CFA Institute®
Future of Finance

SEPTEMBER 2018

INVESTMENT FIRM OF THE FUTURE

BUSINESS MODELS AND STRATEGIES FOR A MORE FORWARD-THINKING INDUSTRY

OVERVIEW

Investment firms face a future in which change is accelerating.

In this report, we set out the changing landscape for investment management and analyze how firms can adapt their models to succeed in the future environment. The report is informed by a survey of CFA Institute members (see page 27 for details). Among those surveyed, 72% expect the pace of industry consolidation to speed up, and 55% believe the biggest challenge for financial performance will be fee or cost pressures.

The urgency to adapt is unleashing considerable stress and disruption on individual firms and the industry as a whole. There are two underlying types of accelerating and disorienting change: 1) adaptive change, in which existing organizations create new business models, adapt to disruptions, and curb the opportunities of new organizations, and 2) destructive change, in which new organizations with new business models destroy existing organizations.

Investment Firm of the Future focuses on asset management and outlines what investment firms are likely to develop into, and what they could develop into with stronger intentional leadership. The current investment industry composition (sized roughly by headcount) is 50% asset management, 5% asset owners, 15% private wealth, and 30% support firms and organizations. Among CFA member survey respondents, Asia is the only region where a majority (56%) expect continued growth in the number of investment professionals. In terms of the composition of investment professionals, 53% say the business case for improved diversity in the industry is strong or very strong, but only 14% say the speed of uptake of diversity and inclusion practices will be fast.

We look out over 5–10 years, which represents an important time horizon for individual firms to better face realities, manage risks, and help craft alternative pathways. We unpack firms into five models by reference to their functional parts: Business Model, Operating Model, People Model, Investment Model, and Distribution Model. The Operating Model is where CFA members expect to see the greatest change, as 72% say the influence of technology and data on decision-making at investment firms will grow significantly.

OF OUR MEMBERSHIP SURVEYED:

72%

expect the pace of industry consolidation to speed up

80%

expect increased demand for products that incorporate personal values

64%

expect that defined contribution participants will be more engaged

51%

say their firm's top technology priority is use of technology for client engagement

This research takes a structured approach to analyzing the future by:

- Leveraging Scenarios that will have fundamental influences on how the investment industry evolves.
- Describing Narratives that will shape individual investment firms' futures through their various functions.
- Identifying Investment Firm Shifts that individual firms can use as a guide to accomplish their respective goals.
- Identifying Industry Shifts that the investment industry may need to accomplish collective goals.

Many of the emerging trends for the next 5–10 years are based on changing client expectations, as seen in some of the key survey findings among CFA members:

- 80% anticipate that demand for solutions mandates will grow.
- 80% expect increased demand for products that incorporate personal values.
- 72% expect their firm's future commitment to the research of environmental, sustainability, and governance (ESG) issues to be higher.
- 64% expect that defined contribution (DC) participants will be more engaged.
- 51% say their firm's top technology priority is use of technology for client engagement, followed by cybersecurity (24%) and use of machine learning technologies in portfolio construction (21%).

Amidst these trends, some cultural challenges for investment firms exist:

- Only 14% say their firm has a very large cultural and financial commitment to innovation in products and services.
- 54% strongly agree that they personally have a strong sense of purpose and wanting to do meaningful work, but only 28% say this is true of their firm overall.

The modular structure we have adopted allows readers to consider the trends alongside actions that can be taken by individual firms or across the industry to impact future outcomes.

SCENARIOS INFORM INVESTMENT FIRM MODELS AND NARRATIVES

The investment ecosystem is full of multiple strands, non-linear parts, and two-way feedback loops that make the landscape very difficult to map, especially in its future form.

We begin by referencing the Scenarios from *Future State of the Investment Profession*: These are descriptions of possible future states, at a high level, not point estimates or forecasts.

These Scenarios are a tool to help organizations prepare for the future. From these, we outline contingent Narratives that make the Scenarios more specific for investment firms at a more detailed level.

Given the Scenarios and the Narratives, we suggest some Shifts for actions that individual investment firms and the industry as a whole can take to adapt given future outcomes.

The links among the Scenarios, Narratives, and Shifts allow leaders to zoom in or out between bigger picture and smaller picture views. This produces a better-balanced picture with more accurate understanding of the issues, more agreement on beliefs, and better connections to actions.

Scenarios

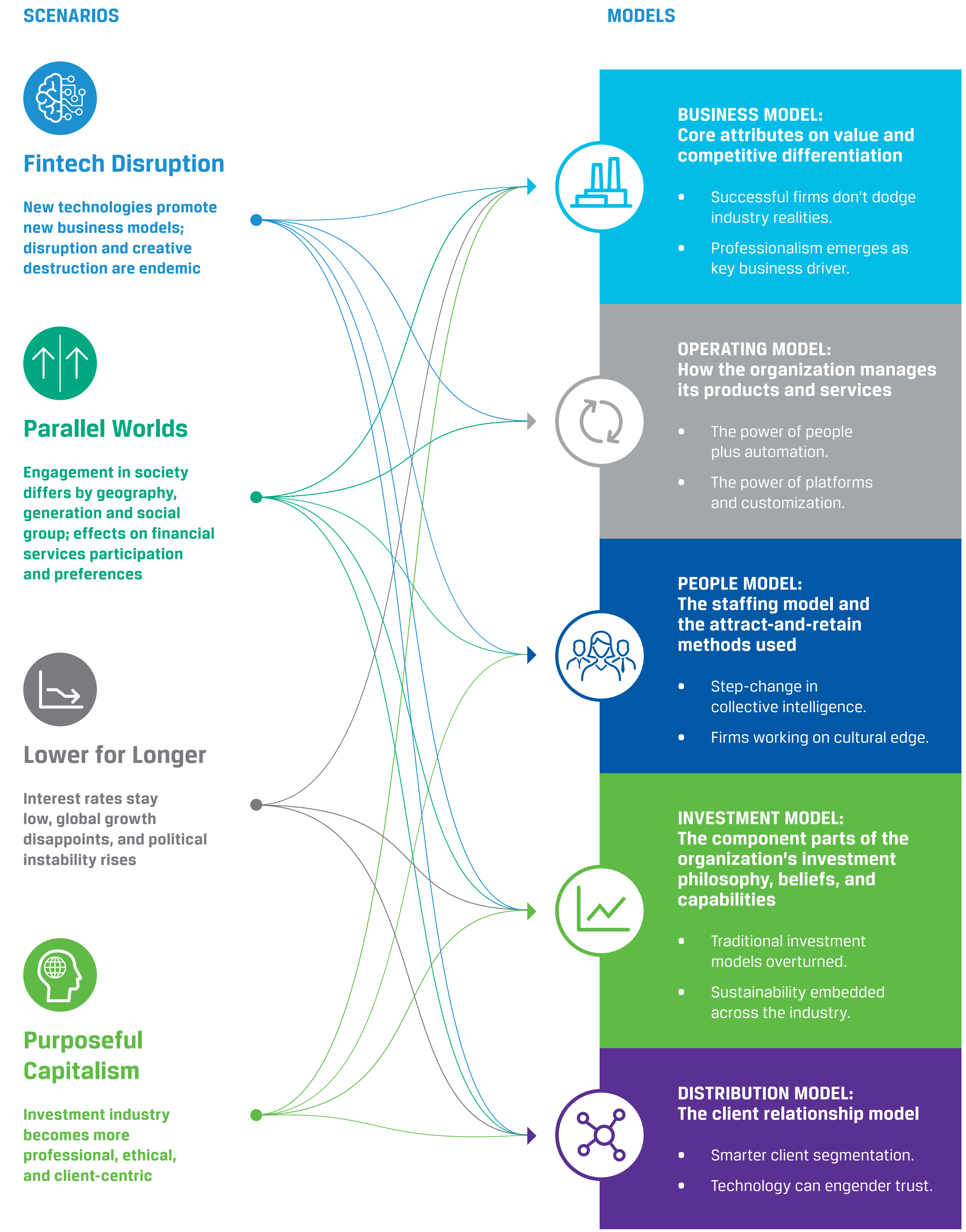
Differentiated stories about possible future pathways and states in the investment industry and the wider world. They are not point estimates or forecasts; as relevant stories they help firms prepare for the future.

