



INNOVATE
FINANCE

Fast forward asset management

Enabling the next wave

February 2023

Executive Summary

- 01 What does innovation in asset management mean?
- 02 Why does innovation matter in asset management?
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Executive Summary

Innovation is everywhere in today's fast-changing world. No longer confined to technology firms, start-ups or the pioneering few, innovation is now critical for businesses to remain relevant and ultimately survive.

Indeed the UK government recently highlighted its wide-ranging importance with the establishment of the [Department for Science, Innovation and Technology](#), aimed at driving the "innovation that will deliver improved public services, create new and better-paid jobs and grow the economy".

In the asset management sector, surges in inflation and interest rates, geo-political instability and the threat of climate catastrophe are creating a more complex investment environment. Combined with expectations for digitalisation, transparency and sustainability, this is raising the bar for value creation. Asset managers are

increasingly aware that investment models which worked well in the past may not be fit for purpose in the future.

Firms face a huge challenge to meet client expectations and deliver strong returns, with environmental and societal impact also of growing importance to clients – all whilst reducing cost to the end investor. In these circumstances, failing to innovate is no longer an option.

Now is the time to act. The next few years will see the most innovative firms position themselves for the greatest long-term success. In contrast, firms that fail to embrace meaningful innovation at speed will increasingly struggle to remain relevant and competitive in a world of fast-moving change. Emerging technology such as quantum computing, artificial generative intelligence and Web 3.0 have an ability to create a new reality that is dramatically different to our experiences today. Asset managers should therefore embrace the



Ben Lucas
Partner, Global Head of Asset Management Consulting KPMG in the UK



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CEO Innovate Finance

possibilities innovation creates by taking control of the future instead of waiting for their hand to be forced, or risk falling behind the competition.

And yet innovation can feel intimidating. Is it an opportunity or a threat for our business? Can our firm really do it, or will we need to buy it? What should we even be aiming to achieve? In asset management – an industry where new ideas are a stock in trade, but where age-old practices can be surprisingly durable – every firm and every leader seems to have their own answers.

KPMG therefore decided to undertake a major research project on innovation in partnership with Innovate Finance, based on interviews with executive leaders across a range of global asset managers. We intentionally sought out diverse perspectives across a variety of roles and functions, with an open canvas on what innovation might mean to different individuals, functions, firms and the industry as a collective. Instead of seeking definitive

answers, we asked contributors to discuss the core characteristics of innovation, to explore grey areas and to offer their views on achieving success. We are hugely grateful to all our participants for their time and insights.

This report sets out the key findings from our research. It seeks to unpick what innovation means in the asset management industry, why it matters, why it can be difficult and which ingredients are required for success.

As we explore in "[What innovation have we seen in asset management, and what's to come?](#)", the industry has achieved some notable innovations in recent years, particularly in responding to client demands driven by ESG and the creation of new asset classes. The sector is arguably more creative than it gives itself credit for. But there are still huge gains to shoot for and the need for greater agility and pace is evident. There is a long way to go before we can say that a strong innovative culture is the industry norm.



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Key takeaways

If we could communicate only a handful of messages to industry leaders, our standout takeaways would be that:

-  **1. Urgency – asset managers need to act now** – Why? The bar for value creation has been raised by transformative technology, geopolitical instability, climate change, investors' focus on the impact of their investments, and higher expectations for digitalisation and ease of investment access.
-  **2. Innovation is more than just new products** – it's the right outcome, delivered in an accessible way for clients at the optimal price. The industry continues to focus on innovative products but the other two factors need more focus to remain relevant to clients.
-  **3. Innovation is never optional forever. If asset managers don't act, someone else will** – consolidation continues and the threat of new entrants is increasing with peaked interest on delivering to retail investors.
-  **4. There are 3 key characteristics where innovation has been successfully delivered:**
 - Moving at pace – fail fast, and fast decision making
 - Strong clear sponsorship and funding
 - Collaboration – within the organisation.
-  **5. Greater collaboration is needed across the industry** – significant efficiencies that can be achieved by organisations on their own have largely been achieved, the next step change will come when the industry works together and with other key players, particularly with regulators.
-  **6. Innovation should not be a one-off transformation but treated as part of the organisation's DNA** – in order to create the possibility of disruption across the value chain, most asset managers have some way to go before innovation is embedded across the firm.
-  **7. Clients should be the key driver of innovation in the next wave** – there was a recognition that innovation to date has typically focused on product, and there is a need for it to pivot further into benefiting end investors.
-  **8. Asset management on the whole underplays the role of technology** – relative to other industries. The rise of emerging technology means managers need to look at what this can offer, and rethink the way they do business and service clients today. To attract talent to innovate you need to place technologists more centrally to help disrupt and reimagine.



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What does innovation in asset management mean?



Innovation is now very much a widely used term, but what exactly is innovation, beyond a generalised view that it involves doing things differently?

All innovation is novel, and technology is often vital, but most would agree that novelty and technology are not the whole story. The concept of innovation seems to imply something more intangible: solving a problem in a fundamentally different way or realising previously unthought of opportunities. The world's leading technology companies rarely innovate through technology alone; they also draw on unlimited thinking, ambition and execution.

“Innovation and change are linked, but not all change is innovation. Innovation is fundamentally a different way of doing something.”

Head of Change

Debate over the meaning and value of innovation cuts across every industry, but views in asset management seem to

be particularly divided, even polarised. Is innovation about incremental improvements – doing things better, faster and cheaper? Is it about finding new ways to deliver existing products and services? Or is it about transformation, differentiation, disruption?

Our research found that while over half of respondents defined innovation in terms of intangible factors like new thinking, mindset or agility, other popular themes included efficiency, technology, value, transparency and client needs. Perspectives were influenced by firms' circumstances and individuals' personal experiences, and there was little consistency of opinion between similar roles and functions.

We also heard different perspectives on the ease of innovation depending on the size and nature of an organisation. There is a school of thought that large global asset managers and those linked to bigger financial groups have the strongest innovative potential, thanks to balance sheet capital that can be deployed to invest in scale experiments or partnerships, and available resources to execute. Set against that, some respondents suggested

that large firms can be cautious or slower due to legacy systems and processes, preferring to refine the core than to disrupt existing business models. Whereas driving significant change in a large organisation is sometimes seen as the equivalent of trying to move an oil tanker – difficult with large ripple effects – smaller, niche players are seen as having some potential advantages in terms of agility and the lack of legacy infrastructure. Counter to that some interviewees felt that smaller firms' desire to innovate is often a defensive strategy to protect against the threat of larger rivals seeking inorganic growth – and that smaller organisations can prefer to wait until bigger players have experimented with new approaches given budgetary focus. Is size really a factor, or are successful firms those that find a way to innovate within their constraints?

“Large organisations are good at gradual innovation, but is gradual innovation real innovation or just business as usual?”

Head of Institutional

This lack of consensus on what innovation in asset management means should not be surprising. In many sectors it's relatively easy to point to the products of successful innovation – like smart phones – and work backwards to identify the ingredients of those outcomes, such as the chemically strengthened glass invented by Corning in 1960. In asset management, the process is much less clear cut.

“You tend to think of other industries for innovation rather than asset management. Innovation will make the future better, but it requires time, money and intellect.”

Head of Strategy

In part this is because one key area of innovation – new investment strategies and asset classes – typically requires several years for ideas to be tested and rolled out, and several more years before success can be fairly judged. Investment innovations are also inherently low-profile. Visibly game-changing innovations, such as the creation of ETFs, are rare. Innovations in other areas like operations or client experience tend to be incremental in nature and often go largely unnoticed by the financial public.

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Innovation is...

"...challenging the status quo to provide a better service, price or experience for customers. It is more than new tools and a new supply chain."

Chief Operating Officer

"...thinking laterally and breaking the norm – are there other ways to solve a problem."

Chief Technology Officer

"giving clients things they need but don't realise they want today."

Chief Investment Officer

"...the ability to monetise something you do today or to create a new value proposition by changing the way you work."

Chief Operating Officer

"...product innovation – it is about beating other people to the punch."

Finance Director

"moving to the edge of what we do – it's about ease, efficiency and transparency."

Chief Operating Officer

"...either doing new things or doing old things more efficiently."

Chief Executive Officer

Some key areas of industry debate about the nature of asset management innovation include:

1. Invention or adaptation?

Is genuine novelty required, or can new applications of existing ideas be innovative? To put it another way, is innovation about the result or the approach?

"In some cases innovation can be minor adaptations to meet client needs. In other cases it can be about creating new businesses."

Head of Strategy

2. Broad or narrow?

Is stimulating greater enterprise-wide experimentation essential to achieving successful innovation? Or can siloed efforts and investments deliver worthwhile gains?

"We dismantled our innovation lab because it was too standalone – it lacked ownership and sponsorship from the areas that needed to feed into it and it didn't connect back to the business."

Chief Financial Officer

3. Fast or slow?

Does innovation always need to be quick to avoid cost build-ups and obsolescence? Or can patience be helpful – such as when building a 3-year track record for new investment models?

"Really it's about timing and what we can do ahead of everyone else."

Chief Financial Officer

4. Evolution or revolution?

Can incremental improvements such as those provided by automation be considered as innovation if they are gradually transformative? Or does this lower the bar for innovation too far, limiting the ambition of asset managers?

"You need to balance evolutionary things and revolutionary things – a relentless focus on automation is not massively innovative but can be transformational."

Chief Technology Officer

5. Leading or following?

Is it enough to be a fast follower, with a focus on safeguarding margins and reducing costs? Or is real innovation about pioneering genuinely new thinking – encouraged by a willingness to take risks, accept setbacks and make mistakes? In truth, the gap between these is shrinking as innovation becomes less of differentiator and more of a core requirement for asset managers.

"We do not need to be at the forefront, but we need to be 'fast followers'."

Chief Executive Officer



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Perhaps it is impossible to agree a single, shared definition for innovation in asset management. Even so, a degree of consensus is vital if firms are to align their internal thinking and plans for innovation. Through the healthy debate we observed three key areas of commonality around the purpose, intention and beneficiaries of innovation:

 **Client outcome**

The outcome should always benefit the end investor. Even where the immediate objective as an example is to source new methods of creating alpha, this needs to translate into positive return, impact and experience whilst also managing cost to manufacture. It may also involve focusing on what clients want tomorrow, rather than what they need today, based on an informed analysis of future requirements.

