

INSIDE OPS

**SILICON VALLEY:
A FRIEND OR FOE TO
ASSET MANAGEMENT?**

**INSIGHTS FOR OPERATIONS
LEADERS IN ASSET MANAGEMENT**

If you are not familiar with Alibaba, you may be soon. It is the Amazon-like tech firm in China that went public a few years ago.

Today, Alibaba is responsible for the world's largest money market mutual fund.¹ A business once reserved for Wall Street is now being breached by tech giants. These tech firms such as Alibaba, Amazon, Google, and Facebook are champions at leveraging their digital platforms, brand recognition, and technology to expand horizontally into new industries.

There is no doubt the technology innovation driven by these firms and others has enabled breakthroughs in new developments across financial services. However, these same firms are becoming competitive threats within financial services today. They are not too shy to be different, innovative or disruptive. The critical question is, will they continue to enable asset managers or will they end up transforming the asset management industry?

COMPETING IN AN AGE OF TRANSFORMATION

Asset managers have historically grown and expanded their businesses from conventional practices such as launching new products, decreasing expense ratios, and scaling operations.

These approaches worked especially well for those that were ahead of the curve compared to their peers. However, opportunities from emerging technologies and the shift in investor demographics have fueled the threat of non-traditional competitors such as Amazon, Google, and Venmo.

To stay ahead of disruptive technology and transformational shifts in the industry,

asset managers need to compete and partner in different ways. The ability to adapt in changing times is critical to keep and grow a competitive edge. Asset managers can adopt the following three practices—straight out of Silicon Valley's playbook—to strengthen their market position.

1. EMBRACE THE INDIVIDUAL ECOSYSTEM

Silicon Valley understands the importance of the user experience and creating an ecosystem that becomes ingrained in users' daily lives. Asset managers should also embrace this belief in the face of evolving investor demographics. Money is shifting to new, younger investors with diverse backgrounds, behaviors, and beliefs. Millennials have a high level of trust in technology and are attracted to services that integrate easily into their lifestyles. To engage with this new breed of investor, asset managers should bring an ecosystem perspective to their investor interaction model.

Some asset managers have had a good start here as a result of their digitalization efforts to-date. Digital platforms allow firms to expand from linear interactions, as well as enable complementary offerings and integration with external partners. Facebook is a good example of building a digital ecosystem. It started as a website for people to stay in contact with friends, but has shifted to a platform that functions across multiple devices for event planning, news, messaging, shopping, and more.

Developing this ecosystem is becoming more critical as the interaction between clients and financial advisors is decreasing. Robo-advisors have been a good solution here. However, while they have brought in assets, robo-advisors alone do not transform the user experience. There is no psychological or emotional impact that affects individuals' behaviors.

The true opportunity for asset managers is to integrate an offering—such as a robo-advisor—across a digital platform that complements other services. This can impact users' behaviors. For example, imagine enabling clients to check their monthly return while updating their status on Facebook. Asset managers should create ecosystems and additional services that attract new investors and become ingrained in their daily routine before Silicon Valley beats them to it.

This shift does not stop with a digital platform. There is software and hardware to address. Tablets, wearables, virtual personal assistants, and smart devices are all becoming connected. The ultimate goal is an ecosystem where all personal devices are integrated and continuously accessible. Asset managers are exploring how wearables such as the Apple Watch and virtual personal assistants such as Google Home or Amazon Echo could be incorporated into the investment experience. Firms that have already made investments in digital platforms will be better positioned to take advantage of these hardware enhancements and gain first mover status.

2. CAPTURE NEW MARKETS

Mark Zuckerberg, the founder and CEO of Facebook, has pledged to provide internet connectivity globally to billions of new users.²

He is not alone in this mission to connect the world. Connectivity will support local economies and businesses, creating increased demand for mobile banking as well as new investment opportunities and investment advisor services.

This global economic growth offers an opportunity for asset managers to grow exponentially. However, building a global enterprise comes with significant challenges. Traditionally, growth has come from brick-and-mortar offices that sell funds, deliver investor support, and instill trust. But in today's environment, it is difficult to scale this way and preserve the company culture at the same time.

Success in new markets will likely hinge on the ability to leverage technology to scale across multiple time zones and languages. Advancements in artificial intelligence, such as machine learning, could help enable scale. One example is chatbots, which are being used to address internal and external queries in real-time. Firms are also exploring ways to use chatbots to offer investment advice.

Picture replacing large customer support offices with a digital 24/7 global platform. This platform and new model would offer range and reduce the internal footprint, as only few technicians would be needed.