Narratives

Descriptions of the current and future state of industry-specific issues. They help firms with understanding the key details of the evolving landscape in the next 5–10 years. They follow from the Scenarios.

Shifts

Descriptions of what should change in the next 5–10 years for positive progress to be made—both at the level of the individual firm and on an industry-wide basis; they help firms to decide on desirable actions and the industry to evolve its practices. They follow from the Narratives.



BUSINESS MODEL

Successful firms don't dodge industry realities

NARRATIVES

1. Industry profitability challenges grow: Firms must learn to push against profit headwinds

Asset management firms have achieved consistently high margins and decent growth in recent times. But current business conditions look much more challenging for both margins and growth reflecting fee pressures, lower inflows, and clients switching to lower-fee products.

The Key Point

Asset management firms must recognize and respond to a deteriorating sector-wide financial position. It is possible they simply accept the tougher conditions through lower profit expectations. We see this narrative as the better outcome for clients. Alternatively, firms can cut costs and try to consolidate. In this narrative, they risk harming their client base. In either case, leaders must put the tailwind conditions of the past fully behind them and adapt their strategy to the new headwind conditions.

2. Regulations and standards get tighter: Firms need a proactive response to regulatory complexity

Regulation is a highly influential factor in the way the industry evolves. The challenges for regulators to support public policies are significant, and jurisdictional differences are creating a highly complex compliance environment. These problems are likely to increase in the next 5–10 years.

The Key Point

Regulation is a key part of doing business in the investment industry that is intrinsically growing in significance because of two factors: the endemic nature of increased complexity and the increasing public policy pressures to address industry limitations. The issue is complicated on two counts: First, there is no global regulatory governance, as regulations are agreed and applied in national settings and rarely move in lockstep; second, the interconnectedness in the ecosystem makes it hard to anticipate the consequences, often unintentional, of new measures.

3. Success influenced by business model differences: Firms must achieve differentiation

Business success has been due to marketing and product innovation as much as investment prowess and performance. While this will likely continue, success in the future may favor bigger organizations that can exploit scale advantages through brand differentiation and robust, yet nimble, technological infrastructure. Organizations with business models focused on growing segments and geographies should also fare well.

The Key Point

The weak underlying growth in revenue and profits for asset management firms masks the differences by geography and segment. In particular, there is profitable growth in Asia, wealth management, investment solutions, and alternative assets. These segments reflect the Parallel Worlds scenario in which new sources of investment funds flow to those firms most attuned to investor needs and wants. In this way, the success of investment firms will reflect how much their business model aligns to growth areas and the agility shown by these firms in their further pursuit.

CAN YOU IMAGINE A WORLD IN WHICH…

- *investment firms proactively partner with regulators to evolve the investment industry into an operating environment that is seen by all as trustworthy and a public good?*
- *most of your firm's clients are domiciled in markets that we currently call "emerging"?*
- *your firm's business plan is shaped and communicated through narratives, scenarios, and strategic goals, rather than hard data, forecasts, and budgets?*

Professionalism emerges as key business driver

NARRATIVES

4. Professionalism increasingly recognized: More professionalism produces greater trust

Professionalism draws on competencies and values and embeds ethics and purpose. These are soft attributes and have not always been easy to judge or manage. The issue is how to change this in a new technological and socially connected environment to produce benefits for the industry, for clients and end investors, and for society.

The Key Point

The extent to which professionalism commands an explicit edge for business varies by industry segment and geography. The Purposeful Capitalism scenario sets out the possibility that the investment industry grows the share of high-professionalism firms that act in aligned, lower-cost, and more efficient business models, and the investment industry strengthens its value proposition accordingly. A narrative of professionalism becoming increasingly recognized by clients and rewarded by employers depends on the industry adopting the enlightened self-interest mantra—recognizing that putting clients first is good for business and society.

5. Brand and reputation increasingly valuable: Bold leadership bolsters the brand

Reputations are critical in investing and are built in part on ethics, communications, and fiduciary responsibility. Working on brand positioning can deepen investment firms' differentiation, but all reputations and brands are vulnerable given the influence of forces that see all finance in a negative light.

The Key Point

In the Purposeful Capitalism scenario, reputation is built less on performance track record and more on trustworthiness, ethics, communication, and transparency. Investment firms could achieve better outcomes for their business and their clients if they focused increased attention on these areas.

6. Culture and leadership resonate: Firms should communicate their values publicly

Culture is recognized as a high-impact driver of organizational performance. Leadership is critical to the effective development and exercise of culture, as well as the creation of successful strategies and business models. These co-dependencies, and the syncing of strategy and culture, are central to the futures of all investment firms.

The Key Point

Purposeful Capitalism describes opportunities for stronger culture and high-principled leadership. Culture describes the norms of behavior that reflect why things are done a certain way (which is mostly about values and beliefs), as well as how things are done (which is mostly about leadership). Culture is accurately described as a reflection of leadership past and present.

CAN YOU IMAGINE A WORLD IN WHICH…

- *your attitude toward your operating environment is considered just as important as your attitude toward your shareholders?*
- *the principal focus on value of your activities is measured by client trust, satisfaction, and outcome?*
- *Integrated Reports are the core material of investment analysis and financial statements are the adjunct?*

The weak underlying growth in revenue and profits for asset management firms masks the differences by geography and segment.

