NORTHERN TRUST

MANAGING ASSETS ACROSS THE GLOBE: RETHINKING THE OPERATING MODEL

As margin pressures grow across the investment industry, investment managers around the world are rethinking their operating models to support growth, adapt to change and position themselves for the future.

Leveraging today's innovative technology and scalable solutions can significantly reduce costs and enhance operational efficiencies – helping firms remain competitive in the drive for Operational Alpha™.

MANAGING ASSETS ACROSS THE GLOBE: RETHINKING THE OPERATING MODEL

EXECUTIVE SUMMARY

Five considerations for supporting growth, adapting to change and positioning investment operations for the future.

1 **Using technology to gain a competitive edge**

Technological innovation is playing a significant role in the asset management industry – and in separating the 'winners' from the 'losers'. Successful firms are increasingly adopting an agile mind-set as they implement and use technology.

As they fine tune their strategies, many are splitting technology into 'core' and 'non-core' functions – adopting distinctive approaches to each in order to help maximise operational efficiency.

2 **Creating holistic compliance functions**

As the landscape grows progressively more complex and global – and principles-led regulation comes increasingly to the fore – asset managers remain concerned about meeting their obligations.

Successful asset managers are embracing regulation collectively as an organisation and avoiding the development of large, 'siloed' compliance functions. They are staying ahead of regulatory change by drawing on technology-led solutions, including 'RegTech'.

3 **Building an ecosystem of outsourcing partners**

As businesses grow, asset managers often outsource non-core functions to attain greater scale, flexibility and speed to market. As they build their outsourcing ecosystems, they may run the risk of creating 'shadow operations' – pockets of resource dedicated to duplicating or checking the work of other departments or outsourced partners.

Ways in which managers can mitigate this include avoiding 'vendor 'lock-in' and anticipating whether they will 'build or buy' technology at early points in their growth strategy. Managers should be 'technology agnostic' and have the flexibility to change their suppliers or approach as required.

4 The front office is ripe for change

As managers seek to maximise efficiencies and reduce costs in today's environment of extreme margin pressure, they are increasingly outsourcing front office functions such as trading to third-party providers.

Many successful investment managers have shifted their thinking from considering 'front', 'middle' and 'back' office functions in isolation – to evaluating instead whether they are 'alpha' or 'non-alpha'-generating activities. These managers only retain functions in-house that are considered critical to alpha-generation.

5 Incorporating fund distribution into your operating model

Market competition means a growing number of fund managers are looking outside their home market to raise assets – but uncontrolled expansion can prove expensive and a drain on resource.

Firms must weigh up cost/benefit calculations of market entry, and develop a strategy to reduce the risks of rapidly-escalating costs. They should ensure their technology architecture and product can meet the needs of their underlying global investors – and incorporate these considerations into their operating model.

83%

OF ASSET MANAGERS PREDICT A FUNDAMENTAL CHANGE IN THEIR OPERATING MODEL IN THE NEXT 12-24 MONTHS.[v]

60%

OF ASSET MANAGERS CITE REGULATION AS A DRIVING FACTOR TO OPERATING MODEL CHANGE.[v]

49%

NAMED TECHNOLOGY INNOVATION AS THE SECOND BIGGEST DRIVING FACTOR TO BACK OFFICE CHANGE.[v]

MANAGING ASSETS ACROSS THE GLOBE: RETHINKING THE OPERATING MODEL

The investment management industry remains under pressure. Costs are escalating for many, fees are stretched for some, and margins are being compressed at a time when the industry is facing increasingly complex regulatory and compliance challenges, as well as growing technology demands.

Many investment houses will find it increasingly difficult to drive performance and achieve investment alpha. Though asset management companies enjoyed an average compound annual growth rate (CAGR) of 7% for assets under management between 2012 and 2018, their profits per asset decreased by 2% CAGR, according to estimates from Bain & Company – and the consultancy has predicted a sharp decline going forward.[i]

Similarly, Morgan Stanley and Oliver Wyman reported that asset management costs rose 8% globally in 2017, which was 5% higher than the annualised growth rate for the preceding five years, limiting margin improvement in what was a record year for asset growth.[ii] The numbers continue to be stark, with little progress on cost reductions made in 2018. In their latest report, Morgan Stanley and Oliver Wyman state costs rose a further 4% in 2018.[iii]

If that were not enough, assuming markets were to fall, and the recovery were slow, the Boston Consulting Group believes margins could drop to between 25% and 28% by 2023 – taking nearly a third off the current margin profile for the industry.[iv]

It is no surprise then that to drive performance in this challenging investment landscape, asset managers and asset owners managing money across the globe are increasingly exploring scalable solutions to help them reduce costs and build efficiencies.

