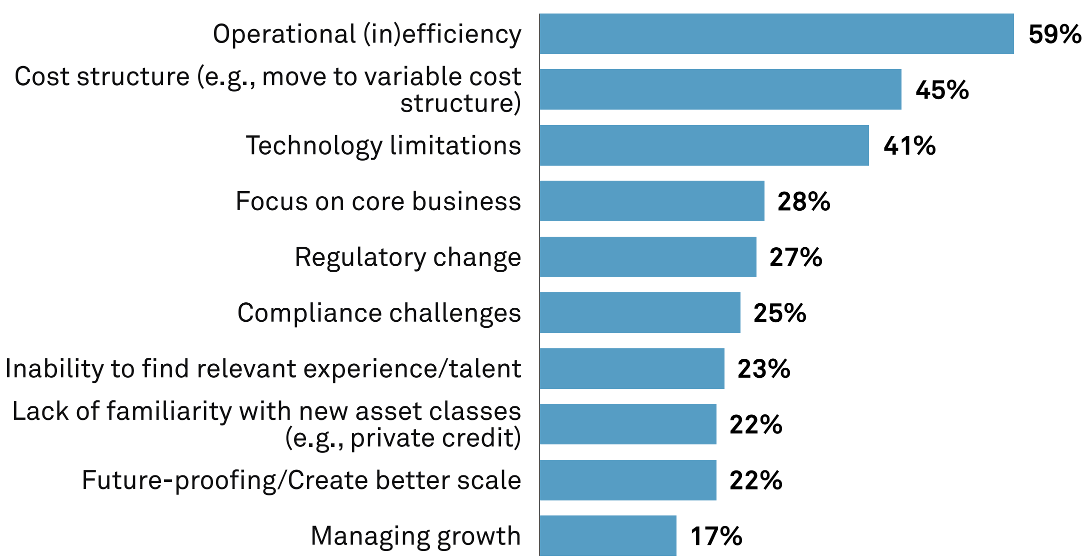

Note: Numbers in parentheses represent number of respondents.
Source: Coalition Greenwich 2023 Asset Management Outsourcing Study

There are many factors asset managers must consider when deciding whether to outsource. The propensity to outsource will change as a firm analyzes its strengths and weaknesses against both their current environment and their anticipated future environment. The factor most likely to increase outsourcing is the cost to maintain a firm's current platform, with 40% of respondents stating these costs increase the likelihood they would outsource. Issues with technology and staffing are also top of mind, and adding cost through new technology and new personnel may be a non-starter. In that case, asset managers could naturally advance to a discussion on outsourcing.

Operating models need to contemplate a broad range of costs. While the explicit fees of a vendor's pricing relative to in-house costs tend to be the dominant consideration, there needs to be a shift to include implicit costs as well. For example, firms need to ask how their execution quality could improve compared to their current trading desk if it is outsourced. Asset managers also need to quantify operational risk reduction via improved settlement rates and the impact on their business if automation increases. In its early stages, outsourcing was a global labor arbitrage play but is now a strategy to extract greater total value from providers with capabilities and expertise that can be consumed on a variable basis.

Benefits of outsourcing accrue to core investment processes but will also extend to complementary ones—trade execution can naturally lead to trade reporting and to sophisticated transaction cost analysis (TCA) and pre-trade compliance checks. The challenges that outsourcing can address are diverse and supportive of strategic goals.