INNOVATION

14%

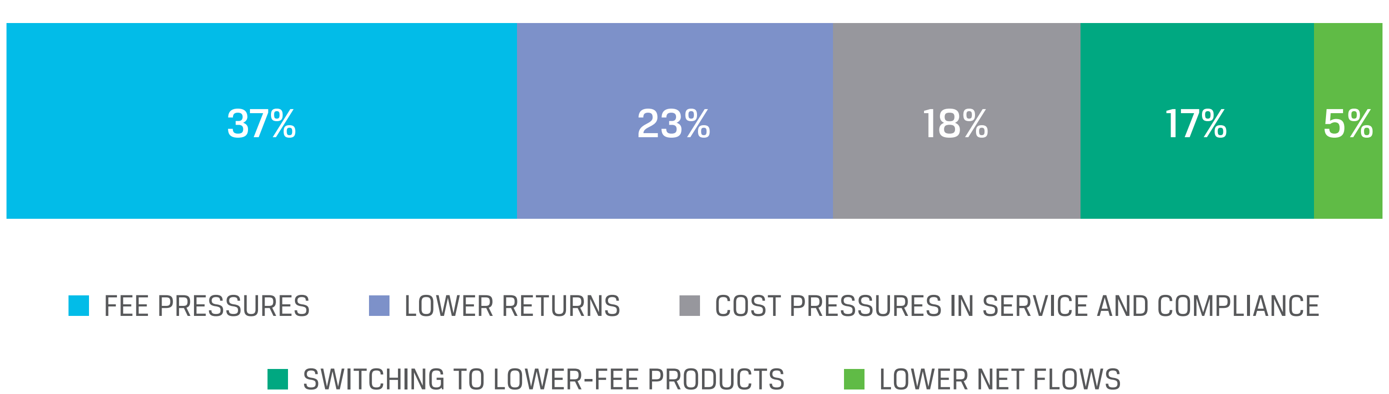
a small minority say their firm has a very large cultural and financial commitment to innovation in products and services

CONSOLIDATION

72%

expect consolidation to speed up significantly or some

THE BIGGEST CHALLENGES FOR INVESTMENT FIRM FINANCIAL PERFORMANCE OVER THE NEXT 5–10 YEARS:



BUSINESS MODEL SHIFTS

INVESTMENT FIRM SHIFTS

Embed organizational agility and client-centric culture

Firm success is contingent on a client-first culture, and the state of agility in particular.

Good culture involves putting clients first. Good agility reflects the ability to understand the landscape, read the changes ahead, and apply the Shifts needed.

The investment firm of the future will:

Achieve organizational coherence
These qualities will follow from strong leadership, the practice of socialization, and a thorough understanding of values and beliefs and their significance. This includes the communication challenge of making a compelling case to influence others, particularly when change is required.

Build fiduciary culture around client outcomes
Organizations must ensure maximum transparency with respect to exercising fiduciary responsibility; build a better framework for measuring client perceptions of value and outcomes; and communicate early and often.

Have adaptable and inclusive leadership
Organizations must be prepared to change course to deal with tougher and more stressful business conditions. Creativity and vision to increase top-line revenues through new opportunities will differentiate firms from those that focus predominantly on managing expenses in the here and now.

Understand and engage with stakeholders
All investment firms have to view their stakeholders on wider terms and reach out to them to manage their expectations. Stakeholder mapping is critical with central positions on this map held by the workforce and clients, owners, the communities in which the firm operates, and wider society.

INDUSTRY SHIFTS

Governance and culture are upgraded

Governance and culture upgrades by asset owners enhance the value created by the entire industry. This is because the limitations in practice of asset owner boards and investment committees have impacts on wider industry practice, and investment firms can legitimately claim that their own practices are limited by these weaknesses further up the chain.

In the investment industry of the future:

Fit-for-purpose asset owner governance becomes the norm through successful development of resources and processes.

Asset owners increase their resources by developing internalized capabilities and improving their delegations—in some cases insourcing, in other cases outsourcing.

Governance is able to ensure better coordination across the value chain and exercise better control on outcomes.

Strong investment culture is developed that is purpose driven and takes full accountability for outcomes.

The power of people plus automation

NARRATIVES

7. IT models on a spectrum moving forward over time: Technology is integral to a new operating model

IT has been substantially set in a reactive context with firms trying to marshal technology to capture efficiencies in the face of legacy issues. The issue going forward is increasingly about evolving the technology strategies and adapting the skills to keep up in the technology arms race.

The Key Point

IT as applied to the investment industry is information and communications technology in which the devices, networking components, applications, and systems combine to allow people and organizations to interact and produce investment content. So far, IT has been helpful but not game changing to investment firms. The Fintech Disruption scenario outlines how we can expect smart machines and systems, data analysis, and inference to play a highly disruptive and destructive role in finance's evolution, in jobs, and in ways of working.

8. Stronger data and analytics strategies emerge: Firms should focus on clearer IT strategies

IT has not been the subject of significant strategic thinking in the investment industry, in part because leaders responsible for strategy have not had enough grasp of the possibilities. As investment firms look ahead, they will find opportunities to build their competitive edge by amplifying and differentiating their IT initiatives, particularly with respect to data and analytics in the investment process and in the client relationship.

The Key Point

Whichever direction investment firms take with IT, they need to devise a clear strategy and implementation plan, something that has been generally absent before. IT must have agile features that are adaptive and involve well-informed and engaged non-IT specialized leadership. The need for T-shaped leadership is acute (see page 15)—here the T-shaped leader needs to have understanding of the whole spectrum of issues across their business and wider understanding into the ecosystem. So, the new IT imperative is integrating data strategy into the business with the essential economics front of mind. Technology enhancements fundamentally involve business models that improve scale or efficiency or address needs better. In the next 5–10 years, we will find many such opportunities.

9. Further innovation in technology: Firms should watch out for the next wave

The one inviolable innovation truth is that we cannot visualize the technology in the wave after the next one. So, as technology is so transformative, the issue is how investment firms build an innovation infrastructure and culture to be up with the trends and adaptive to what happens.

The Key Point

Innovation is transformative in a series of waves breaking over all parts of industry and society. The time it takes to go from breakthrough technology to mass-market application is contracting rapidly. For example, in the United States, it took the telephone 76 years to be adopted by half the population. By contrast, the smartphone did it in under 10 years. In this narrative, Asia will emerge as a key center of this innovation. It already represents the region where the largest R&D expenditures in financial services are being made on innovation (see PricewaterhouseCoopers, "Get Ready for RegTech"). The client/customer interface and distribution model are the areas most likely impacted.

CAN YOU IMAGINE A WORLD IN WHICH…

- *artificial intelligence leverages the human intelligence within your organization?*
- *artificial intelligence and human intelligence complement one another and do not compete with one another?*
- *95% of investment decision-making comes from artificial intelligence algorithms designed by skilled humans?*

The power of platforms and customization

NARRATIVES

10. Investment platforms proliferate: Platforms dramatically improve client experience

Investment platforms are user interfaces that attract buyers of investment services and facilitate the marketplace for investment products, either using in-house investment or open architecture choices of product. The opportunities lie in both B2B and B2C contexts and one-sided and two-sided designs. These platforms are increasingly automated and drive costs down.

The Key Point

Investment platforms are efficient digital technologies and are subject to many of the other transformational factors affecting other revolutionary and evolutionary technology platforms (think Amazon and Airbnb). Such platforms have innovated their business models to exploit scale, needs, and flows. They use ideas and intangible capital rather than large physical capital. The businesses introducing platforms are both mainstream investment firms and fintech start-ups.