The Operating Model - a Roadmap to Delivering Value

Asset managers that want to future-proof their firms are repositioning themselves by re-evaluating and optimising their operating models. Many seek to take advantage of new opportunities, innovative thinking, and new methodologies in the search for Operational Alpha™ – the value an organisation gains by improving operational processes to increase efficiency, maximise technology and reduce costs.

There is no 'one size fits all' operating model in asset management. But broadly speaking, an operating model comprises the people, processes, and technology that define a company's business approach and vision for the future. Operating models provide the roadmap to delivering value. They address how resources should be allocated, how client and other key business relationships are developed and serviced and how critical functions, such as the back, middle, and front office, are supported.

Operational Alpha™ is the value an organisation gains by improving operational processes to increase efficiency, maximise technology and reduce costs.

+8%

RISE IN ASSET MANAGEMENT COSTS IN 2017

+4%

RISE IN ASSET MANAGEMENT COSTS IN 2018

To achieve Operational Alpha™, it is now more important than ever for investment firms to be agile, competitive, and efficient. Scalable solutions can help firms reduce costs, eliminate redundancies and shorten time to market. The results can include higher-quality data flows, improved governance and transparency, better assessment of costs, re-evaluation of priorities, and enhanced client relationships.

Where does a firm begin when rethinking the traditional way of doing things? This paper highlights five key opportunities that will allow asset managers to make great strides toward future-proofing their operations. These include:

- Focusing on technological innovation;
- Thinking about regulation and compliance;
- Building a 'best-of-breed' ecosystem of outsourcing partners;
- Rethinking the front office; and
- Ensuring that your operating model meets the demands of distribution strategy.

1. USING TECHNOLOGY TO GAIN A COMPETITIVE EDGE

For many investment managers, today's operating models are increasingly complicated networks with technology at their core.

The financial services industry – and asset management more specifically – is adapting to the increasing importance of technology. For example, the use of artificial intelligence (AI) holds the promise of helping firms identify complex patterns and trends, potentially improving investment strategies. Automation can help drive accuracy and speed across many functions - including valuations, trading and reporting - while reducing execution costs.

PwC believes that as technology (in the form of automated advice and client service) becomes prevalent, the industry will consolidate in certain developed markets, with up to 20% of the firms currently in existence either being acquired or eliminated.[vi]

Asset managers have to stay ahead of the curve in order to remain competitive and technological innovation is playing an increasingly decisive role in separating the 'winners' from the 'losers'. Successful firms continuously evaluate the role of technology in their operating models and create integrated, holistic solutions across their platforms. Technology is already estimated to be 15%-20% of the industry cost base,[vii] and, as Morgan Stanley and Oliver Wyman point out, leading players are outspending their mid-tier rivals on innovation by a ratio of as much as 3:1.[viii]

This is evident in today's market, with a majority of respondents (62%) to Confluence's *Asset Management Trend Survey Report Q4 2017* citing 'replacing manual processes with automated technology' as an important goal for back office operations over the following 12 to 24 months. Achieving data accuracy/consistency was the top back office challenge, while 82% felt that centralising data was extremely important.[ix]

15-20%

OF INDUSTRY COST BASE IS ATTRIBUTED TO TECHNOLOGY SPEND.

62%

OF ASSET MANAGEMENT SURVEY RESPONDENTS CITE "REPLACING MANUAL PROCESSES WITH AUTOMATED TECHNOLOGY" AS AN IMPORTANT GOAL FOR OPERATIONS.

One particular concern for many firms is technology drag. Technology depreciates both financially and in terms of performance, and traditional investment cycles in technology last around five years. However, with industry-wide moves to heighten digital capabilities and draw on agile development techniques, innovation is occurring much faster than this.