“Innovation is driven by client needs – you need to follow clients’ needs and anticipate where you can.”

Head of Digitalisation

 **Pace**

The benefits of innovation may take time to be felt, but the process itself needs to be rapid to control costs and remain current.

 **The organisation’s DNA**

Innovation needs to be a consistent part of an asset manager’s fabric, displayed through behaviours, value creation and execution. Culture and mindset came up strongly as being central to innovation, with an emphasis that an innovation culture is a tone set at the top and reinforced by executive sponsorship, a clear vision and story around the purpose of innovation for the firm, and accountable owners.

“What words come to mind when you think of innovation?”

Disruption Technology **Culture** Execution Engaging Diversity
 Distributed ledger technology Growth **Pace** Long-term Puffery Credibility Creativity
 New Forward thinking **Challenge** Confusion Talent Threat **Mindset**
 Network **Alpha at scale** Progress Empathy **Change** Necessary Data Resources
 Improvement **Eyeroll** Difficult **Open mindedness** Thought Better Vision **Adjacent possible**
Clients Survival Commercial **Opportunity** Courage Useful Risk
 Underfunding Next generation **Excitement** Computing power **Incremental** Energy

In summary, there is little consensus over the nature and meaning of innovation in asset management. In a diverse industry, this wide spectrum of views may not be a disadvantage. It has not stopped firms from pioneering new products or those with sufficient scale and funding from experimenting with cutting edge ideas, but it does seem to make it harder for many asset managers to generate the clarity and

vision that are crucial to generating demonstrable enterprise-wide benefits from innovation.

As such, firms cannot afford to ignore key areas of debate. Every asset manager should ensure it is hearing a range of opinions and developing a balanced understanding of innovation that suits its specific circumstances. We return to this concept of an ‘innovation spectrum’ in [“How to innovate well”](#).

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Why does innovation matter in asset management?

In many other industries, leading firms now view innovation as a non-negotiable element of their DNA.

Continuous innovation is no longer the mantra of Silicon Valley alone, it's increasingly central to business strategies in sectors as diverse as retail, entertainment, healthcare, manufacturing – and finance. Academic studies see positive long-term correlations between innovation and profit margins, earnings growth and total shareholder returns, such as [Are Innovative Companies More Profitable?](#)

Of course, innovation is not without its risks. It carries no guarantee of success and can often be costly or time consuming. Where it distracts management or disrupts core activities, it risks alienating existing customers or creating reputational damage.

The potential for artificial intelligence (AI) to reinforce human and gender bias is a case in point. For example the [Chartered Insurance Institute has highlighted](#) the risk of automated

decision making applying gender biases learned from historical data, which can result in females being charged higher premiums, receiving less in claims settlements or facing a greater exposure to mis-selling compared to their male counterparts.

The possibility of unintended consequences can also make us wary of change too. Environmental pollution and online hatred are just two unwanted side-effects of the smart phone's invention. Innovation in asset management has also arguably not always fully delivered – for example providing new sources of alpha (such as green funds and digital assets), but without necessarily achieving a step-change in client experiences or net investor returns.

The temptation to spend resources elsewhere can be particularly strong in asset management, where aggregate profit margins have historically been higher than in many financial sectors. Experience of disappointing cycles of problem solving and short-term fixes – often wrongly labelled as

innovation – may also be off-putting. And the disruptive power of innovation can seem unnerving to an industry used to projecting reassurance to clients. We explore this further in the [“barriers to innovation”](#) section.

“Necessity is the mother of invention, but we have not had the necessity.”

Head of Strategy

However, not innovating at all, or failing to maintain innovative momentum, is often the riskiest option – as illustrated by the likes of Toys R Us, Tower Records, Borders Books and General Motors. Whilst asset managers haven't historically been under as much pressure as other industries to innovate proactively given their typically high profit margins, this tide is clearly changing and almost all of our interviewees for this report see innovation in asset management as crucial to both protecting and creating value and remaining competitive. They cited

strategic purposes that ranged from reacting to industry developments to enhancing business as usual or totally transforming current industry practice.

“Margins are increasingly being eroded – you need to evolve the business model to stay competitive.”

Chief Financial Officer

Innovation can help asset managers to achieve positive differentiation; to keep business models lean and competitive; or simply to maintain relevance in a rapidly changing world. In contrast, a failure to innovate will leave even the most successful firms at increasing risk of being outcompeted or acquired by those that do, with competition being driven both from within the industry and by the growing number of new market entrants. High profit margins may provide some protection now, but these can quickly be eroded and it often becomes more challenging to then invest in the necessary innovation once a firm has fallen behind the curve.



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Based on our research, we group asset managers' motivations to innovate into two broad categories – push factors and pull factors.

Push Factors

Downside risks provide the burning platform for innovation. One firm's emerging concern may be another's existential threat, but all push factors involve some combination of competitive forces and other adverse changes in the operating environment. They include:

- **A shrinking institutional client base** – There has been growing consolidation and purchasing power among asset owners. They are also becoming more sophisticated buyers, strengthening their in-house investment management teams and looking to partner with fewer external managers – with a focus on those that are able to offer diverse product offerings backed up by effective, agile and scalable operations.
- **Changing end investor preferences** – The growing importance of understanding individual preferences made difficult by the continuing dependence of many asset managers on distribution intermediaries ranging from IFAs and platforms to investment consultants.
“How can we build new relationships when there are fewer in-person interactions – could the role of digital actually create more distance?”
Chief Technology Officer
- **Margin compression** – With average fee levels falling ever closer to zero and increasing costs of disclosure and compliance, profit margins will start to fall, particularly amongst mid-tier firms unless they have a distinctive source of differentiation. Asset managers face a challenge where ETFs and other passive funds with ultra-low cost beta offerings are creating a growing pressure on active fees. In addition, there is increasing demand for firms to pass on benefits of scale by reducing fees as assets under management rise.

“We are seeing players who used to buy mutual funds now creating their own vehicles and coming to asset management providers to be sub-advisors, lowering the bps seen on mutual funds.”

Chief Executive Officer

- **Competition from new entrants** – FinTechs and other players with strong data and technology capabilities present the possibility of cannibalising asset management revenues. Just as digital banks have done in retail banking.
- **A shift in investment assumptions** – Triggered by rising inflation and interest rates, as well as global tax changes and the post-pandemic trend of de-globalisation, the end of decades of falling yields could call many investment strategies and business models into question.
- **A volatile global political environment** – This is driving the need for Asset Managers to become much more agile in their ability to respond and adapt quickly to changes.

“Our industry is facing a number of challenges now – increased regulatory scrutiny, complex geopolitics, reducing margins - we're having to do more, but with less.”

Chief Executive Officer

Innovation

Pull Factors

Potential upsides represent positive motives for innovation, especially in the longer term. However, they can be imprecise and hard to quantify. We have grouped the potential value that innovation can create around some of asset managers' most important stakeholder groups:

- **Investors** – Innovation offers a huge range of opportunities for asset managers to improve investor choice, outcomes and value for money. Close, constructive client relationships will build investor trust – for example, by guiding investors through market volatility and demonstrating how asset managers create value. Possible examples include:
 - Increasing investor returns, either by identifying new sources of alpha or by reducing costs to serve.
 - Using digital technology to make client experiences more frequent, frictionless and tailored – increasing engagement and understanding among individual investors, and delivering a holistic, unified asset management offering to institutional clients.
 - Aligning investments more closely with investors' specific beliefs and preferences.
 - Improving transparency and accountability around the role of asset managers and the value they create.
- **Staff** – The ability to innovate depends on attracting, retaining and motivating the best talent. However, it's innovative companies that will find this easiest to achieve. Giving staff a strong sense of purpose, encouraging lateral thinking and incentivising creativity and experimentation can create the foundations to support talent acquisition and retention in this virtuous cycle.
- **Regulators** – The mandatory nature of regulation means that it is often viewed as a 'negative driver' of change. But conduct measures like the

new Consumer Duty are shifting the emphasis of regulation onto transparency and value, increasing asset managers' motivation to focus on delivering better investor outcomes. Growing regulatory requirements around ESG themes are also encouraging firms to better understand and implement investor beliefs.

“Regulation should just be shining a light on things we already care about.”

Head of Strategy

- **Shareholders** – By defending asset managers against margin pressure and creating positive future opportunities, innovation can be a strong value creator for the owners of asset management firms.
- **Society and the environment** – Asset managers have increasingly important societal and environmental responsibilities. Innovation can not only help to fulfil these, but also to enable asset managers to lead on global causes. Possible examples include:
 - Using digital interfaces to provide better financial education to investors, as well as improving accessibility including reaching younger investors, underserved demographics and those in less sophisticated markets.
 - Applying innovative techniques and data to better manage ESG risks, collaborating with peers to agree industry standards for tangible ESG measurement and reporting, and improving real world outcomes in areas such as carbon emissions and biodiversity.

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What about barriers to innovation in asset management?

Innovation is all about looking forward, but it's important to look back too if asset managers are to identify the lessons – both positive and negative – they can learn from experience.

Recent years have seen many innovations in the industry, ranging from the shifting ESG focus and the development of factor and thematic investing, to the application of AI to portfolio management and the emergence of digital assets.

Even so, many industry leaders admit to feeling that asset management has not always been as fast to embrace innovation as other sectors of financial services. It's certainly true that the investment vehicles which remain central to the industry have only undergone a few truly transformative changes in over a century – namely mutual funds, hedge funds, UCITS and ETFs, which largely appear at the core as they did when they first launched. Furthermore, innovative efforts on the operations side have often focused on outsourcing as a route to greater efficiency.

The industry's strong levels of profitability also raise the question of whether the benefits

of innovation – and of growing scale and industry concentration – have been passed on to investors or retained by asset managers themselves.

Whatever the core reason is, our research clearly shows that asset management leaders see several reasons why the industry may not always be as innovative as it could or should be. The obstacle to innovation cited most frequently is one we have already mentioned: **A lack of economic necessity**. But while this may have been true in the past, it seems less likely to remain so in future with the continued squeeze on alpha and pressure on fees, as well as growing competition, rising investor expectations and changing consumer demographics.

So, what other barriers to innovation are there in asset management? Our research points to several possibilities, each in some way related to the others.