11. The growth of goals-based investing: Customization should be synced to outcomes

Desire from end investors for investment products and services that deliver client-friendly outcomes has grown. This is a particularly interesting opportunity in the algorithmic and digitized areas, where the industry can be more innovative in meeting demand; that includes a latent but pent-up demand for investment propositions that reflect consumerist trends brought out in the Parallel Worlds scenario.

The Key Point

The central idea in this narrative is that the industry structure was shaped by gatekeepers who built portfolios from beta and alpha components, usually by bringing together asset allocation and manager selections. This did not serve end investors adequately in that they had limited transparency or opportunity for direct engagement. Increasingly the preference of the intermediaries is in favor of investment plans designed to meet investor needs through customized, adaptive solutions that evolve and deliver unique investor-directed outcomes.

12. The growth of lifestyle finance: Customization should be synced to values

There has been limited appetite from end investors thus far for investment products that are customized to their values, that express their values, or that even report on impacts relevant to their values. The issue is whether this new paradigm will or should emerge and whether products can be developed within realistic cost and price parameters. It seems likely they can.

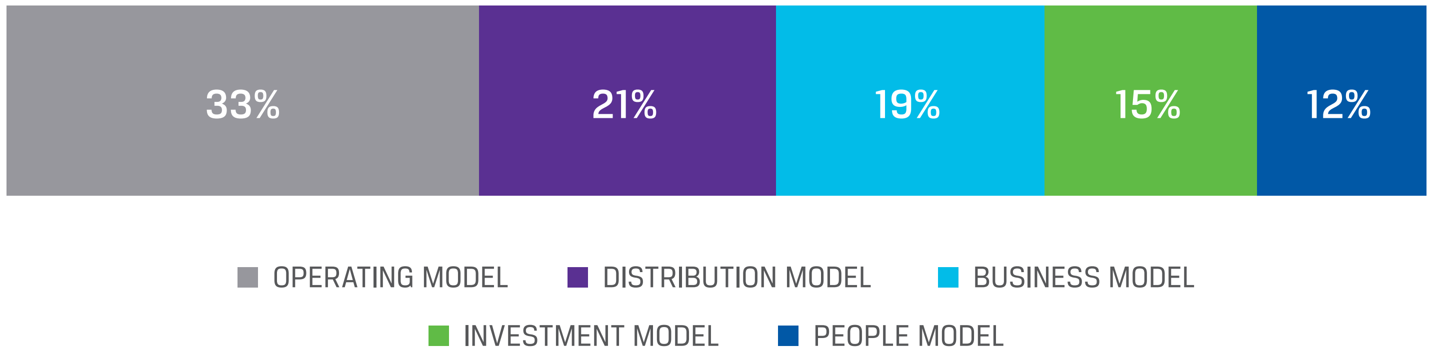
The Key Point

In the Parallel Worlds scenario, we recognize an increasingly democratized world in which individual expression is possible in all consumption choices. Financial services offerings have been largely homogeneous and non-differentiated to date. But the future is likely to take on personalized, simple, and speedy preferences, and the personalization can be extended to the extra-financial considerations involving issues related to sustainability and responsibility. This involves ESG and other softer dimensions in investing.

CAN YOU IMAGINE A WORLD IN WHICH…

- *your clients customize their financial reports to the same degree as their mobile devices?*
- *the use of neuroscience allows you to truly measure how much value your clients derive from their risk and return journey with you?*
- *the default DC pension strategy consists of the hyper-customized products that map to a person's unique characteristics and preferences, rather than their age?*

Which do you think will change most significantly for investment firms in the next 5–10 years?



The time it takes to go from breakthrough technology to mass-market application is contracting rapidly.

MACHINE LEARNING

21%

say that their firm's top tech priority is the use of machine learning technologies in portfolio construction

PERSONAL VALUES

80%

expect increased demand for products that incorporate personal values

OPERATING MODEL SHIFTS

INVESTMENT FIRM SHIFTS

Use every tool to differentiate the operating model

Insourcing and buy-or-build decisions are critical to the value chain and use of technology.

Decisions on strategic partnerships and choice of technology and the quality of their execution will increasingly differentiate operating models.

The investment firm of the future will:

Understand comparative advantage to strengthen strategy
All parts of the investment firm's value chain can be managed with internal or external intellectual property. The trick is knowing your comparative advantages and getting the mix right accordingly.

Be comfortable with technology
It is hard to be positive about investment firms that fail to benefit significantly from technology. They will surely be operating with an unduly costly infrastructure, as technology has the potential to transform the value chain.

Make data strategy a comparative edge
IT and data strategy must work with agile and adaptive features implemented by well-informed but non-IT specialized leadership. The new IT imperative is fully integrating data strategy into all levels of the business.

Exploit investment platforms to build scale
Investment firms should be able to use investment platforms to exploit their opportunities from building scale and addressing client needs. In particular, technology enables platforms to scale their customization models within appropriate cost limits.

INDUSTRY SHIFTS

Technology is firmly embedded

Data strategy, AI, and tech provide essential collective intelligence. This involves moving technology from IT implementation providing business support to data strategy and AI providing essential collective intelligence in the end-to-end investment process.

In the investment industry of the future:

The application of technology shifts the economics (i.e., lower costs for end investors) and accuracy (i.e., improved control of outcomes) of the investment process.

The inter-workings of technology and people are significantly accretive to the value generated by investment firms and experienced by end investors.

Bias around technology must be managed to ensure successful implementation; while many believe that AI and machine-learning technology mitigates human bias, in many cases it has been found to amplify human bias.

The technology used in quantitative and systematic investment approaches produces large-scale improvements in added industry value.

Step-change in collective intelligence

NARRATIVES

13. Challenges in achieving collective intelligence: Firms need to capture the cognitive diversity premium

Investment firms build collective intelligence from well-trained professionals employing disciplined decision processes and effective communications. The success of these models hinges on the ability of these investment firms to deepen the range and adaptiveness of the skills they hold.

The Key Point

There is continuing competition for professional talent among investment firms, particularly on the leadership level. This likely takes place in an overall shrinking of industry headcount as costs come under increased pressure; the challenge is to use fewer people to achieve more by changing the roles played by people and technology. Asset management firms' headcounts likely follow sell-side firms in this trend with the aggregate global workforce peaking in the next 5–10 years.

14. The effectiveness of decision making: Firms can take bias out of key decisions

Group decisions are critical to investment firm organizational effectiveness. Teams, committees, informal groups, and boards do well with the socialization and governance attached to decisions, but biases limit the effectiveness of decision outcomes and accuracy of results.

The Key Point

The issue for investment firms is how effective their decision processes are on both investment portfolios and business issues. Subconscious biases exist at the personal level that are often reinforced at the group level. This makes them especially problematic, not least because one of our subconscious biases is overconfidence. The highest-level decisions are among the most challenging and thus subject to pressures for change. These often involve complex applications of values and beliefs in situations where such issues are not fully settled or even understood.

15. Progress on diversity and inclusion: Firms can realize improved performance through diversity

Investment firms have notably weak gender diversity in their workforce composition and poor inclusion practice in their behaviors. They are gradually realizing the business case for diversity and more inclusive cultures but must acknowledge the size of the challenge involved.