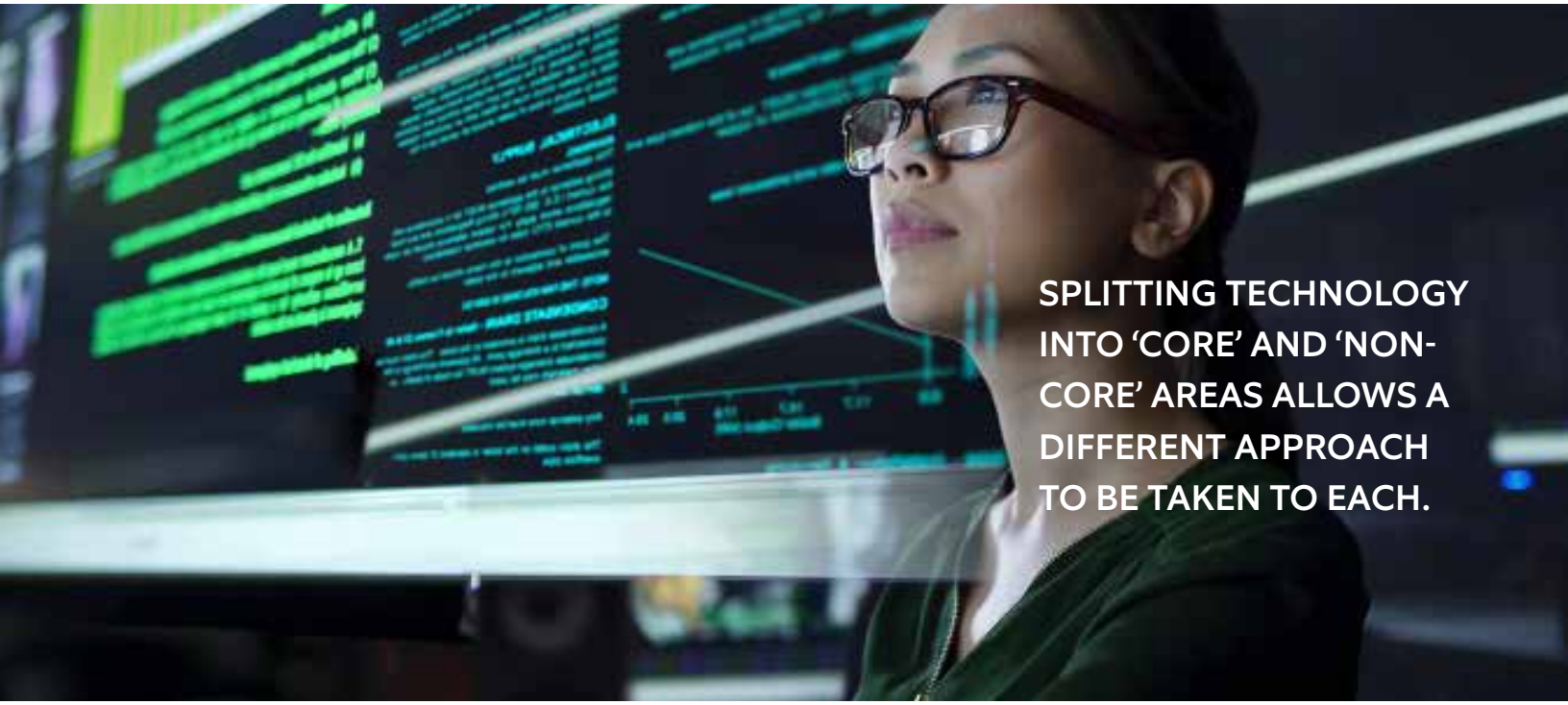
The most successful investment firms are not just moving to agile solutions; they are adopting an agile mind-set. This includes placing cross-functional teams around products and services, and empowering those teams to achieve results.

Successful asset managers are also hiring technology talent to drive a new and creative vision and culture in their organisations. They are identifying disruptive technologies, and re-designing long-standing processes. They are embracing machine learning to perform repetitive tasks faster and with greater accuracy. Many are using public and private cloud capabilities to gain efficiencies and scale in powering their businesses. They are also drawing on predictive analysis to deliver data-driven insights to support their decision-making.