Regulation

Asset management is heavily regulated and this perceived inflexibility is often cited as a barrier to innovation. However, some leaders

admit this can sometimes be a convenient excuse. As we explore in the next section on "[How to innovate well](#)," firms and regulators could work together more closely to improve investor outcomes, particularly with the growing focus on consumer duty which looks to ensure that customer needs are put first and foremost. Regulators are also focusing more on how they encourage innovation whilst still mitigating risk. For example, the Monetary Authority of Singapore (MAS) was cited positively as striking a well-balanced stance here.

This approach could become a growing international theme, with regulators in multiple jurisdictions trying to lower the barriers to innovation in order to make their market more appealing for investment. The UK's Financial Conduct Authority (FCA), for example, has initiated an innovation advisory group which acts as a panel to advise on innovation; increased its focus on recruiting skillsets from the technology industry; and allowed applicants to enter a [regulatory sandbox](#) to further encourage and stimulate innovation in the market.

"Blaming the regulators feels like red herring and scapegoat – other industries are managing to innovate whilst facing similar regulatory requirements."

Chief Operating Officer



Balancing regulation & innovation: Monetary Authority of Singapore (MAS)

The mission statement of MAS is "To promote sustained non-inflationary economic growth, and a sound and progressive financial centre", and it is frequently cited by asset management leaders as facilitating financial innovation and encouraging the creation of innovation labs in Singapore.

One of MAS' key initiatives is the FinTech Regulatory Sandbox, which relaxes certain regulatory requirements for selected FinTechs, permitting real world experimentation within appropriate safeguards. In 2015, MAS launched the Financial Sector Technology and Innovation scheme – which has provided rounds of grant funding worth hundreds of millions of Singapore Dollars – and in 2020 it launched the Global FinTech Innovation Challenge to search for "innovative solutions that can help financial institutions respond to two critical global challenges: COVID-19 and climate change."

In 2022, MAS launched Project Guardian, a collaborative initiative with the financial industry, which aims to "test the feasibility of applications in asset tokenisation and decentralised finance (DeFi) while managing risks to financial stability and integrity."



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 **Short termism**

Asset managers face continuous pressure to beat the market. For listed firms, quarterly reporting adds to the sense of being on a performance treadmill. Short-term ROI metrics abound and are often reinforced by internal KPIs and remuneration criteria. The result is limited appetite for making patient in-house investments of time, capital and resources required for new approaches to bear fruit, to transform efficiency, or to grow new products to a commercially viable scale.

 **Culture and mindset**

Interviewees frequently cited cultural resistance or lack of motivation as a key limiting factor in both adopting an innovation mindset and delivering success. Culture as a topic had a number of threads to it:

- **Disincentivisation.** Short termism is often reinforced by a lack of incentives to innovate – and in some cases even incentives not to do so. These include risk appetites that discourage experimentation; the difficulty of defending intellectual property in the investment world; a lack of support and enablement for potential innovators; and executive reward structures that make leaders wary of uncertain outcomes or benefits that will only be realised in the longer term. It is very hard to create a ‘permission to fail’ culture when avoiding failure is seen as critical to career advancement.

“Setting the right tone from the top down is very important.”

Chief Technology Officer

- **Fear of failure.** In addition to the tone set at the top of house, regulatory anxiety and concerns around financial waste or reputational damage (both firm and individual) compound this fear. This can deter experimentation, prevent innovation from being given enough time to develop and stop failing programmes from being halted in a timely way (see [“Deciding” pitfall in the next section](#))

“Striving for perfection is the biggest barrier to innovation – you need to be prepared for some things to fail and to learn.”

Chief Operating Officer

- **Resistance to challenging the status quo.** As in every industry, individuals may be wary of innovation that could make their role redundant. In addition, a fast-moving ‘trial and error’ mindset does not sit easily with asset managers’ instinctive desire to reassure investors.

“There can be an assumption that the same things will always be successful.”

Chief Operating Officer

 **Governance**

Applying the firm’s standard change governance framework to innovation projects or ideas is often a cause of frustration and delays, counteracting the need for pace described earlier. Balancing the need for empowerment, with effective steering (to stop or progress experiments) via a robust

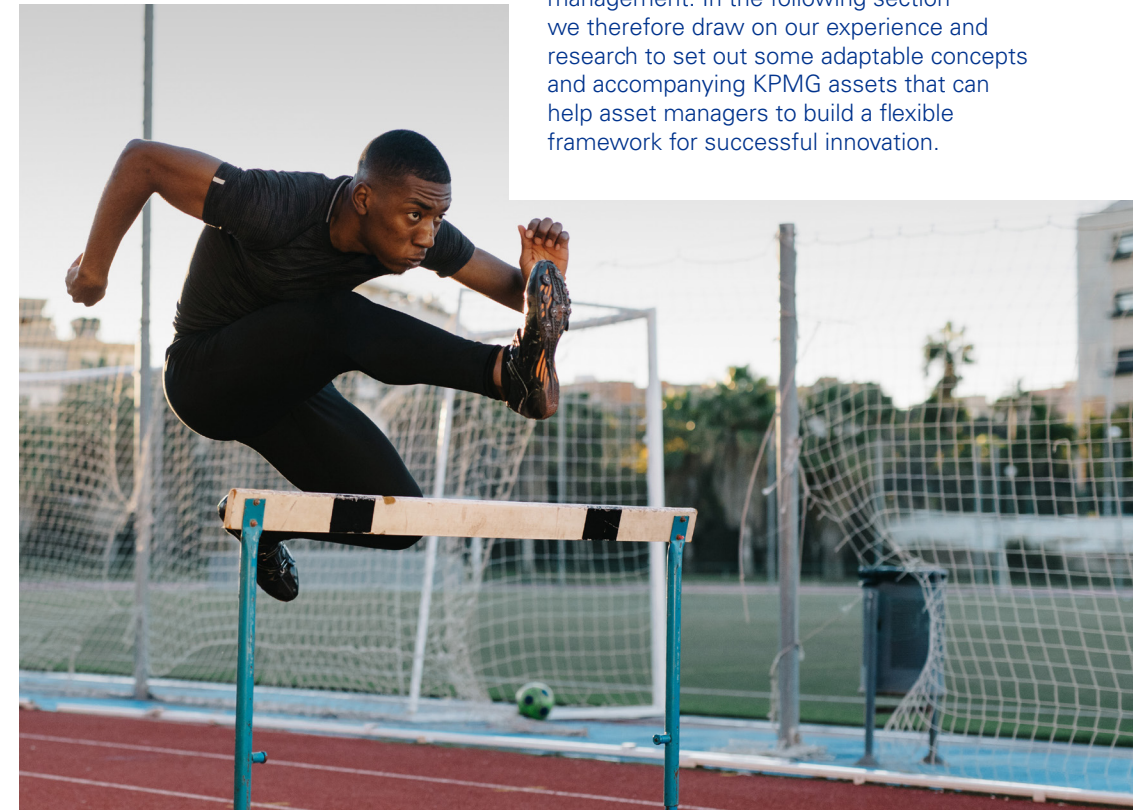
yet rapid assessment process is a much-needed step change within the industry. This also includes the flexibility to swap priorities for projects already in-train and adjust the programme of work in a timely way. We explore approaches to addressing this in the section [“How to innovate well”](#).

“Innovation can fail because people get in the way (people with different attitudes, mindsets, priorities).”

Chief Financial Officer

One firm’s major challenge may be another’s minor obstacle. Even so, our research gives a clear impression that few industry leaders feel completely in control of innovation. It often seems to be perceived as something that other organisations do better, that is only accessible to those with large capital budgets, or that is impeded by factors beyond asset managers’ influence.

Overcoming barriers to change and taking control of the innovation process is clearly vital to successful innovation in asset management. In the following section we therefore draw on our experience and research to set out some adaptable concepts and accompanying KPMG assets that can help asset managers to build a flexible framework for successful innovation.





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How to innovate well in asset management?

Given the importance of innovation to long-term success – but also the obstacles that firms face, and the risks that innovation can bring – it's essential to understand how to innovate well in asset management.

To explore this more deeply, we used our research to understand how firms can establish a clear strategic view of their innovation goals and consistently use innovation to anchor their outcomes to delivering the right offerings to the right investors, in the right way and at the right price.

In our view, the answer doesn't necessarily lie in big bang solutions or transformational change. Ideally, good innovation should be a core competence that's integral to an organisation's culture.

“If you want a forest then you need to have planted it 50 years ago.”

Chief Technology Officer

Embedding innovation into the DNA of asset managers creates an enabling environment that will continually generate, test and implement new ideas. This will help firms to pivot to emerging

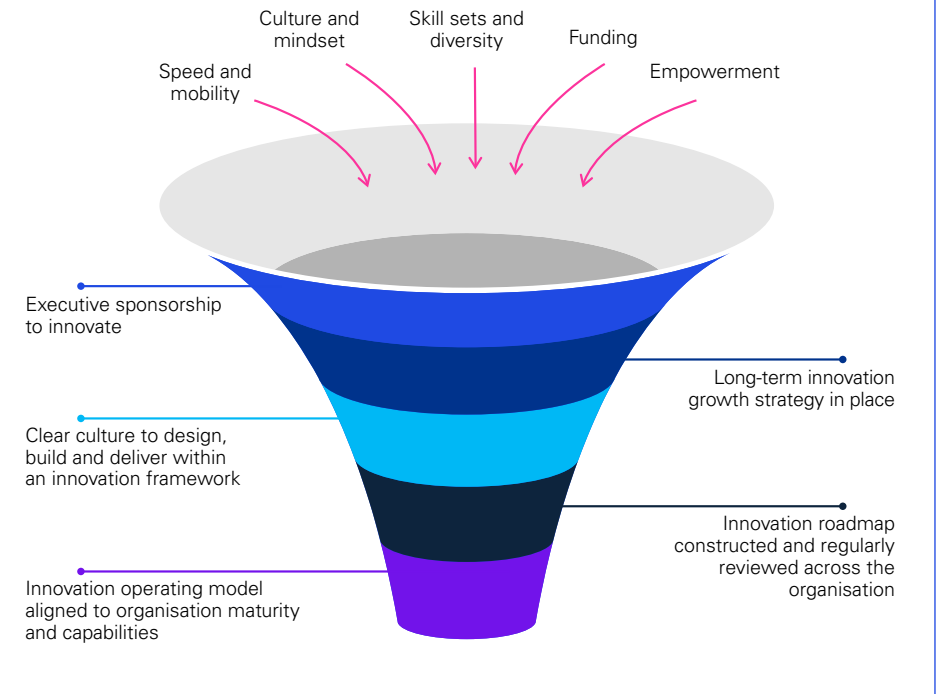
opportunities, and to defend against disruption by problem solving future uncertainties effectively.