The Key Point

Human ecosystems survive and thrive best where there is robust diversity. The reason is diversity is demonstrated to lead to greater adaptability and creativity (see Woolley, Aggarwal, and Malone 2015). Firms interested in the positive benefits of diversity look to diversify their people along multiple dimensions, including ideas, gender, ethnicity, national origin, knowledge, and educational institution, among others. Diversity, in its values case, concerns these dimensions. Making the business case requires firms to look for teams marked out with a range of perspectives, knowledge, experience, and ways of thinking.

CAN YOU IMAGINE A WORLD IN WHICH...

- *hiring interviews are dominated by discussions of your firm's values and beliefs?*
- *the primary source of competitive advantage comes from the creativity and empathy of your staff?*
- *diversity is something that your firm no longer worries about because it is both measured and managed?*

Firms working on cultural edge

NARRATIVES

16. Cultures centered on business results: Firms should see the link from culture to client outcomes

Over time, the industry has moved to a strong focus on business results. Some of this is positive for clients, where better performance occurs too, but historically this has involved trade-offs where short-term results take too much precedence over longer-term factors.

The Key Point

Cultural strength is commonly observed in an efficient results ethos. This is reflected by the performance management and reward system that supports and encourages behaviors consistent with a firm's business model and results. The most common compensation structures among investment firms are linked to shorter-term business results. Leaders, in particular the chief executive, by and large embody the desired results-oriented culture; and boards see their responsibility as acting where leaders do not deliver the results expected.

17. Client-centered cultural biases: Firms will benefit from a fiduciary culture

Investment firms' cultures vary by context and geography. But there is a generalized version of culture that has succeeded in "people businesses" based on extreme commitment to clients and clients always coming first. The issue is whether this can grow as a model.

The Key Point

In the research (see Groysberg et al. 2018 and others) there are three key parts of culture, which relate to clients, results, and employees. Effective culture will generally be shaped by the balance among these three states. There is notably a special place reserved for cultural strength observed in the client ethos—the purpose and drive of the organization in serving its clients—which supports the client value proposition.

18. People-centered cultural biases: Firms will benefit from a culture that prioritizes people and teams

A people-centered culture in many situations can be a valuable asset, a source of competitive advantage, and a means to create long-term value. It has particular value to investment firms and their clients because the outputs from these firms derive most of their power from human and intellectual capital. It may be increasingly in demand as firms work on the increasing challenge to manage talent.

The Key Point

The edge from a people culture comes from various attributes: it encourages maximum creativity, facilitating collaboration, and giving personal recognition; It helps workers develop through training, mentoring, and performance management; and it makes allowances for top talent and high performers but gives respect to all professionals. Such a focus can act as a more sustainable edge and create a more ethical culture relative to one that is single-mindedly driven by results.

CAN YOU IMAGINE A WORLD IN WHICH...

- *your firm's annual report starts with soft data on the impacts of intellectual capital, human capital, and social capital on your firm's earnings?*
- *your firm's "town hall" meetings devote the bulk of their time to culture?*
- *your firm's commitment to corporate social responsibility initiatives exceeds 5% of the annual budget?*

HEADCOUNT

56%

of those in Asia expect the number of investment professionals to grow significantly, but this is the only region where the majority expect headcount growth

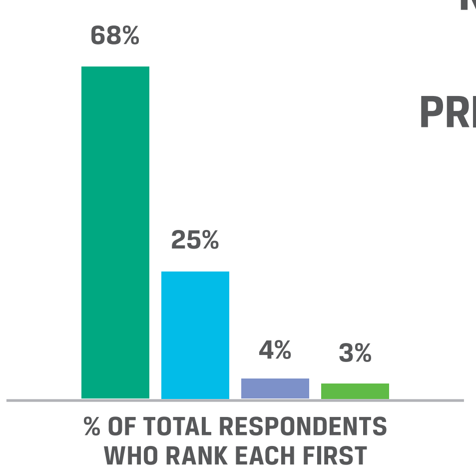
DIVERSITY

53%

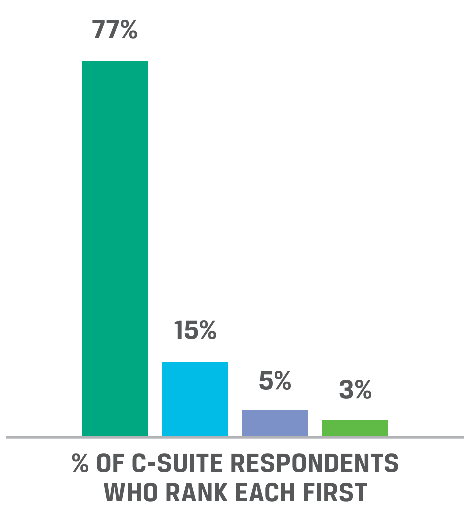
say the business case for improved diversity in the industry is strong or very strong, but only 14% say the speed of uptake of diversity and inclusion practices will be fast

> Firms interested in the positive benefits of diversity look to diversify their people along multiple dimensions, including ideas, gender, ethnicity, national origin, knowledge, and educational institution, among others.

RANK HOW YOUR FIRM'S CULTURE GENERALLY PRIORITIZES STAKEHOLDERS



CLIENTS
SHAREHOLDERS/OWNERS
EMPLOYEES
COMMUNITY/SOCIETY



PEOPLE MODEL SHIFTS

INVESTMENT FIRM SHIFTS

People and technology—better together

Collective intelligence that harnesses technology and is built around diverse skills is critical. Investment professionals need deeper situational fluency and emotional intelligence to complement technology. Diversity is a big contributor to better decisions.

The investment firm of the future will:

Build stronger line-ups of diverse skills
The complex nature of investment firm business and craft leads to highly specialized professionals. But firms will need more diversity. This calls for more "T-shaped professionals"—those that have both domain-specific specialist knowledge and wider understanding and perspective.

Create greater collective intelligence
Investment relies substantially on group decisions. Getting the best possible results from groups involves exploiting their combinatorial elements: governance, process, teamwork, and culture come to the fore, with technology as a new component to add to the mix. We can define the goal as T-shaped teams that successfully merge narrower edgy skills with wider vision skills.

Have leaders who intentionally build culture
The most sustainable and edgy cultures are built on people (how people are valued) and clients (how clients are served). They are also aligned to strategy, synced with leadership, and widely owned by all employees. At most organizations, culture resides in the background, but to be truly effective it must have the sustained attention of leadership.

Recognize the merits of simplicity and the problems with complexity
Investment firms should adopt an "as simple as possible, but no simpler" mantra; understand limits of team size in organizational design; and build out with technologies that simplify the human element.

INDUSTRY SHIFTS

Portfolios benefit from collective intelligence

The required shift involves making investment thinking more rigorous, integrated, and customized. Doing so means taking thinking and acting out of separate silos and creating a unified and integrated portfolio process that considers both industry realities and unique client needs.