Key Technology Considerations

Investment firms wanting to rethink their approach to technology, particularly in the context of refining their operating model, must take several key factors into consideration. The first is whether it makes more sense to build or buy new infrastructure. Asset managers must be mindful about potential future limitations when making their selections. Will the firm have the flexibility to move across platforms and providers in the future?

Managers that have resource constraints may choose to outsource certain functions to a third-party provider who already has the technology built into their solutions and the ability to invest in technological innovation.



Here, it is often helpful to split technology into two separate areas of 'core' and 'non-core' focus, as this allows asset managers to take a different approach to each.

In the 'core' section, investment firms should place anything that can support them in attracting or retaining business. Any technology or system that helps articulate their vision, informs investment decisions, or is part of the product set, should be included in this first section and be part of any agile programme.

The second area of 'non-core' focus relates to any technology that is commoditised, such as reconciliations, which should be procured as a service where possible. This can allow firms to devote greater resources to, and focus more closely on, their areas of expertise.

Other ways managers may use technology to gain a competitive edge include adopting a cloud-first strategy. By placing architecture in the cloud, managers are able to reduce development cycles and create a more flexible cost base. Investment firms should also sunset legacy applications as new technologies are introduced to help prevent regulatory concerns that may arise later from fractured data and operations.

Managers that have resource constraints may choose to outsource certain functions to a third-party provider who already has the technology built into their solutions and the ability to invest in technological innovation. Outsourcing can level the playing field for smaller or medium-sized firms by reducing the amount of investment required to move away from an outdated technology model.

1. Rethinking the Operating Model: Using Technology to Gain a Competitive Edge

- **Successful firms evaluate** the role of technology in their operating models, and create integrated, holistic solutions across their platforms.
- **The most successful investment firms** are not just moving to agile solutions; they are adopting an agile mind-set. This includes hiring key talent to drive new and creative visions.
- **Investment firms must consider** whether it makes more sense to build or buy new technology solutions. Asset managers must also be mindful about potential future limitations when making their selections.
- **Splitting technology** into 'core' and 'non-core' functions helps asset managers take a different approach to each to maximise efficiencies.
- **Asset managers** should consider adopting a cloud-first strategy.
- **Outsourcing certain functions** to a third-party provider with technology built into its solutions can help managers harness the latest innovations.

2. Creating Holistic Compliance Functions

Regulation continues to be a focus of the investment industry, and as the regulatory environment evolves, the role of compliance within the operating model is also transforming.

According to a survey from ThomsonReuters,[x] regulation was the single biggest concern of financial institutions in 2019. The most commonly cited challenges included financial crime, anti-money laundering and sanctions, culture and conduct risk, and the adequacy and availability of skilled resources.[xi]

> *Regulation was the single biggest concern of financial institutions in 2019.*
>
> THOMSONREUTERS SURVEY

The Regulatory Landscape

In the last 10 years, the global regulatory landscape has changed in complexity. Investment firms that want to stay ahead of the changes are looking at the role of compliance through a new lens.

Key regulations, such as the European Union's Markets in Financial Instruments Directive (MiFID) II, are not just being implemented regionally, but are under consideration globally. MiFID II regulation saw the unbundling of investment research from execution, and there are signs that managers outside of its scope are voluntarily seeking to adopt the same unbundling as an example of best practice.[xii]

For example, MiFID II is not mandated in Asian markets but has become best practice in cross-border markets such as Hong Kong, Australia, and Singapore which have implemented their own Manager-in-Charge regimes. Modernisation and the advent of multiple post-trade regulations - such as Form CPO-PQR, Form PF, and form N-PORT in the US, and the Alternative Investment Fund Managers Directive (AIFMD) in the EU - are also adding a sense of urgency to the adoption of new standards.[xiii]

While many of these regulations are more prevalent outside the U.S., they are slowly being adopted as best practice as managers compete with each other to be seen as best-in-class in terms of their regulatory compliance and adherence to the highest standards. The globalisation of key regulations – driven in part by competition – is therefore an evolving trend.

Regulations have also emerged that are focused on culture and governance. The UK's Senior Managers and Certification Regime (SMCR), for example, effective from December 2019, focuses more exclusively on personal conduct to drive standards of investor protection and market stability.