Every asset manager is unique and, as we have seen, views about innovation vary widely across the industry. An adaptable core framework can help firms to avoid false choices between evolution and revolution, allowing asset managers to evolve towards revolution in the way that suits them best.

1. Best practice: What good looks like

Successful innovation can occur in any area of the asset management industry, depending on the capabilities, resources and ambitions of different organisations. Recent examples of successful innovation span portfolio management (such as analysing alternative data for investment signals), operations (such as the automation of reconciliations) and distribution (such as lead generation for sales teams). Even so, many areas of asset management activity appear relatively untouched by innovation in recent years. To optimise their resilience against competition, asset managers should seek to innovate right across the enterprise. That includes enhancing their current capabilities and developing new ones, in response to disruptive forces and the emergence of new service opportunities.

The ingredients for innovating well



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There is no simple way to define best practice in innovation, but our research suggests that the industry's most successful innovators often display two key features.

One is **the right organisational structure**. Innovative asset managers use a range of organisational models, ranging from dedicated hubs that centralise resources and decision-making to decentralised approaches that aim to embed innovation throughout the firm. There seems to be some correlation between an organisation's overall innovation maturity and its level of decentralisation, suggesting that firms may be best to start with centres of excellence to create focus and enthusiasm before working towards an integrated culture of innovation over time (thus avoiding unintended silos). Firms may also find that the optimal model involves a mix of innovation embedded across existing business lines and the creation of additional business lines for ideas that are better served through new structures. Whatever organisational structure is chosen however, there are certain underlying principles that need to exist in all models in order to ensure investment is made in the right places and that teams are empowered to explore and experiment.

"Innovation is a decentralised effort – I'm a strong believer in empowerment with everyone thinking."
Head of Digitalisation

"You need to embed engineers in business/investment teams and remove the layer of business analysts to create self-service teams."
Chief Technology Officer

The second key feature is an **innovative culture and mindset**. This underpins the chosen structure, whatever it may be, and helps it to deliver continuous innovation. Key characteristics of a successful culture of innovation typically include:

 **Strong leadership**

Robust endorsement and sponsorship from leaders are key to driving innovation and ultimately embedding it into everyday ways of working. It should provide clarity over the desired outcomes and responsibilities for innovation, with the right mixture of governance and encouragement. For example, one leading asset manager overcame challenges with its decentralised approach to innovation by

creating an innovation council with senior leaders in attendance and a budget funded directly by the CEO for innovation projects. This created positive energy within the firm, recognising leadership interest and backing for new ideas generated on the ground.

 **Continuous communication**

Constant interaction across the organisation is vital to maintaining close partnerships between innovation hubs and spokes, and to avoid siloed thinking.




"A high conviction in communicating your strategy helps to get buy-in. Innovation is then driven by problem solving (rather than centralising it)."
Chief Financial Officer

 **Innovation awareness**

Detecting innovative potential throughout the lifecycle of techniques and technologies is also important. This means not only identifying potential use cases for the latest developments (such as quantum computing) but continually exploring cutting edge solutions that may be suited to replacing existing tools.

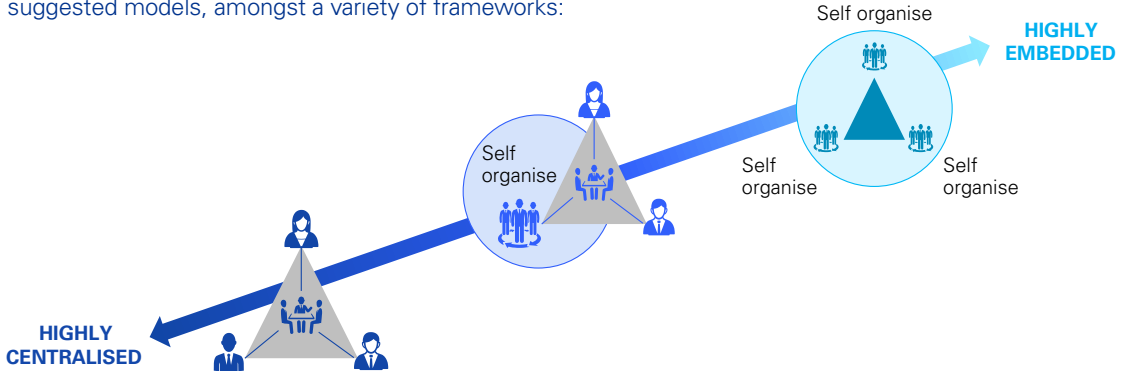
"There are two set of imagination – people who understand what tech brings, and people who understand the business context and how you would apply that technology. You need to have people whose job it is to make those connections."
Chief Operating Officer

Considerations for an optimal innovation organisation:

-  **"Do you have ringfenced funding?"**
-  **"How are decisions made and overseen?"**
-  **"Where does the majority of innovation happen in the organisation today?"**

Innovation organisational model options

We observed varied ways of implementing innovation across organisations with varying degrees of success – these are some suggested models, amongst a variety of frameworks:



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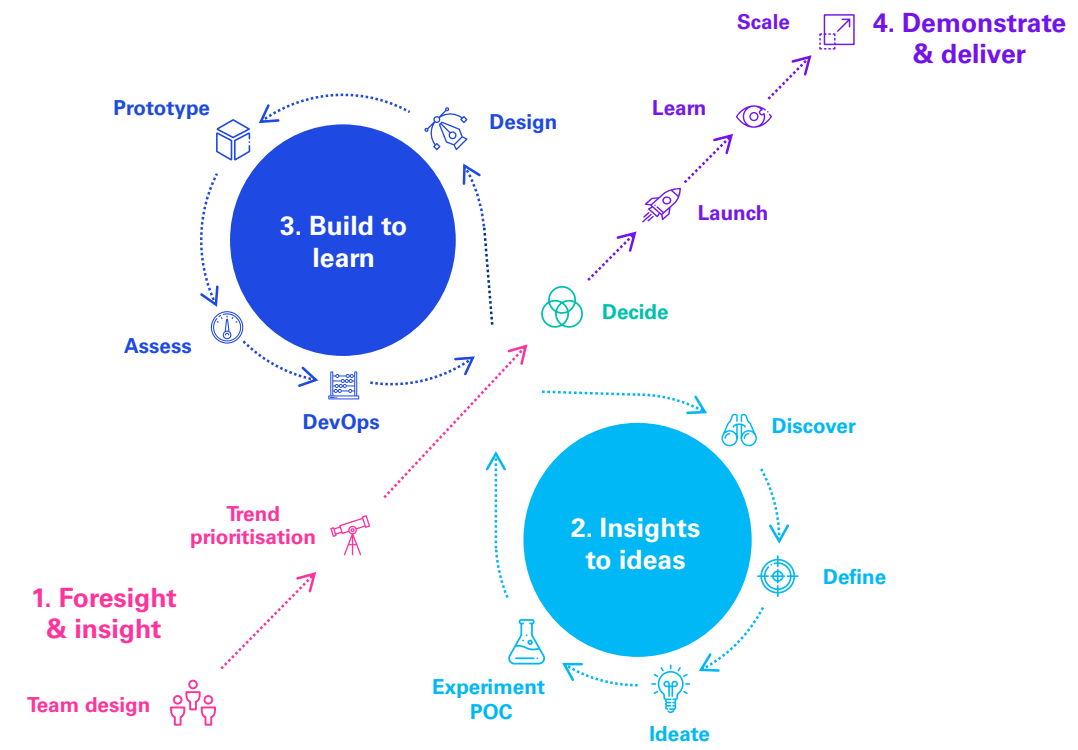
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2. Pathways and pitfalls: How to innovate well

If best practice is the goal, how can asset managers get there? At KPMG we use a four-stage model to visualise successful innovation, supported by subject matter experts and collaborative hubs such as the [KPMG Insight Centre](#) and [KPMG Illuminate](#). Pathways like these can help firms to understand best practice and model it in their own organisations.

Our model for the process of innovation is comprised of four key stages:

1.	<p>Foresight & insight</p> <p>Researching and analysing external drivers of change such as economics, demographics and competition; considering the implications for products and services; identifying new technologies and capabilities; and prioritising relevant insights.</p>
2.	<p>Insights to ideas</p> <p>Exploring, building and testing ideas; sharing them with the C-suite; assessing potential benefits and the required resources and partnerships; and prioritising innovations based on market assessments and customer research.</p>
3.	<p>Build to learn</p> <p>Gaining sponsorship and mobilising resources; designing and building innovation prototypes; conducting iterative testing with continuous feedback; and creating a hierarchy informed by the application of similar ideas by rivals or start-ups.</p>
4.	<p>Demonstrate & deliver</p> <p>Deciding whether to repeat the development cycle, hand over to delivery teams, outsource delivery or halt the project; providing the support needed for launch, improvement and scale-up; and using feedback from early adopters to refine the concept.</p>

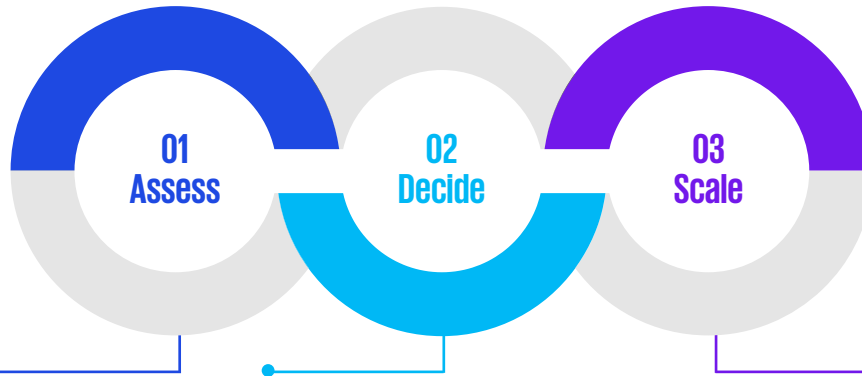


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Common pitfalls

Regardless of their chosen approach, our research shows that asset managers seeking to embed innovation pathways often get stuck at similar points as they seek to turn ideas into tangible, scalable products and services.