In the investment industry of the future:

The "Total Portfolio Approach" investment model becomes widely adopted by investment professionals, integrating asset classes, factors, governance (board and executive), and temporal dimensions. By extension, it can deal with the sustainability dimensions: financial and extra-financial factors; financial and real-world impacts, allocation and ownership; and value and utility.

The skills model adds more people that are "T-shaped," those that are adept at reconciling deep-level knowledge and understanding, with the wide perspective across the whole organization, with recognition of the limits of their knowledge.

The people model develops "T-shaped" teams—that is, teams with broad and deep collective intelligence that act using the power of one team culture and cognitive diversity.

Traditional investment models overturned

NARRATIVES

19. Mandates rebalanced between components and solutions: Outcomes become the new benchmark

Investment products that are simply components in an end investor's strategy are losing ground to preferences for mandates that have explicit outcomes attached. The key aspect in this is the accentuation of the fiduciary responsibility inherent in solutions services and products.

The Key Point

The growth of outcomes and solutions mandates (which are generally whole-fund services) relative to other benchmarked mandates (which are components of a strategy) is a central industry trend. The thesis is that end investors increasingly prefer to get their results as close as possible to their ultimate goals rather than go through a two-stage process that mixes a diversified array of mandates and managers with a focus on performance relative to benchmarks. There is a related idea that asset managers have had their business focused too much on alpha, which is ultimately both unsustainable and hard to differentiate.

20. Systematic investment becomes mainstream: Firms should see the potential for reduced costs

Systematic methodologies are rules-driven processes with technology inputs that lower costs and have lower governance in their application—these are increasingly attractive in lower-return/higher-complexity times and are increasingly becoming core allocations.

The Key Point

The core and satellite structure of management remains widely favored in investment vehicle structuring. This is because it helps in the top-down management of risk in logically appealing ways—funds can seek their risk balance in their weightings to the core and satellite allocations. Increasingly, systematic allocations with a large preponderance of cap-weighted indexing are used as a principal core allocation.

21. Private investment becomes mainstream: Firms should see the potential for added value

Investor appetite for returns that match the attractive figures of the recent past has increased interest in private markets. For large funds this has often become the principal satellite allocation that lifts their overall return to acceptable levels in Lower for Longer conditions, but overcrowding from investors threatens their future returns.

The Key Point

The satellite structure of management that is sitting alongside a larger core component remains widely favored by end investors. This is because it helps the top-down management of risk in logically appealing ways. Increasingly, private market exposures and, to some extent, hedge funds are used as the principal satellite allocations. High active share public market mandates may appear in this category too.

CAN YOU IMAGINE A WORLD IN WHICH...

- *private assets form significant holdings in defined contribution participant accounts?*
- *passive portfolios make up more than half of public equities and bonds?*
- *factors are more than half of the active management assets under management in public markets?*

Sustainability embedded across the industry

NARRATIVES

22. ESG models make progress: Firms can do more to integrate sustainability into their investment models

The terms and concepts around use of ESG, sustainable investing, and responsible investing have developed into a spectrum of sustainability models that are practiced as an adjunct to the other dimensions of the investment model. The future practice in this area needs to become more mainstream and standardized to be successful. It should also be complementary to long horizon investing and system-wide thinking. This would contribute significant value.

The Key Point

The Purposeful Capitalism scenario states that there are factors supporting fresh models in the responsible and sustainable investing areas. The driving force is complex: investors have multiple analytical and context issues to manage across short-term and long-term time horizons with balances to be struck in this mix. The key is more thinking that is system-wide rather than the reductionism that is more common.

23. Increased focus on stewardship and governance: Stewardship as the principal alignment tool

Stewardship in the exercise of ownership rights and responsibilities with respect to investee companies has been a small-scale part of the investment industry to date. The issue is whether this changes and investors play a much bigger part in corporate governance and activism, with accompanying impacts on the performance of corporations and through that on investors' own performance.

The Key Point

The fundamental issue for investors is dealing with corporations in situations where they seem less than fully aligned to a legitimate long-term sustainable value proposition. Conflicts of interests are a primary source of doubt for investors. Such doubts may grow in the future as corporations face transformational circumstances and situations where corporate assets may become stranded. There are considerable challenges for investors to be effective in their thinking and their corporate actions.

24. Impact positioned alongside risk and return: Firms should manage and master ESG data

The central issue is what asset owners and asset managers should think or do about the impacts of their investee companies and assets. What, if any, is the responsibility that resides with owners for these impacts, and how should it be accounted for? This question is connected to the asset owner's "license to operate."

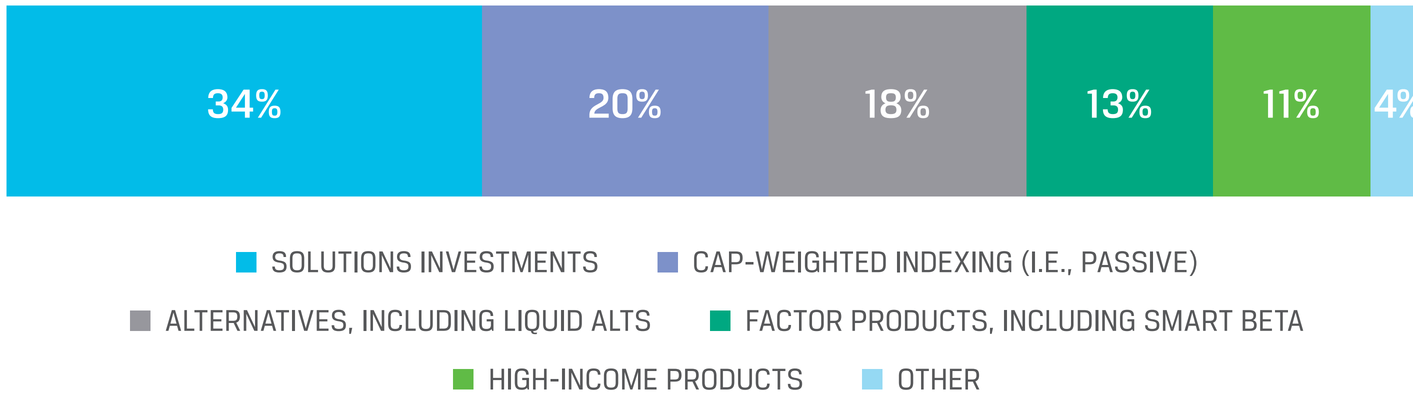
The Key Point

To those investors where impacts of investment matter, the impacts will need to be placed in some context, and in this narrative the UN Sustainable Development Goals may play a guiding role. These goals are quickly becoming a widely accepted version of what national governments and society broadly see as desirable states to work toward. They define the shape of a Sustainable Development Investment framework that some funds will seek to adopt.

CAN YOU IMAGINE A WORLD IN WHICH...

- *stewardship activities are given more than 5% of the investment management firm's budget?*
- *universal owners—large-scale, long-term, and leadership-minded institutions—work together in highly collaborative ways in their stewardship activities?*
- *asset owners all report on the impacts from their portfolios on the UN Sustainable Development Goals?*

THE STRONGEST GROWTH IN PRODUCT DEMAND IN THE NEXT 5–10 YEARS



STEWARDSHIP

64%

expect the application of stewardship and ownership rights to portfolios to grow over the next 5–10 years

SUSTAINABILITY

72%

expect their firm's future commitment to the research of ESG and sustainability issues to be higher in the next 5–10 years

Investment products that are simply components in an end investor's strategy are losing ground to preferences for mandates that have explicit outcomes attached.