Australia's Banking Executive Accountability Regime (BEAR) lays out similar requirements, while the U.S. Securities and Exchange Commission's (SEC) Regulation Best Interest Rule will require broker-dealers and investment advisors to rethink advice models, disclosures, supervisions and compliance oversight. They will likely also need to overhaul their end-to-end technology and operational infrastructures to adapt.[xiv]

Other regulators, such as the Monetary Authority of Singapore (MAS) and the Central Bank of Ireland (CBI) either are consulting (in the case of Singapore) or are looking to consult (in the case of Ireland) on bringing in accountability regimes in the near future.

Another aspect of regulation that is important to keep in mind is that which governs data, such as data privacy and storage. As new laws concerning the use of data come into effect, such as the EU's General Data Protection Regulation (GDPR) and the California Consumer Privacy Act (CCPA) in the U.S., firms need to ensure their processes can adapt accordingly.

As the industry increasingly moves towards principles-led regulation, asset managers need to be more tailored and forward-thinking in their approach to meeting regulatory obligations. This is because under principles-based regulation, the onus of compliance lies with each individual organisation to define their approach to meeting standards, and evidence how it meets regulatory requirements.

For asset managers, ensuring compliance with multiple regulations – with accompanying requirements for reporting and transparency, disclosure and risk management – is not necessarily straightforward. A firm's operating model must both facilitate these requirements and adapt to meet future regulatory change.

Key Regulation and Compliance Considerations

Part of the challenge for asset managers is determining who takes on the responsibility for regulatory compliance within an investment firm. This is often divided between chief operating officers (COOs), heads of legal, heads of compliance or chief compliance officers (CCOs), and heads of regulatory change.

While some investment firms have ring-fenced regulatory responsibilities to certain named individuals or departments, others are adopting best practice by embedding compliance considerations across their organisations. In this way, no department or region is bearing the brunt of the responsibility in isolation. Successful asset managers embrace regulation collectively as an organisation, adopt a global approach, and build a sustainable ethos and culture into their operating models. Most importantly, they have avoided the development of large, 'siloed' compliance functions within their organisations.

Technology may provide part of the solution to compliance challenges. Regulatory technology (RegTech) tools hold the promise of allowing asset managers to proactively deal with regulatory change, and embed their policies and procedures into more manageable, accurate processes.

DEMAND FOR SKILLED STAFF AND TOP THREE COSTS OF COMPLIANCE*

86%

DEMAND FOR SKILLED STAFF AND KNOWLEDGE.

73%

ADDITIONAL SENIOR STAFF REQUIRED TO COPE WITH VOLUMES OF REGULATORY REQUIREMENTS

52%

INCREASED PERSONAL LIABILITY

**Identified by respondents of the ThomsonReuters Costs of Compliance Survey 2018*[xv]

Successful asset managers embrace regulation collectively as an organisation, adopt a global approach, and build a sustainable ethos and culture into their operating models.

In a 2019 RegTech brief, EY breaks down new technologies in the regulatory reporting space into five key areas: report automation platforms, visual analytics, robotics, next-generation data architecture, and business process management.[xvi]

EY points out that regulators, RegTech firms, professional service organisations and financial institutions will all need to work together in an effort to continue to innovate, reduce overall costs of compliance, and accurately and effectively report to regulators.[xvii]

To remain competitive, asset managers will need to be forward-thinking – considering regulatory changes on a two to three-year time horizon, and dealing with challenges in a strategic way. This means building a framework into their operating models, and leveraging existing practices and processes already in place. Most importantly, investment firms will need to adopt a holistic approach, rather than considering each new regulation as piecemeal – and they must be global in their approach.

2. Rethinking the Operating Model: Building Holistic Compliance Functions

- **Successful firms** have avoided the development of large, 'siloed' compliance functions within their organisations, and have resisted delegating responsibility for compliance to certain groups or individuals.
- **RegTech helps asset managers** proactively deal with regulatory change.
- **Investment firms should be forward-thinking** and consider regulatory changes on a two to three-year time horizon.
- **Asset managers must adopt** a global and holistic approach to regulation in order to manage their compliance functions successfully.
- **Firms can utilise solutions** available to support regulatory compliance through the application of technology and data.
- **For example, an outsourcing provider's access** to transaction data can allow it to help investment managers meet their transaction reporting requirements under MiFID II.