The first pitfall is **assessment**. Common problems include a failure to adapt in response to diverse stakeholder feedback, or allowing a tunnel vision – such as fixed ideas about firms’ activities – to hinder innovation. Using the “5 why” framework pioneered by Toyota can help to get to the bottom of assessment problems.

The focus of assessment can sometimes narrow too quickly, leading to missed opportunities to identify innovation potential or necessity. It’s also important to ensure that the process brings together different perspectives, particularly technology and business representation.

The second sticking point is **deciding**. This is about the frequency and speed with which innovations are reviewed and either pursued, paused or abandoned. Quarterly or half-yearly review cycles, backed up by fear of failure, can hinder the innovation process by preventing ideas from failing fast and committing too many resources to unsuccessful projects instead of channelling them to where they’re most needed. One useful approach can be to add paused projects to product roadmaps, so they can be revisited and revamped in future.

The third and arguably the greatest hurdle is **scaling**. The practical barriers to scaling innovative products and services are well known. They include devising and executing a market entry strategy across segments and regions, as well as embedding a new service across the whole organisation. Appropriate resourcing, clear branding and effective partnering can all help to leverage the positive experience of early adopters and expand to widespread uptake.



“You need a balance of near-term quick wins and evolutionary things versus further down the line and potentially revolutionary things.”

Chief Technology Officer

“You need to think beyond foundations otherwise change will be too slow. It’s about standing up MVPs to get some early wins.”

Chief Operating Officer

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3. Key levers: Enabling successful innovation

Innovating well means combining formal processes and practical resources with the right enabling factors and qualitative elements. Based on our research, we see the following as key levers to enable successful innovation in asset management – in addition to the availability of funding.



Focusing on investors

Benefits to end investors should be integral to the innovation process. Using clear design principles can help asset managers to set guidelines that will align ideas and implementation with client interests. Effective guidance should emphasise the importance of suitability, transparency and fairness, backed up with clear ethical principles – especially when it comes to the analysis and use of personal data.

For many asset managers this also heightens the need for collaboration across the value chain in order to be clear on who their end clients are, and to develop an 'outside in' understanding of them.

“Continuous improvement comes from staying close to clients, listening to customers, being client led, and viewing relationships as strategic and long-term.”

Head of Institutional



Getting technology right

Technology does not create innovation by itself, but it is often the critical solution enabler. It plays a vital role in visualising creative solutions

and changing our perceptions of what's possible. Making optimal use of technology means maximising the value of in-house systems (which can provide a competitive advantage) while making effective use of external providers (which can offer wider or faster capabilities). Striking the right balance is key to ensuring that operating models are agile enough to support high-quality innovation. Firms have used client data to generate tailored insights, and acquired the human skills needed to research and harness new technologies effectively, which have become sub-enablers to the technology success. Technology's true power to disrupt and revolutionise the entire asset management ecosystem can be unleashed when the industry collaborates and coalesces around core emerging technologies as we outline in [“What innovation have we seen in asset management, and what's to come?”](#)



Talent & diversity

This encompasses several elements. First, building a future-facing workforce. That involves identifying skills gaps, hiring talent with expertise in areas that will increase in importance in the future, and supporting the development of new skills over time to avoid the need to re-recruit. Second, identifying a wide range of talent, building the diversity of thought (both professional and personal) that will help to maximise idea generation, optimise risk identification, and create a pipeline of future leaders. Studies have shown a clear link between the diversity of an organisation and its ability to innovate – 85% of executives in a [Forbes study](#) either strongly or somewhat agreed that “a diverse and inclusive workforce is crucial to encouraging

different perspectives and ideas that drive innovation” and [Harvard Business Review research](#) found that employees at companies with two-dimensional diversity (categorised as those with leaders who exhibit at least three inherent and three acquired diversity traits) are 70% likelier to report that the firm was able to capture a new market. Thirdly, offering a holistic employee value proposition that matches attractive rewards with recognition, experience, development and advancement – including a high level of mobility in career paths.

FinTechs and tools such as SimplyGetResults can be utilised here to provide a global mapping of skills that you have and those that you need across the organisation, as well as creating visibility for employees on their development path and internal mobility opportunities. These tools, powered through AI and analytics, benefit and help support both talent retention and the effective planning of future skills and workforces.

“Hiring the right people from diverse backgrounds is essential for driving innovation.”

Chief Operations Officer



Empowering people

Empowerment is about encouraging all staff to view innovation as integral to their jobs, whatever their core responsibilities. This could include giving people the time and permission they need to think outside the norm; providing suitable forums for ideas sharing; connecting innovators with stakeholders throughout the organisation; or encouraging a sense of intellectual freedom that offsets regulatory

self-censorship. Having appropriate incentives and motivations in place for staff to innovate – alongside achieving an open, no blame culture – is crucial to encouraging experimentation and learning from failure. For some staff – such as technologists – it is important to create roles with appropriate prominence and independence. This will aid in the creation of self-service innovation teams that can operate with limited support from the centre.

“Creating a constant conscious research mindset across the organisation is valuable.”

Chief Technology Officer



Maintaining speed

“Do it fast or don't do it at all” is a key theme of successful innovation. Speed helps firms to respond to new developments, achieve quick wins, maintain efficiency and maximise the value of new ideas. Innovating fast is not about creating a sense of pressure. It is about reducing friction, making quick decisions and pivoting fast around obstacles. Innovative asset managers conduct rapid, regular innovation reviews that decide which projects should advance, which should be paused, and which abandoned. Effective prioritisation focuses efforts on the most promising projects – providing more time where justified, but also allowing ideas to fail fast. That helps firms to place smart bets and avoid trying to do too much at once.

“I'd rather pay for people's speeding tickets than their parking fines.”

Chief Executive Officer

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4. Review and revisit: Seeking continuous improvement

Continuous improvement is important to ensuring that innovation is not only embedded within asset managers' DNA, but that it also improves in line with evolving best practice. In our experience, firms can help to maintain high standards of innovation by regularly ensuring that they can confidently answer the following questions:

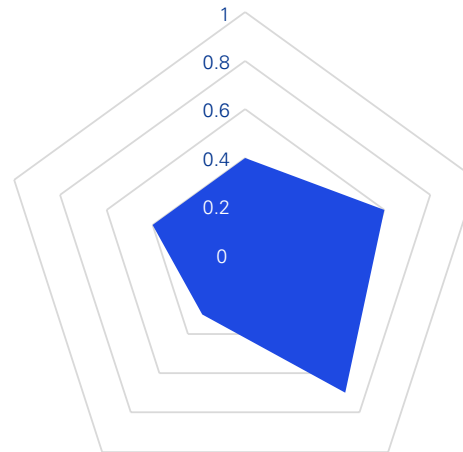
- ✓ Do you have a clear innovation strategy that's supported by the C-Suite and aligned with your goals and ambitions?
- ✓ Do you have supporting resources such as road maps, resourced plans, budget allocations and exit ramps that complement your innovation strategy?
- ✓ Is there an effective process in place for selecting, prioritising and managing innovation initiatives?
- ✓ Is there clarity on whether innovation co-exists or is embedded within the change and transformation portfolio?
- ✓ Is your innovation portfolio actively managed in response to market, technological and business developments?
- ✓ Do you have a clear financing strategy for your innovation activities and projects?
- ✓ Do you have metrics or KPIs that measure the impact of innovation on your business?

Our research also suggests that quantitative tools can help to map and monitor asset managers' innovation maturity. For example, KPMG's Innovation Maturity Scale ranks firms on five criteria covering funding, culture, empowerment, skills and speed. This periodic self-evaluation, such as for each stage of the four-step process outlined on p.13, is beneficial for monitoring what is working and what isn't, enabling the necessary adaptations to ensure that innovation is effective. It is also important to assess this with feedback from a diverse group of people to see how responses and evaluation correlates, for example technologists, change agents and business users as well as leaders.

Innovation Maturity Scale

Funding

What investment is going into innovation by the firm? How much time is allocated on innovative ways of working and roadmap revamps?



Speed and mobility

What structure is in place across the organisation? Are innovation teams centralised or decentralised across the organisation? What % of the organisation have innovation as part of their practices?

Culture and mindset

What is the message from the CEO-down on innovation? Is it part of the work-life culture?

Skillsets and diversity

Does the organisation have diversity of thought and the right skill sets available to innovate effectively? Is the way the working model set up attracting the correct talent?

Empowerment

How are employees empowered to take innovative ideas forward? What governance is in place to sponsor, steer and support innovative ways of working?



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5. Additional accelerators: Increasing innovative power

Whilst many of the building blocks for successful innovation relate to the organisation itself, not all barriers to innovation are internal, and not all solutions are entirely within the control of leaders. External engagement and partnering can play a vital role in optimising innovation.

External partners can help firms to embed innovation into their operating models and bring fresh perspectives and insights on the longer-term horizon for both the organisation and overall sector. That might include outsourcing specific activities to service providers, working with technology vendors, partnering with academia and acquiring the human skills required to drive innovation. Much like how asset managers already collaborate with advisors, brokers, exchanges and banks to perform some of their core activities.

“Building in-house can give a competitive advantage, but we are happy to use providers if there are good open-source options.”

Chief Technology Officer

Partnering with specialised technology providers is a particular area of focus for many successful innovators. FinTechs have increased firms' innovative agility and broadened the industry's sense of what technology can do, and what a positive digital experience could look like. They can provide fresh technology perspectives and

“There's a huge opportunity to get the right partnerships, for example many good companies are tackling disintermediation and simplifying the supply chain.”

Chief Technology Officer

have clear potential to give more firms totally new capabilities or to leapfrog legacy systems altogether.

Set against that, firms can sometimes find partnering with FinTechs more challenging than they expect. FinTechs' maturity tends to affect their scale, track record and ability to provide post-implementation support. Additionally, while business users may be excited about a solution that solves their day-to-day problems, technology and architecture teams need to be engaged effectively in order to consider how FinTechs will plug into and sit alongside enterprise platforms, ensuring cost effectiveness and alignment to the overall strategy.

“Partnering with tech firms can be difficult from a procurement perspective – a lot of them don't have the track record.”