INVESTMENT MODEL SHIFTS

INVESTMENT FIRM SHIFTS

Refocus investment processes on outcomes

The control and delivery of client outcomes is a critical new focus—hence the growing emphasis on investment solutions, which are by design aligned to outcomes and so have natural advantages.

The investment firm of the future will:

Build investment edge through advanced intelligence
Firms need to adopt stronger investment practices tied to the disciplines of beliefs, frameworks, processes, and measurement. The need for integrating more elements in the investment model is critical. There are potentially four dimensions to this greater "joining-up": short- and long-term, financial and extra-financial, allocation and ownership, return and impact.

Strengthen investment models
On top of the greater sophistication needed in integrated management, there are other needs. At the top level, this is about a better investment model with better analysis. At the detailed level, we should see better design and use of investment solutions with appropriate alignment to desired outcomes.

Require more precision to achieve client outcomes
Managing to outcomes involves a more complex investment challenge in successfully integrating the different risk and return premia, in particular making market exposures less dominant.

Build a stronger investment culture
An investment culture is required that emphasizes investment skill as a craft and a passion and includes a purpose-driven calling and mindset.

INDUSTRY SHIFTS

Sustainability is woven into the fabric

The adoption of an effective and purposeful long horizon investment framework is a critical shift for the industry. This involves getting sustainability joined up on multiple dimensions: financial impacts and real-world impacts, short- and long-term, financial and extra-financial factors, allocation and stewardship, and value and utility.

In the investment industry of the future:

Sustainability issues are fully incorporated and integrated into the investment process, building on the risk and return picture and adding an extra dimension in addressing the wider impacts of portfolio positions.

Investors can make and keep commitments to long-horizon principles and exercise discipline in the integration of short-term and long-term considerations.

There is consistency of asset owner practice and decision making on ESG factors via stewardship; and mandates specify clear sustainability goals and metrics.

Universal owners see materiality in their portfolio and stewardship impacts, which they intentionally integrate into their strategies.

The data used in the investment process is consistent and coherent on ESG factors with a blend of accuracy, consistent interpretation, and good judgment.

DISTRIBUTION MODEL

Smarter client segmentation

NARRATIVES

25. Technology enhances client relationships:
Firms should use technology to know customers better

The use of detailed personal intelligence about customers in the investment area has been limited in the industry so far. There is significant potential in the application of sophisticated technologies to create customer relationship management (CRM) processes in hyper-connected forms that are personalized, simple, and speedy.

The Key Point

Customer data and intelligence are currently based on some relatively simple categorizations. Distribution models vary with unique issues to consider in institutional, retail, and private wealth segments. It is in retail and private wealth where firms have to travel farthest with new technologies that are potentially transformational with respect to capture of personal data and its application to improved customer delivery covering improved communications, targeting, and customizing. Asia is likely the biggest test-bed for the application of these new technologies.

26. Technology enables customized engagement:
Client interfaces need behavioral savvy

Client technologies still suffer from legacy systems in which communications and transaction processes are quite primitive. These must be upgraded so they are nimble enough to deliver a sophisticated product to end clients, and simultaneously simple enough for customers to interact with them.

The Key Point

The wealth interface requires significant change to deal with the impacts of technology that are subject to widespread disruption everywhere, with financial services coming to this changing field quite late relative to other industries. Critically, the communication challenge must deal with mobile devices, PCs, and tablets as end investors increasingly seek the engagement to happen wherever they are. There are five building blocks for this emerging solution architecture: visualization, data, application programming interface (API), analytics, and location-based delivery.

27. Technology enables customized messaging:
Expansion of soft data transforms servicing

Current servicing for all investing's customers—institutional, retail, and private wealth—is bland and communicates with badly targeted features. The use of personal data and technology enables much better targeting using more customer intelligence, behavioral savvy, nudging, and ultimately empathy.

The Key Point

Under the new principles of consumerism and as described in the Parallel Worlds scenario, product preferences center on personalization, simplicity, and speed. For such a specification to be delivered, investment firms must make considerable improvements to their communication strategies and methods.

CAN YOU IMAGINE A WORLD IN WHICH...

- *clients stay with or select your firm based on credibility and competence despite poor returns in the past?*
- *your primary relationship with your client is via a mobile smart device?*
- *client measures of trust, satisfaction, expectation, and outcome are systematically tracked through feedback loops?*

Technology can engender trust

NARRATIVES

28. Trust significance grows:
Firms should adopt behaviors and technologies that monetize trust

Because trust is perceived as difficult to measure, most firms connect it weakly to value. But it is tremendously important as it carries so much potential to extend relationships and to discourage product switching. Therefore, it has the potential to play a much bigger part in the industry of the future.

The Key Point

The central issue is how trust might evolve in the context of transformational technology. In a future in which investment firms offer personal, simple, and speedy propositions, can they also achieve trusted engagement? While technology can create faster, deeper trust in ownership and transactions, it can be used to the detriment of the client and is not sufficient on its own to create long-term trust and value.

29. Blockchain use in transaction assurance:
Firms should see blockchain as streamlining transactions

Blockchain is a new technology that has the capacity to influence the way business is done in the investment industry. Its greatest potential seems to be in boosting trust in the system by providing excellent transparency. The issues are how it will be developed and how much trust is given to it.

The Key Point

As outlined in the Fintech Disruption scenario, blockchain can be applied in the intermediation of trust in various areas where our current financial system is effective but makes use of a clunky central counterparty model. Blockchain removes the need for any kind of third party to facilitate an exchange in a transaction. The trust must exist in the idea, and people must trust the platform, the spreadsheets, and the time stamps, but trust in another person is not necessary in the traditional sense.

30. Cybersecurity grows in significance:
Cybersecurity critical to confidence and outcomes

Data is becoming more significant in the investment industry. The industry must create much stronger confidence in the security with which data, particularly personal data, is handled. It must be recognized that this will be hard to achieve with increased use of mobile technology.

The Key Point

Cybersecurity is already important, and it becomes even more significant for investment firms and regulators in the future. Investment professionals describe cybersecurity increasingly as a preeminent risk relative to others faced by corporations (sources: PRI; Next Generation of Trust). The central challenge for investment firms is in their increasing wish to use personal data, which leads to the need to balance security with customer convenience and experience.

CAN YOU IMAGINE A WORLD IN WHICH...

- *you engage in financial conversations with clients that are not just about retirement, but that are as diverse as their lives?*
- *disclosure and transparency for your firm are 95% generated via blockchain processes?*
- *the tech titans (e.g., Amazon, Alphabet, Apple, Alibaba, Baidu, Tencent) are the dominant investment industry players?*

The central challenge for investment firms is in their increasing wish to use personal data, which leads to the need to balance security with customer convenience and experience.