3. Building an Ecosystem of Outsourcing Partners

As asset managers move into new areas of business and diversify their strategies, the tools they use and the approaches they take to manage different products and services can change. As they grow, firms may look to outsourced providers to enhance or replace their in-house capabilities. By embracing outsourcing and developing an 'ecosystem' of trusted partners, asset managers can create solutions that provide greater scale, flexibility and speed to market – and in turn, help them achieve Operational Alpha™.

Supporting a legacy silo structure of outsourced providers can be problematic. Monitoring complex assets becomes a resource drain, and is economically unstable for many investment firms.[xviii] At the same time, as more activities duplicate, there is a greater potential for errors, misunderstandings, and misalignments between parties. Operational frameworks may spring up to consolidate fragmented data sets or to oversee different outsourcing suppliers. When this happens, 'shadow' systems – pockets of resource dedicated to duplicating or checking work of other parts of the organisation or outsourced providers – are sometimes created.

Key Considerations Concerning the Outsourcing Ecosystem

Many organisations, particularly larger firms taking a multi-sourcing approach with different suppliers, struggle with service standardisation. Having multiple providers can mean dealing with vastly different service approaches or systems set-ups. They may therefore employ staff to cross-check and normalise the work of multiple suppliers in order to manage their day-to-day business, which can be costly and inefficient.

How can investment firms address these challenges? First, technology must be organised so the data is accessible and flexible for all parties and platforms. Asset managers should avoid 'vendor lock-in' - a situation where technology, process, and partners are inextricably linked and impossible to separate.

In addition, investment firms and their service providers should be 'technology agnostic' and have the flexibility to change their suppliers or approach as required.

The most successful investment firms are holistic in their thinking. Rather than working on a case-by-case basis, they adopt a broad strategy for building their systems, and are mindful of how technology selection and integration may impact future requirements for expansion. They develop a 'best-of-breed' ecosystem of technology and outsourcing partners, and have strategic or preferred partners in place at a functional level.

It's important to remember that asset managers can outsource activity but not responsibility. For this reason, the oversight function gains even greater importance under an outsourcing model.

Technology must be organised so the data is accessible and flexible for all parties and platforms.

Planning for Expansion

However, ahead of each business expansion, asset managers need to assess the likely long-term costs of building in-house capabilities versus buying them. What are the costs of procuring and maintaining both the technology and the resources to carry out the new function? Would the new function be duplicating work already carried out by other parts of the business or by an outsourced partner?

In a 'buy' scenario, managers should see whether there are synergies with existing suppliers at the process level, and whether the supplier technology integrates with existing systems.

Firms that want to be more efficient need to carefully review their outsourcing arrangements, remove duplicative processes where possible, and consolidate services with providers that can offer global solutions.

Successful asset managers are mindful of how technology selection and integration may impact future requirements for expansion.

3. Rethinking the Operating Model: Building an Ecosystem of Outsourced Providers

- **Asset managers should avoid 'vendor lock-in'** - a situation that occurs when technology, process, and partners are inextricably linked and impossible to separate.
- **Investment firms and their service providers** should be 'technology agnostic', with the flexibility to change their suppliers or approach if necessary.
- **Rather than working on a case-by-case basis with each supplier**, successful asset managers have adopted a broad strategy for building their systems, and are mindful of how technology selection and integration may impact future requirements for expansion.
- **Asset managers should complete a 'build-versus-buy'** assessment before diversifying.
- **Outsourcing provides access to scale and new solutions** to support a business as it grows and its need for new capabilities evolves.

4. The Front Office Is Ripe for Change

For many asset managers, the front office has been an untouchable component of their operational framework. Functions such as trading have been considered core to asset management. Managers have tended to bundle their front office activities together, while outsourcing their back and middle office functions.

In today's market, many firms have cast their eyes to components of the front office, particularly trading-related functions, and are embracing new solutions and approaches. This is partly because technology has blurred the lines between front office and middle office solutions and functions, and partly because the enormous pressures facing asset managers do not seem likely to abate anytime soon.

Cost, again, is a key driver of change. The costs of building and running a trading desk have increased. In the case of international asset managers in the U.S., Greenwich Associates found that investment research budgets had dropped 45% between 2009 and 2018. Meanwhile, the average trading desk manages 20 execution relationships and 32 research relationships with just two full-time traders.[xix]

Outsourcing front office functions such as trading is often seen as a way for asset managers to control costs and also gain access to technology and expertise by partnering with firms that offer scale and specialisation.