Chief Risk Officer

Engagement with regulators can also help asset managers to accelerate innovation. Regulators in a number of jurisdictions are becoming increasingly proactive in their industry engagement, including promotion of cross-border innovation – such as the UK's HM Treasury and the Monetary Authority of Singapore's collaboration in FinTech matters

and broader ambition to “strengthen financial co-operation”. There is scope for firms in many markets to benefit from working more closely with supervisory authorities. ESG regulation, which incentivised a wave of innovation, is an example of a complex area where closer engagement between asset managers and supervisors could lead to more effective, harmonised investment practices.

Finally, asset managers can use targeted collaboration with their peers to develop new shared structures and practices. Our research shows strong appetite for industry-wide innovation, which has clear potential to address inefficiencies created by the industry's fragmentation and complex value chains. Client onboarding and the associated KYC (Know Your Customer) activities are often cited as an area where innovative collaboration has huge potential to improve speed, efficiency and compliance – benefitting firms and investors alike.

“There are challenges in trying to do things together rather than alone, but industry problems require industry solutions.”

Chief Operating Officer

Different partners will benefit different situations, and the nature of who firms collaborate with will depend in large part on the time horizon being considered. For example, FinTechs often help to provide a solution for immediate challenges, whereas working with academic institutions may be aligned more to focusing on the medium and longer term.



Tips for developing your organisation's innovation maturity:

- **Monitoring the latest industry developments, competitor initiatives and emerging trends** in technology to identify potential implications for innovation.
- **Creating a tailored blueprint for an innovation organisation** that includes an integrated innovation strategy; a suitable structural approach to innovation hubs and spokes; a target end state for innovation processes; key tools and KPIs to manage and enhance processes; and an overview of the key enablers required for successful innovation.
- **Developing the resources and capabilities that enable successful innovation.** These include investment capital, future-focused skill sets, investor data, strong leadership and effective stakeholder communication.
- Ensuring that innovation can occur at pace by **setting up rapid, agile decision-making and oversight** that will allow firms to fail fast, pivot quickly and overcome common barriers and pitfalls.
- Engaging with a range of potential partners including asset owners, FinTechs, industry bodies, competitors, regulators and government to **identify how collaboration can accelerate in-house innovation** activities.

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What innovation have we seen in asset management, and what's to come?

It's hardly surprising that conversations about innovation in asset management quickly veer towards the latest developments – especially in technology.

As we've seen, technology is a key enabler of innovation and the industry's leading source of disruption. Notable tech-enabled innovations of recent years include robo-advice, cryptocurrencies, follow-me investing, and platforms enabling the democratisation of private assets. Advances in technology are also a driver of urgency in the industry, and the broader business world, as illustrated by the recent surge of activity triggered by the release of ChatGPT (see more in the section "[ChatGPT and Artificial Generative Intelligence \(AGI\)](#)").

Keeping a close eye on the latest emerging technologies allows asset managers to grasp their implications for investors and firms, to learn from the experience of

pioneers in adjacent industries and to assess the potential for innovation to sweep away existing elements of the industry altogether. The recent report published by the Investment Association (IA) in July 2022 "[Investing for the Future](#)" explores three potential future paths for asset management, which we touch on later.

"What is interesting is the intersection between ESG, the mutual fund structure and technology. When there is so much pressure on not greenwashing, is the mutual fund structure the right construct for it?"

Chief Risk Officer

The innovative force of ESG

The importance of monitoring sources of disruption – and their implications – is illustrated by the impact of recent innovations. The revolution stemming from ESG is a prominent example of disruption forcing the

hand of innovation across the industry. Over the 16 years since the UNPRI framework was launched, we have seen the industry grapple with the need for greater transparency and clarity in areas including messaging, scoring methodologies, fund categorisation, asset allocation explanation and investment restrictions – all with the objective of unpicking what an ESG fund is and what it delivers in a way that is understandable to the end investor.

This focus on transparency is being further reinforced through regulatory scrutiny in the form of the SFDR, further consultation on sub-categories of Article 8 funds, and the interplay with broader client-focused regulations such as the UK's Consumer Duty.

Asset managers have had to respond in many ways, starting with the launch of new ESG funds – [Refinitiv Lipper data](#) shows that investment into ESG-focused funds more than doubled between 2019 and 2021 and ESG funds now account for 10% of fund

assets globally. But products are only half the story. Firms' business models have changed threefold, by:

- Creating new teams focused on ESG stewardship and new "head of" roles to lead on Sustainability and Responsible investing, with a focus on ESG investing as an asset manager.
- Revisiting their values, principles and ethos as corporates.
- Redesigning data and technology architecture to capture new data points to generate meaningful insights that tell the impact story.

These changes are intertwined, reinforcing one another as investor and industry scrutiny grows on "walking the walk not just talking the talk". Due diligence and asset manager selection increasingly places prominence on who their assets reside with, not just the talent and capability to stock pick.



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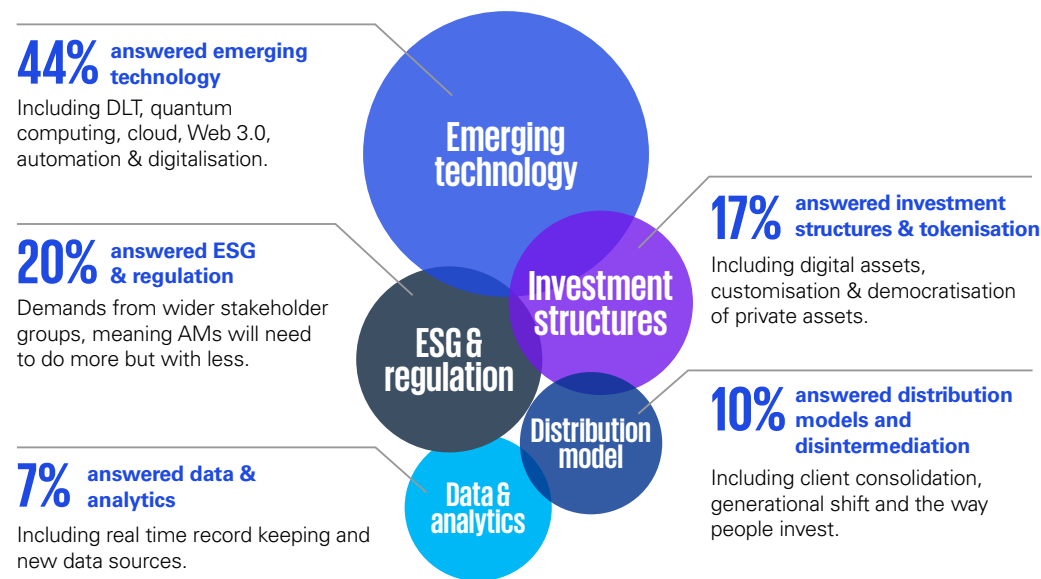
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The broader ecosystem from asset servicers, data providers and FinTechs has responded at pace too – global venture fund investment into [ESG-related FinTechs](#) is estimated to have increased 2.5 times between 2019 and 2020 (from approximately \$0.7 billion to \$1.8 billion) and last year [KPMG predicted](#) that total global investment in ESG FinTech could grow to \$166.7 billion by 2025. More and more firms are emerging to help advisors understand investors’ sustainability preferences – and to educate clients about ESG and investing more broadly. Examples include impact investing platforms with model portfolios (e.g. Circa5000); apps gauging the carbon impact of investments (e.g. Sugii); and psychometric questionnaires to help advisors with ESG profiling (e.g. Oxford Risk). Other FinTechs and tools such as [KPMG’s ESG iQ](#) are enabling asset managers to extract data from multiple sources and aggregate to inform investment decisions, conduct peer analysis and provide greater insight on ESG scoring.

The impacts of disruption can be long lasting. ESG has brought transformative change to the industry, but there is clearly more still to come. Obvious areas for improvement include the validation and transparency of corporate disclosures, the need for greater international comparability, and the importance of tackling greenwashing and ‘swashing’ (social washing). Many of these challenges point towards a need for closer and more effective engagement between asset owners, corporates, asset managers and regulators to increase convergence towards industry standardisation.

Asset managers themselves also need to make further strides to embed ESG – fully

“What do you see as the biggest driver of innovation and disruption in the asset management sector in the next decade?”



integrating transition plans and corporate strategy with financial performance and investment process.

There are also two key transformative developments that will see a step change in the asset management industry’s contributions to the ESG agenda. Firstly, asset managers need to make further strides to embed ESG – fully integrating transition plans and corporate strategy with financial performance and investment process.

Secondly, the potentially ground-breaking ability to not only source and gather data, but to leverage it to determine and predict future investor trends and effectively quantify impact.

Looking ahead at what is still to come...

The ESG revolution is only one example of disruptive innovation in asset management. One of the recurring themes to emerge from our research is that innovation can be thought

about as finding new ways to deliver the **right investment outcome** to the **right customer** at the **right price**.

This was reinforced by the fact that asset manager interviewees tended to “bucket” innovation into three categories:

1. **Investment & product**
2. **Distribution**
3. **Middle & back office**

We have seen numerous examples and successes where pockets of innovation have occurred within functional siloes. Our interviewees referenced examples such as:

- The Data Insights Unit of a leading global asset manager provides a research service to investors extracting actionable insight from alternative and big data sets, looking at underlying companies from a range of sectors to support better investment decision making.
- Use of a data robot to provide hyperpersonalisation for customers and recommend relevant investments.
- Creating an inhouse cloud sandbox environment using synthetic data to be able to rapidly test new concepts.

However, the focus to date has predominantly been on front office and client-orientated areas of the business and there are far fewer examples of innovation within the spine of the organisation. Attempts to tackle cross functional use cases such as ESG and client onboarding have also been delivered with mixed results. Engaging multiple teams with legacy systems seems to be particularly challenging, as we explored in the section [“How to innovate well”](#).

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The spectrum of innovation change

As asset managers seek to identify and understand future sources of disruption and areas of innovation, our experience suggests that it can be helpful to classify these along a spectrum from existing, through emerging into aspirational innovations:

1. **Existing:** these are in progress innovations requiring a level of acceleration to catch up with other industries and sectors.
2. **Emerging:** these are technologies and solutions that already exist, and we are seeing increased demand for them in asset management.
3. **Aspirational:** here we see innovations perhaps further embraced by other industries, at a conceptual stage of exploration in asset management, or with a "jury is out" view as to whether they will really take hold.