Many asset managers have successfully positioned themselves domestically, but globally, have limited competitive advantage. This is not the case for Silicon Valley. Tech giants such as Amazon and Google have high brand recognition on a global level, which could provide peace of mind to those prospective customers who did not previously have the need or ability to invest. Investing via an online marketplace may seem natural to them. If they are already purchasing other products through Amazon, why not purchase mutual funds too? To compete, asset managers should continue to invest in their technology infrastructure and build relationships with global partners.

3. DON'T GET LEFT BEHIND DEBATING ACTIVE VS. PASSIVE

Hedge funds are notorious for making advantageous investment decisions using alternative datasets. One famous example was a fund that used satellite imagery to track the number of cars in Walmart parking lots.³

This ability to acquire and analyze alternative datasets is becoming more accessible and will continue to be a market differentiator. As traditional asset managers debate between active and passive management, they need to be cautious of new entrants that could introduce entirely new investment strategies by leveraging alternative datasets and artificial intelligence.

There is a vast amount of structured and unstructured data generated daily, which spans from earnings reports issued by companies to the purchasing habits of hundreds of millions of Amazon users. This amount of data is not feasible for humans to analyze, and is often proprietary to the generating entity. But when acquired and analyzed effectively, it becomes a powerful resource for predicting behavior. Consider firms that have access to large datasets and significant investment in deep learning capabilities that could be a threat.

Asset managers need to stay ahead of the artificial intelligence curve. Advancements in these technologies, such as deep learning and natural language processing, have increased portfolio managers' ability to cipher through copious amounts of data. This is already a trend across the industry and will continue to evolve. For success, it will be foundational for asset managers to have a strong approach and strategy for obtaining and leveraging data. Investments should be made in analytical and computing capabilities to support emerging technologies, which can evolve and become smarter through supervised and unsupervised learning. Those who spend the time up front to succeed will not be willing to collaborate, so now is the time to get ready.

BOOKS, GROCERIES —AND MUTUAL FUNDS

The assembly line was once the driving force for American companies to prosper. Ford, General Electric and U.S. Steel became marquee names because of their ability to automate, improve cycle times and reduce labor costs.

Now enterprises like Amazon, Facebook, and Google dominate headlines. They have succeeded by layering digital solutions and big data onto historically physical or mechanical services. Consider what Uber, a self-proclaimed tech firm, did to the taxi industry. Look at what Amazon, initially an online bookstore, did to the retail, entertainment, and food industries. These tech firms have applied what they do best to penetrate other industries.

The same might occur in the asset management industry. Alibaba's involvement within financial services might not yet be that impactful. However, the method used to acquire assets and scale is

what is groundbreaking. Alibaba sweeps leftover change from online purchases into a fund. This goes beyond disruptive technology to transformational shifts across industries. It is changing consumer habits and lifestyles. The reality is that no matter how efficient an asset manager runs its operations, it will likely lose to a firm that successfully interacts with consumers and engages with partners.

The barriers to entry for asset management are not high, especially for the likes of a company like Google that sits on hundreds of billions of dollars in cash.⁴ However, the opportunity cost of tech firms' time is still better invested in larger technology initiatives. They would rather digitalize and disrupt social networks or shopping experiences. This will not always be the case, as Alibaba has proved. Once asset management aligns with the overall strategy and complements other business lines, Silicon Valley will strike.

THE TIME TO ACT IS NOW

Asset managers have become more efficient across the organization thanks to technology innovation from Silicon Valley.

This disruption will continue with advancements in artificial intelligence, digitalization, and other emerging technologies. Asset managers need to embrace these emerging technologies and must also acknowledge the broader transformational trends that come with them.

They cannot ignore the fact that companies from outside the industry are eager to capture new opportunities. The steel industry now competes with 3D printing. Computers can beat the best poker players. Driverless cars are on the streets. Drones are delivering packages. Do not presume vast transformation is not possible within asset management; as assured, Silicon Valley does not.

NOTES

1. Xie, Yifan and Yap, Chuin-Wei. "Meet the Earth's Largest Money-Market Fund." 13 September. 2017. <https://www.wsj.com/articles/how-an-alibaba-spinoff-created-the-worlds-largest-money-market-fund-1505295000>

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CONTACTS

Michael Sands

Manager

michael.sands@accenture.com

Ross Tremblay

Senior Manager

ross.tremblay@accenture.com

Michael Kerrigan

Managing Director

mike.kerrigan@accenture.com

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