As mentioned earlier, for mid-size and smaller players, outsourcing is also an opportunity to level the playing field. Some start-up firms choose to set up a business based entirely on an outsourced, scalable model that can be 'flexed' up and down as market conditions dictate.

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FOR MID-SIZE AND SMALLER FIRMS OUTSOURCING IS AN OPPORTUNITY TO LEVEL THE PLAYING FIELD.

Some established managers are also outsourcing up the value chain across all front office functions, such as trading, foreign exchange, and transition management. In some cases, they are moving towards fully outsourcing all traditional front office capabilities.

Top-performing managers have shifted their thinking from 'front', 'middle' and 'back' office to 'alpha' and 'non-alpha'-generating activities – with only functions critical to alpha generation remaining a core part of the operations.

Key Front Office Outsourcing Considerations

As responsibility cannot be outsourced, investment firms must ensure that they retain sufficient oversight, and that they are given full transparency across all systems and controls. They must also ensure that they are working with secure, well-capitalised, independent counterparties that are heavily invested in technology and cyber-security – and have lengthy experience in outsourcing partnerships.

4. Rethinking the Operating Model: Outsourcing the Front Office

- **Managers have traditionally handled their own front office activities** while outsourcing back and middle office functions – but this is changing.
- **Outsourcing is seen as a way for asset managers to control costs** and gain access to technology and expertise by partnering with firms that offer scale and specialisation.
- **In some cases, investment firms are moving towards fully outsourcing** all traditional front office capabilities.
- **Many top performing managers have shifted their thinking** from 'front', 'middle', and 'back' office to 'alpha' and 'non-alpha'-generating activities.
- **While fund managers can outsource certain functions**, they cannot outsource responsibility. Investment firms must ensure that they retain sufficient oversight, and that they are given full transparency across all systems and controls.
- **Multiple options are available**, whether that is front, middle, component, or end-to-end outsourcing, which allow managers to flexibly design a model that best suits their needs.

5. Incorporating Fund Distribution Into Your Operating Model

Raising assets is the lifeblood of any asset management firm, and distribution is a vital component of the operating model. Given how challenging it is to identify new opportunities, it is unsurprising that fund managers are zealous about broadening their distribution, including looking to new asset types and markets for asset growth.

Investment managers are expanding their distribution efforts by entering new markets and offering new products in both their domestic strongholds and overseas. While distribution can be focused on internal markets, PwC predicts that regional and global platforms will dominate the industry.[xx] The firm believes managers will need to determine early on which jurisdictions to establish their platforms in, and which product sets to offer.

The structure of any new fund product should be designed to meet the needs of the target investor audience. Managers should consider where and to whom they intend to sell, and look for the right legal and expense structures to meet the demands of their target investors.

An important consideration is having 'boots on the ground' to establish rapport with policymakers and standard setters in every jurisdiction of operation. According to PwC, the soft skills of diplomacy and cultural knowledge will be as important as traditional functional skills.[xxi]

Complexities of Cross-Border Distribution

One area of expansion is cross-border distribution. For investment firms that get cross-border distribution right, the rewards can be substantial – but the market is not without its complexity.

For example, a UK investment firm seeking to register five funds across Italy, Switzerland, Germany, Austria, and France would need to:

- Set up new currency share classes in euros and Swiss francs, and support new FX requirements.
- Register with the appropriate authorities for each country as regulations and market practices dictate.
- Appoint a paying and/or representative agent to service investors locally.
- Translate their Key Investor Information Documents into at least three different languages.
- Ensure their marketing and pitch books are legally compliant in each market.
- Appoint a third party to do their tax reporting where required.

Therefore, the cost of these activities is a significant component that becomes a concern even before marketing and sales considerations come into play.

To safeguard against the risk of uncontrolled cost escalation, investment firms need to closely weight up the cost/benefit calculations of market entry, fund structures and domiciles, and business strategy.

To safeguard against the risk of uncontrolled cost escalation, investment firms need to closely weight up the cost/benefit calculations of market entry, fund structures and domiciles, and business strategy. Would a targeted approach, focusing on a particular segment of a market, or a small group of countries where certain strategies are used, make more sense than large scale market entry, for example?