Accelerate to catch-up

Demand driven & growing

Disruptive & revolutionary

Industry collaboration

EXISTING

EMERGING

ASPIRATIONAL

- ▼ **Establishing the digital foundations:** including cloud migration, data centres and data architecture.
- ▼ **Enhanced data capabilities:** for differentiation and intelligence, real time access to data, improving standardisation and removing duplication.
- ▼ **Highly automated infrastructure:** reducing human effort and driving efficiencies, digitising new processes.
- ▼ **Digital assets:** launching new products based on assets stored and transmitted electronically, meeting increasing investor demand in new asset classes. Requires navigation of the unknown regulatory and controls environment.
- ▼ **Blockchain as a core technology:** tokenisation and disintermediation revolutionising the mutual fund structure and fund ecosystem as we know it.
- ▼ **ChatGPT and artificial generative intelligence (AGI):** the next generation of artificial intelligence, with user friendly front-ends, enhancing client experience, reducing costs and eliminating certain roles in the industry.
- ▼ **Web 3.0 and decentralised finance (DeFi):** increasing the security, efficiency, transparency, accessibility, openness and interoperability.
- ▼ **The open metaverse and virtual reality:** engaging with existing and new clients in a new educational interactive realm, transforming employee engagement and creating new virtual assets.
- ▼ **Quantum computing and quantum simulation:** exponential processing speeds and machine learning algorithms revolutionising and optimising investment strategies and portfolio and risk management.



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As we look along the spectrum from emerging to aspirational innovation, it becomes clear that technology is not merely an enabler of innovation, but also an enabler of disruption. Key developments include:



Cloud based infrastructure

Cloud is revolutionising the world around us, and the asset management industry has arguably been a slow adopter. The move to cloud creates significant opportunities for the industry – it enables pace and agility and provides the conditions for everyone in the organisation to be able to experiment. It allows the build-test-learn cycle to run more cheaply and with lower risk, thus reducing the cost of innovation.



Real time access to data

To some degree true real-time access to data depends on the creation of a synchronised fund ecosystem – distributed ledger technology (DLT) can act as an enabler here creating a permanent and validated source of truth that cannot be altered across the value chain. Simply put however, the optimal outcome is clients being able to access a (near) real-time asset view not far disconnected from the fund manager view used for portfolio management.



Digitisation of new processes (vs automation of what exists today)

This begins with a shift in mindset to solution design – the ability to question

processes undertaken today and why they happen, and to identify what really needs to happen in order to deliver required outcomes. This is a space where we see DLT and blockchain returning to the scenes. Where this technology was previously seen as a solution seeking a problem, asset managers are increasingly recognising its potential to streamline middle and back-office functions in collaboration with administrators and service providers.



Digital assets and DLT

We are now seeing the rise of digital assets, an innovation that has already been implemented in the asset management world. DLT underpins digital assets such as cryptocurrencies, non-fungible tokens (NFTs) and tokenised assets. Whilst there is demand for cryptocurrencies and some traditional asset managers are beginning to manage these for institutional investors, most of the potential industry benefit of DLT is likely to come from using the underlying technology itself.

From this secondary perspective, digital assets can and should be viewed as an infrastructure innovation opportunity, as illustrated by the fractional ownership model (tokenisation), settlement cycle changes (the move from T+2 to T-0 settlement) or smart contracts. We have already seen [examples of tokenised fund launches](#) for specific asset classes, such as Singapore ADDX launching a tokenised fine wine fund, and claims that

the UK could permit tokenised fund shares within a year.

Tokenisation at scale unlocks the possibility of democratising numerous unlisted classes of asset, and of changing the way assets are traded – allowing any investor to access opportunities previously restricted to institutional or professional investors based on minimum investment thresholds.

Custodians are readying themselves to hold and track digital assets securely, but there will need to be changes across the value chain in order to ensure compatibility. This underlines the need for industry wide collaboration if digital assets are to go from an experiment with limited scope and participants to a fully scalable solution. This will only come about through industry collaboration, government engagement and policy setting in order to create a shared standard.



Internet infrastructure and Web 3.0

Web 3.0 refers to the next iteration of the internet, built on distributed ledger technologies, with the aim of creating a more decentralised and democratised data network that is more open and transparent. A lot of potential applications of Web 3.0 on the asset management industry are similar to those already discussed for DLT (e.g. new digital assets, NFTs and smart contracts), however we have previously discussed DLT when applied within an organisation or within the current ecosystem.

Web 3.0 has the potential to eliminate boundaries and borders, opening up current ecosystems to achieve a truly decentralised finance (DeFi) system, creating new markets, platforms and infrastructure and disrupting the traditional asset management model. In this world decentralised autonomous organisations (DOAs) could facilitate investors in making their own investment decisions and managing their own portfolios of assets, with smart contracts automating and eliminating many of the processes and functions completed today (e.g. settlement). However with these changes comes new risks, which regulators need to keep up to date with.

There is little consensus on when Web 3.0 will be universally used at its full potential, and the reality is there will likely be a period of coexistence of the new decentralised networks and traditional centralised networks. However for an organisation to ensure they are ready for the next iteration of the web, they should start exploring and assessing its core building blocks – digital assets and tokens, smart contracts and DLT.

“The biggest disruption to asset management in the future will be Web 3.0 – internet infrastructure will be everything...and we will forget it is there.”

Chief Technology Officer

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“What if we asked ChatGPT to generate a portfolio for us, if we give it a constraint? It did – it understood the concept of a portfolio and understood the constraint... how many people are going to start using ChatGPT to challenge their fund managers.”

Chief Digital Officer



ChatGPT and artificial generative intelligence (AGI)

During the time we conducted this research, we have seen the arrival of one of the most talked about technologies in decades and a new phenomenon that is taking the world by storm. The launch of OpenAI’s ChatGPT at the end of 2022 has opened up the world of artificial intelligence (AI) to the masses, with all of us able to access it on our phones and use it for a range of tasks from negotiating discounts on phone bills to writing Python code.

However, AI is not a new capability, it has been around for years. What sets ChatGPT apart is the user experience on the front end. People are able to have a human like dialogue with it – accessibility and interaction are key. Whilst the current hype of ChatGPT might cool off, in its wake it will leave a heightened awareness of AI – both that it exists and that it can be used for a multitude of daily tasks. It will trigger a new age of technology, when computers have to deal with humans on human terms (vs historically interacting with them on their terms), and the pace at which technology will replace human roles will continue to accelerate.

OpenAI introduced the first GPT in 2018 and within a five-year timeframe we are moving towards the launch of the fourth iteration. Speculation is rife on GPT-4’s release date and its precise specifications, but what is clear is that it will have vast numbers of parameters and be trained on an extensive collection of data to be even faster and more accurate – ultimately enabling an increasingly natural,

communicative experience at a fraction of the cost. This challenges the many who thought this would take a decade to happen.

“Computers will become far smarter than humans and the pace at which that reality is accelerating towards us is astounding. Year on year improvement of AI is exponential (not linear) and AI’s ability to improve itself is a reality”

Chief Technology Officer

To assess the impact of ChatGPT on the world of business, we must first understand what it is and how it works. A recent [article](#) by Paul Henninger, KPMG’s Global Head of AI, examines this in more detail – in summary, ChatGPT is a large language model (LLM) that uses unsupervised learning to predict something, coupled with an interaction analytics layer that uses reinforcement learning (incorporating human feedback). The applications are vast from simple tasks such as responding to emails in your tone of voice or creating PowerPoint slides in your style, through to more technical tasks such as writing code.

Turning to asset management specifically, our initial observation coming out of our research was that there were two schools of thought depending on the degree of exposure to ChatGPT. On the one hand there were individuals that had read about it, they were interested in what it could do but were largely pessimistic about its capability and speed of adoption. In contrast there were individuals that were already experimenting with it in their organisations, who were much more optimistic about its potential impact but ultimately pessimistic about the results for humanity.

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Whilst our research shows a spectrum of awareness and enthusiasm about ChatGPT across the asset management industry, there was broad acceptance through our interviews that this technology has the potential to transform the business model and enhance client experience significantly. The potential applications interviewees cited and in some cases were experimenting with span the enterprise and value chain, including:

- Transforming retail client engagement and advice – creating new channels and modes of communication through investment platforms with the new generation of investors.
- Automating commentary production (e.g. factsheets or client reporting) – significantly reducing human involvement to reviewers of output, not producers.
- Streamlining RFP response development – using your own firm's specific information to prepopulate RFPs, reducing the need for dedicated RFP writers.
- Conducting investment research – consuming, digesting and distilling vast data sets.
- Sharing information across the organisation – plugging into the intranet to access all data across the company, reducing the capacity required in corporate functions.

“It will be a significant catalyst for change which will drive enhanced client experience, reduced cost and a threat to certain categories of roles in our business.”

Chief Executive Officer

Beyond the use cases for cost efficient content generation and rapid information retrieval above, some asset managers are already recognising the game changing opportunities when combining ChatGPT with other technologies. For example, ChatGPT could create an investment model and use the processing power of quantum computing to run this model for you on behalf of your clients.

However, ChatGPT is reliant on the data that it can access. This reinforces the opportunity for asset managers in private assets, where data is not readily available, and dramatically increases the value of proprietary data (across asset classes) – the vaulted data. Asset managers need to ask themselves how they use and protect this. In addition, asset managers need to be cognisant of the wider ramifications and risks that this technology presents for cybersecurity and fraud. For instance, when paired with other new technology such as Microsoft's Valle this could create a scenario in which anyone could mimic not just what a person says but how they sound, overriding access controls.

Whilst ChatGPT in its current form is by no means perfect, what human is? What once might have seemed like a far-off eventuality has very quickly become a near-term reality, and organisations need to start thinking about what this means for them. There also needs to be significant thought put into the ethics of how this new technology is applied. Could we end up with AIs responding to emails to each other, or technology writing its own code (this is already being done by GitHub), or multiple ChatGPTs talking to and learning from each other – all without any human intervention?

Whilst there is a spectrum of views on how existential the threat from ChatGPT (and future iterations) may be, and how soon it will arrive, the world will soon split into two groups – those who have embraced the technology and are powered by it, and those who aren't.