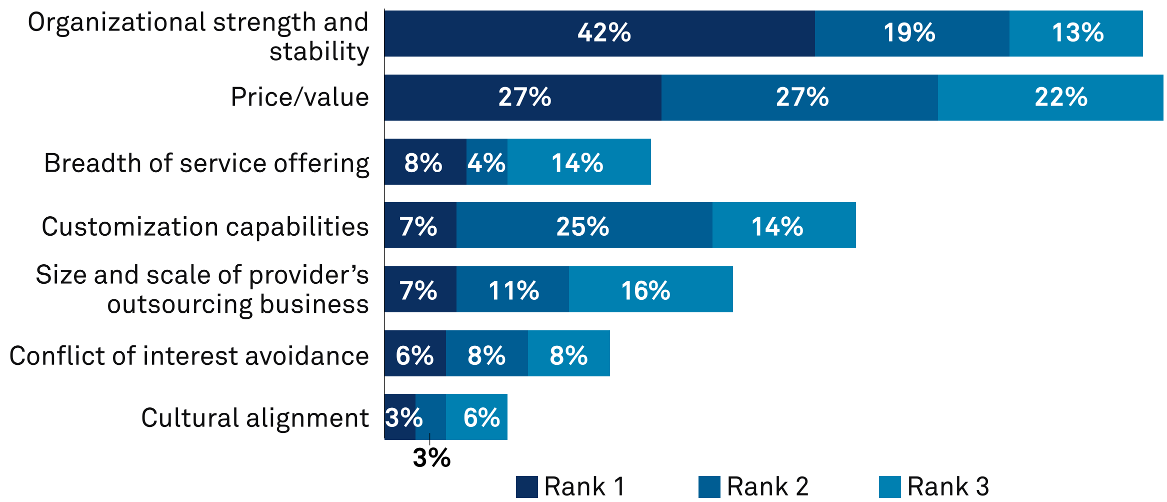
## Challenges Addressed via Outsourcing




Note: Based on 131 respondents.
Source: Coalition Greenwich 2023 Asset Management Outsourcing Study

Asset managers are aware of potential flaws in their operational processes; 59% cite operational inefficiency as a problem that outsourcing can address. Cost structure (not just absolute costs) and technology limitations are also key drivers of outsourcing. Imperfect operating and technology models lead to inefficiencies that can add risk to an enterprise. Additionally, firms are recognizing that they need to expand their product set and may not be optimized to do so. When an organization believes it has a combination of inefficient operations, costs incompatible with fees and underwhelming technology, a rethink is required.

## Considerations for Outsourcing




Note: Based on 139 respondents.
Source: Coalition Greenwich 2023 Asset Management Outsourcing Study

Outsourcing is not just a technology play, but also a personnel play, as the outsourcer becomes embedded into the asset manager's processes. Therefore, 61% of asset managers cite organizational strength and stability as the first or second most important consideration in outsourcing. The importance of organizational strength extends far and wide—from the quality of staff performing the work, to senior management support of outsourcing as a strategic goal for the agent, to the financial stability of the agent.

Breadth of service and the ability to customize are other vital considerations. Once a firm looking to outsource is comfortable that the provider can cover a wide range of services, the next step is to determine the scope of the engagement. The ability to customize is, therefore, not solely about processing or reporting, but more about designing an operating model comprised of the bespoke set of services required and valued by the client.

Asset managers don't always need the biggest provider, but rather one they can trust the most to be there for the long term. In particular, asset managers below $50 billion do not consider size the most important attribute; less than 3% ranked that as the top consideration. The willingness to engage with newer or smaller entrants to this space allows the asset manager to influence the strategic direction of the outsourcing partner.

The benefits and motivations for outsourcing today are a continuation of the outsourcing evolution. Core custody was enhanced by complementary processes such as fund accounting to ensure smooth operations. Then it became efficient to have these firms take ownership of certain activities that helped the performance of the fund, such as foreign exchange and securities lending. This evolution has been on a steady path toward the front office, and solutions now are diverse and can be tailored to fit into multiple parts of the investment process, across the entire life cycle or across asset classes. When asked if they were likely to choose a single outsourced trading provider for multiple asset classes, 62% of respondents stated that they were.

A well-thought-out operating model is a key contributor to success. Growth to the level anticipated by asset managers will be difficult to achieve, more so if utilizing an insufficient investment life cycle platform. Client demands are changing, and an asset manager's strategy must evolve with those demands. But the strategies of 2025 will not succeed if they are run on platforms designed for the environment of 2018.

### The Role of Fees

Forty-three percent of respondents are not considering flexible management fees tied to performance, but 37% already do, and 20% are considering it. Currently, the industry generally charges a basis point fee on the value of AUM. Under the traditional model, fees are earned in good years and bad, bear markets and bull markets. However, if the trend for variable fees hastens, then asset managers would need to reexamine their cost structure, and may then think differently about their strategic priorities and ideal end state.

# Conclusion

For many, the past few years have felt like one massive effort to extinguish pop-up fires, and asset managers did well in their immediate responses to those challenges. Of course, there is no rest for the weary, and as the industry moves ahead, the necessity of longer term strategic plans becomes more important. Indeed, the investment industry will continue to rapidly change even if the tumult decreases.

Yet, according to our research, some asset managers are comfortable with their existing platform, despite concerns that it is perhaps not optimized for the future. While there remain many unknowns in the current environment, one item asset managers control is their operating model. Rethinking and rebuilding with flexibility, growth and cost in mind can help ensure that they not only survive upcoming challenges, but that they thrive.

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