Importance of Investor Data

When investment firms operate across multiple markets from a single fund domicile using third party distributors, they often find it difficult to measure exactly where their sales success is coming from – and even from which distributors the flows are originating – adding further complexity.

When subscriptions arrive via a global distribution platform, they are held in the fund register as part of a larger nominee position. Acquiring data that relates back to the underlying distributor is a bit like peeling back an onion, and a very painstaking manual process.

In addition, firms may not have accurate sales data for their distribution network, which makes it difficult to understand the success of sales managers and distributors, and makes sales planning and deciding where to focus and deploy resources challenging.

In Asia, there is no single overarching fund framework, and cross-border distribution into global markets where UCITS/Cayman and local funds compete is common. Decisions around sales strategy, distribution channel, target market, fund structure and domicile are complex and need to be carefully considered and planned in advance by the fund manager.

Firms may not have accurate sales data for their distribution network, which makes it difficult to understand the success of sales managers and distributors.

Key Fund Distribution Considerations

Before entering a market, asset managers must ensure that sales and service are a key part of their business proposition, and that their technology architecture can meet the needs of their underlying investors, particularly as those investors tend to be increasingly global.

At a time when distribution shelf space is shrinking, and the number of mutual funds in developed markets is expected to decline by up to 25%,[xxii] it is more important than ever to build the right operating capabilities around distribution, and to understand the needs of the target investor. Leveraging key partners to support a global and/or local model that delivers in a local time zone, language, and other cultural nuances, while providing investors with 24/7 access to their data, will be critical to success.

5. Rethinking the Operating Model: Incorporating Fund Distribution

- **Distribution** is increasingly becoming regional and global.
- **Cost is a significant component** across distribution channels.
- **When investment firms operate** across multiple markets from a single fund domicile using third party distributors, they often find it difficult to measure exactly where their sales success is coming from.
- **Before entering a target marke**t, fund managers must ensure their technology architecture and product construct can meet the needs of their underlying, increasingly global investors.
- **Leveraging key partners** to support a global and/or local model that delivers in a local time zone and language, and provides investors with 24/7 access to their data, will be key.

Rethinking the Operating Model: The Future is Now

The investment industry is changing, and now more than ever, agility and flexibility are keys to success. A myriad of pressures, from falling margins and revenues to the rapid pace of technological innovation, shine the spotlight on asset managers' operations. Those who stay ahead of the curve are adopting new solutions and seizing opportunities to future-proof their operating models.

Successful operating models can lead to successful businesses – while inefficient ones are unlikely to survive in the long-term. The most successful asset managers are those that grow their businesses while controlling their costs. In today's compressed market condition this is best achieved with Operational Alpha™.

While the pressures are significant, so are the opportunities. Whether the solution involves embracing new technology, navigating regulation differently, leveraging the right outsourcing partners, re-evaluating front office functions, or taking a fresh approach to distribution, the successful asset manager of the future will integrate people, processes, and technology – and prioritise all three.

Successful operating models can lead to successful businesses – while inefficient ones are unlikely to survive in the long-term.

FOOTNOTES

[i] Bain & Company "After the Easy Money Boom, Stark Choice for Asset Managers" Last Updated: 2 July 2018 https://www.bain.com/insights/after-the-easy-money-boom-stark-choices-for-asset-managers/

[II] Morgan Stanley and Oliver Wyman Blue Paper "Winning Under Pressure" March 2018. https://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2018/march/Wholesale-Banks-Asset-Managers-Winning-Under-Pressure-2018.pdf

[III] Morgan Stanley and Oliver Wyman Bluepaper "Searching for Growth in an Age of Disruption", 2019, https://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2019/mar/wholesale-banks-asset-management-analysis-2019.pdf

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A proven partner to some of the world's most successful and innovative investment managers, Northern Trust has over 30 years' experience administering the full spectrum of investment strategies for clients around the globe. We help facilitate improved speed-to-market, operational efficiency, business focus and distribution for our clients' traditional and alternative funds. Our solutions include fund administration, global custody, investment risk analytics, back-and-middle office investment operations outsourcing, institutional brokerage and solutions to support regulatory change.