CYBERSECURITY

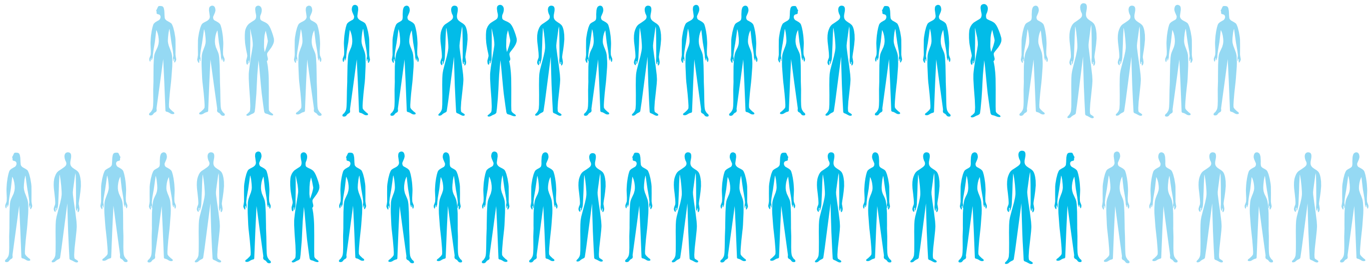
24%

say cybersecurity is their firm's top tech priority

TRUST TECHNOLOGY

68%

of institutional investors and 40% of retail investors say that the increased use of technology by their investment firm has led them to trust their asset managers/adviser more (from *Next Generation of Trust*)



64% EXPECT THAT DEFINED CONTRIBUTION PARTICIPANTS WILL BECOME MORE ENGAGED

DISTRIBUTION MODEL SHIFTS

INVESTMENT FIRM SHIFTS

Find ways to engage clients

Better engagement is needed, using technology in a way that speaks the customer's language. New data provided by clients, customers, and end investors add opportunities to customize. New levels of engagement are possible if new forms of trust can be established.

The investment firm of the future will:

Gain a client edge through client intelligence
Use customer relationship management (CRM) principles, drawing from extensive customer data, extending the opportunities for personalized, simple, and speedy engagement. Build trust through excellence in engagement, appropriate use of data, and connection to client-specified goals.

Extend customization into wealth and defined contribution
Seek opportunities to build out customized investment products to wealth and defined contribution business segments using consumerization success principles that are in other sectors (e.g., technology nudges such as "people like you will like products like this").

Speak in an accessible language
The combination of people and technology affords the best opportunities to make the complex into simple propositions that retain sophistication. Such engagement reaches out to customers drawing on their values-based preferences. It uses intuitive dashboards. Use of personal data must balance cybersecurity with customer convenience and experience.

Commit more heavily to the creation of trust
Trust has great value to both the saver giving trust and the firm getting it. Use technology to facilitate trust, and use client audits and other measurement to help manage trust.

INDUSTRY SHIFTS

Outcomes replace benchmarks

High-precision, outcome-driven mandates become dominant in the industry. Mandates evolve from benchmark-anchored arrangements to outcome-driven frameworks that are comprehensively aligned to end-investor needs and goals.

In the investment industry of the future:

The dominant mandates in the industry are outcome-driven and specified in terms such as "liabilities plus a spread", "CPI plus a spread", or "cash index plus a spread". The precision of these mandates deepens the client dialogue on needs and values.

Mandates specify risk in fundamentally important terms like drawdown risk and mission impairment with time horizons front of mind, and much less in terms of peer comparisons and tracking error.

The industry favors a total portfolio approach using mandates overseen by CIOs or OCIOs that take overall responsibility for investment outcomes.

Investment industry firms and professionals are motivated more strongly by purpose.

Investment firms operate in wider specified mandates in which strategic partnerships offer clients access to wider intellectual property and investment intelligence.

CONCLUSIONS

Investment firms face a future in which change is accelerating.

This requires investment firms to recognize these changes and adapt to them by:

- Exploiting technology.
- Building greater collective intelligence through teams with deep knowledge and wide perspective.
- Doing far more joined-up investment thinking and practice.
- Engaging more by identifying client needs and managing to their desired outcomes.

The future state of the investment industry will reflect progress by investment firms on these issues. We suggest a forward-thinking investment industry that copes well with change will be characterized by:

- Holding itself up to clearer, higher standards.
- Becoming more proactive and purposeful.
- Adding value well beyond the rewards it enjoys itself.
- Making positive contributions to society's deeper-rooted issues.

This can become reality if investment firms adopt the principles and strategies outlined in *Investment Firm of the Future*. The Shifts representing actions to be taken are summarized below.

CFA Institute is committed to further consultation with leading industry figures on the issues raised in this report and in particular moving our industry to higher standards of professionalism.

CFA Institute restates its support for the investment industry through credentialing, education, standards, research, and advocacy activities.

As we outline a more forward-thinking future for the industry, we also view this report as a source of thinking for CFA Institute itself to reflect on its vision, strategy, and goals to support its mission "to lead the investment profession globally by promoting the highest standards of ethics, education, and professional excellence for the ultimate benefit of society."

FIRM SHIFTS	**Embed organizational agility and client-centric culture** Firm success reflects state of agility and fiduciary mindset	**Use every tool to differentiate the operating model** Insourcing/buy or build are critical decisions in the value chain and tech	**People and technology—better together** T-shaped diverse skills with tech added are a game changer	**Refocus investment processes on outcomes** The control/delivery of client outcomes changes everything	**Find ways to engage clients** Better engagement using tech in a way that speaks clients' language
INDUSTRY SHIFTS	**Governance and culture are upgraded** Enhance the value created by industry	**Technology is firmly embedded** Data strategy, AI, and tech provide essential collective intelligence	**Portfolios benefit from collective intelligence** Thinking is collective in rigorous, integrated, customized processes	**Sustainability woven into the fabric** An integrated and sustainable long-horizon investment framework	**Outcomes replace benchmarks** High-precision, outcome-driven mandates become dominant

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About the Report

Unless otherwise noted, data in the report are from a CFA Institute member survey conducted 27 February–8 March 2018. In total, 2,518 responses were received, with a margin of error of +/–1.9%. Respondents had roles such as portfolio managers and analysts (51%), C-level or consultants (20%), financial advisers (11%), and risk managers or strategists (11%); 86% were men and 14% were women. Respondents came from the Americas (60%), Asia Pacific (16%), and Europe, Middle East, and Africa (25%).

The CFA Institute Future of Finance initiative is a long-term, global effort to shape a trustworthy, forward-thinking investment profession that better serves society. For more information, visit **futurefirm.cfainstitute.org** or contact us at **FutureFinance@cfainstitute.org** to offer your ideas about how to shape the industry for the future.

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About CFA Institute

CFA Institute is the global association of investment professionals that sets the standard for professional excellence and credentials. The organization is a champion for ethical behavior in investment markets and a respected source of knowledge in the global financial community. The end goal: to create an environment where investors' interests come first, markets function at their best, and economies grow. There are more than 150,000 CFA® charterholders worldwide in 165+ countries and territories. CFA Institute has eight offices worldwide and there are 151 local member societies.