The open metaverse and virtual reality

The convergence of the physical and virtual worlds in the metaverse could have a significant impact on how asset managers interact with their clients, as well as creating new investment opportunities in virtual assets. As companies start trading in the metaverse, opportunities and risks will be created; there will be positive ESG impacts from reducing travel; and new virtual interactive spaces for working, meeting or training will emerge.

Augmented reality (AR) and virtual reality (VR) will be significant enablers here, but will also lead to other opportunities such as data visualisation and screening real assets remotely. This may sound futuristic, but virtual reality has been part of gaming industry for some time and many younger generations now frequently interact virtually. Asset managers are also already using VR to engage with employees across the world, and the use of VR to view real assets gained traction during the pandemic when travel restrictions prevented in-person assessments.

As the generational shift of wealth occurs and investor demographics change, the ability to engage with new and existing clients and employees in the interactive realms where they spend much of their lives will become a key part of the value proposition.



Model portfolio and portfolio customisation – the role of quantum computing (QC)

QC has the potential to give the asset management industry an immense step change in computing power. This would be an order of magnitude change, accelerating the speed and accuracy of portfolio optimisation, risk analysis, financial modelling and arbitrage to previously unimagined levels. Investment managers would be able to analyse market data more quickly and at increased volumes, perform complex simulations and forecast or predict market trends at a pace far greater than today – enabling more informed investment decisions and asset allocations, and generating higher returns and improved portfolio performance.

This change would lend itself to the ambition of hyper customisation discussed earlier, and possibilities around quantification of impact investing. Furthermore, use cases around fraud detection and risk management could create greater trust in the investment ecosystem. Whilst there is divergent thinking on when, and if, quantum methods will deliver tangible results in asset management, the accelerating development of quantum computing in the wider world could also create new external risks (such as cybersecurity) that asset managers should consider.

“Quantum computing is going to fundamentally change the world in which we live in...the number of things that you can do with quantum computing is mind-blowing. And it is in our lifetime.”

Chief Technology Officer

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What does this all mean for the future of asset management?

Going forward, technology will unlock new paths, enabling asset managers to identify new and creative solutions that may previously have seemed impossible.

Asset managers don't need a settled view of every technology, or to adopt every new development. But maintaining an awareness of evolving technologies will help firms to identify potential threats or opportunities, and to decide when more attention might be merited. An awareness of emerging disruption-enabling technologies will also help asset managers to prepare for more radical transformation affecting the entire industry.

Time for a revolution of the fund ecosystem?

This type of transformation is most likely to occur where multiple technologies combine

to create an existential threat to established structures and processes. Imagine, for example, a world in which the full potential capabilities of ChatGPT (or other AI), Web 3.0 and quantum computing could be harnessed – enabling investors to use verbal AI for investment analysis and asset selection, the infrastructure of Web 3.0 to execute their own investments, and the power of quantum computing to manage their portfolios and risk.

The IA's paper "[Investing in the Future](#)", published in 2022, examines this kind of possibility. It explores a hypothetical Investment Fund 3.0 that creates an interactive investor experience, facilitated by hyper customisation that tailors risk and return exposure to an individual.

This fundamental deconstruction of the traditional mutual fund structure would require a transformation of fund services provided in the industry. The technologies and concepts

explored earlier – DLT, digital assets and tokenisation – and an appropriate regulatory investor protection framework would be fundamental to enabling this. Perhaps most importantly, it would call for truly uninhibited, aligned collaboration between participants, providers, regulators and government.

The value of such an outcome is clear. In addition to customised service meeting clients' precise needs, the removal of cost from the value chain would doubtless achieve the "best product at the best price" ambition.

"Digitisation offers us a generational opportunity to transform both the cost and the quality of fund investments, but this will only happen if we stop thinking that digitisation is just a sexier way of doing the same things that we do now.

Digital funds will be very different indeed. Investors will hold tokens as title, not shares or units, and those tokens will pledge a wide variety of investment outcomes to the investors. The hard distinctions between principal / market-traded, and open-ended / closed-ended funds will evaporate, and fund classes will be history.

So, product choice can flourish, while simultaneously, complexity wilts. The number of entities intermediating the delivery of fund investment will consolidate, and the operating model will be much simpler and cheaper as a result. Participants in the current process need to rethink their business models if they are to have a role in the new world. The requirement for 16 or so entities to deliver a basic equity ISA will seem, in retrospect, as absurd as it really is."

Dr Ian Hunt – Author on digital innovation

Today, this appears to be a very extreme scenario. It would undoubtedly be hard to achieve, and it seems likely that human skills and creativity will remain valuable to good investment advice and selection. Even so, it is a reminder that while asset management will always be required, asset managers in their current form may not. The implications are clear – asset managers need to consider and assess the impacts of technology in the context of the new world order if they want to be the disruptors and not be disrupted.



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Conclusion and next steps

Innovating successfully in asset management is complex and challenging. Goals and outcomes can be hard to define. Uncertain or conflicting views about what innovation looks like, what it can do, and whether it's worthwhile can lead to the risks of innovation appearing to outweigh the benefits.

Looking further ahead, it can feel daunting to contemplate the sheer scale of innovation that could be unleashed by the intersection of emerging technologies.

Innovation will no longer be optional. It's a vital response to the rapidly changing environment in which they operate. It's essential to achieving lasting success in an increasingly competitive industry, and to maintaining the flexibility required to take advantage of radically different futures.

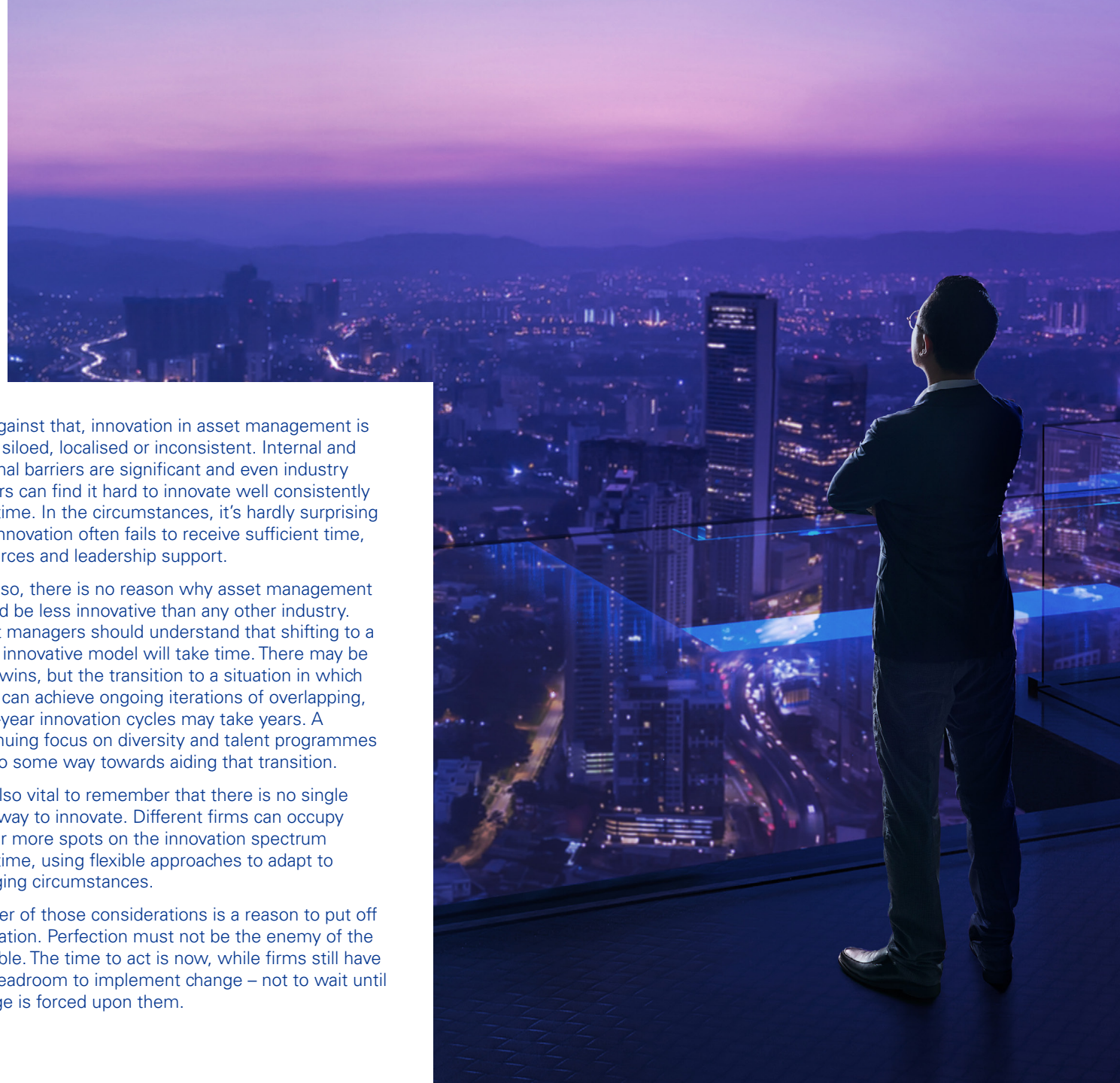
The good news is that there are many examples of good innovation dotted around the industry, ranging from proven to evolving such as the development of new investment products, cloud transformation and use of data science and insights to drive faster, better decision making. The increasing spotlight on new and emerging concepts such as tokenisation and digital assets is a positive sign that the industry is considering the possible disruption, with working groups starting to tackle the "how" through operational and regulatory lenses.

Set against that, innovation in asset management is often siloed, localised or inconsistent. Internal and external barriers are significant and even industry leaders can find it hard to innovate well consistently over time. In the circumstances, it's hardly surprising that innovation often fails to receive sufficient time, resources and leadership support.

Even so, there is no reason why asset management should be less innovative than any other industry. Asset managers should understand that shifting to a more innovative model will take time. There may be early wins, but the transition to a situation in which firms can achieve ongoing iterations of overlapping, multi-year innovation cycles may take years. A continuing focus on diversity and talent programmes will go some way towards aiding that transition.

It is also vital to remember that there is no single right way to innovate. Different firms can occupy one or more spots on the innovation spectrum over time, using flexible approaches to adapt to changing circumstances.

Neither of those considerations is a reason to put off innovation. Perfection must not be the enemy of the possible. The time to act is now, while firms still have the headroom to implement change – not to wait until change is forced upon them.





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