Built by investors for investors

TECHNOLOGY ORCHESTRATING SHIFTS IN THE INVESTMENT LANDSCAPE

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The global investment landscape is changing at a rapid pace with widespread ramifications on the way investment managers conduct investment research, assess investment opportunities, build investing strategies, and design investment products for clients. In the backdrop of this landscape, inarguably, technology is playing a key role in orchestrating change that is engendering both risks and opportunities. Recognising and proactively addressing these will ensure that you, as service providers, are better positioned to thrive in a future where technology is almost table stakes. In this evolving ecosystem, the key shifts on our radar include a variety of pressing aspects, as delineated below.

The Mighty Three

I. Information and data

In the investment business, analysts tend to spend significant time and effort in gathering and monitoring information about a company's business, management, earnings, growth prospects, competition, etc. A few decades ago, a resourceful analyst could develop an edge by collecting information ahead of others. However, technology has ensured easy access to information to all – today, any information that you seek is literally available at the click of a button. Virtual earnings calls and AGMs have democratised management meetings for common investors. Social media and investor forums have accelerated knowledge sharing among wider networks. As a result, the previously enjoyed information arbitrage has narrowed significantly and with the advent of Generative Artificial Intelligence, is probably almost on the verge of disappearing.

In an ecosystem fuelled by abundance of data along with user friendly tools for processing and analysing that data, your ability to draw insights from the data becomes increasingly important. Basically, the way you use and then react to a given set of information distinguishes you from the herd. Think of it this way, if everyone has the same information, is running similar algorithms, and is chasing popular investment themes, then consistently outperforming the market over a long period becomes challenging.

On one hand, democratisation of information has made it nearly impossible to find obvious arbitrage opportunities or Graham style bargains trading at net-nets or deep discount to tangible value. At the same time, the advent of passive, algo, quant or rule-based investing will lead to polarisation in markets where most of the gains in the market stem from a few handfuls of stocks.

In this landscape, mispricing opportunities will inevitably arise – enabling firms with better data analytics and behavioural skills to capitalise upon these opportunities. However, it is important to highlight that, in a polarised market, such mispricing might take a longer time to correct – thus, patience and a long-term view are essential.

II. Investment analysis

Technology is enabling disruption at an unprecedented scale – it is steadily disrupting some of the traditional well established business models while weakening the moat around businesses which were previously considered infallible. Correspondingly, technology is enabling the creation of new-age businesses that do not adhere to the traditional linear business models.

Analysis the traditional way

Most traditional business models revolve around owning tangible assets, producing inventory, and selling the products through own or third-party distribution channels. This created a linear relationship between production and consumption. In such businesses, theoretically profit could be made by selling just one unit/product, thereby enabling firms to generate revenues from an early stage and become profitable at low scale.

What has changed?

In the last decade, however, the new tech businesses which have emerged do not fit into the traditional model.

Ownership vs distribution:

Instead of owning means of production, they develop means of distribution or connection. Their primary function isn't production of any good or service but is to facilitate the exchange of value between different user groups.

Delinking of revenues:

Often, their primary function may not have a direct link with revenues and thus, in the initial period, they may not earn any revenues while they continue to invest in servicing their users.

Tangible vs intangible:

As compared to traditional businesses where investments are primarily in tangible assets and thus, are reflected on the balance sheet, new-age tech businesses invest in intangible assets like research and development, customer acquisition or brand building, etc. While these are shown as expenses on the income statement, they are generally not reflected on the balance sheet. So, these companies report losses in early stages.

The new imperatives

When analysing such companies, analysts should first and foremost acknowledge that traditional financial metrics of assessment are inadequate here. Without an established track record, proven profitability, or strong balance sheet, it is difficult to objectively evaluate the new tech businesses. At the end of the day, believing every story narrated by charismatic founders may lead to kissing lots of toads without any guarantee of meeting the prince. Thus, one needs a deeper judgement and modified analytical framework to optimally capture the unique characteristics of such tech powered companies. Factors to be considered while building this framework could include:

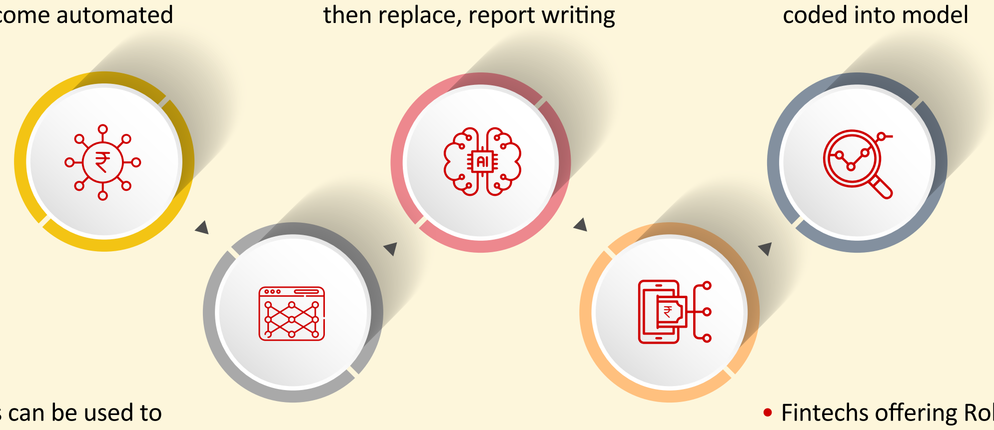
- Understanding the company's target market, the pain points that they are alleviating, and the value proposition for the customers
- Assessing their core competency in terms of R&D, innovation, tech infrastructure, etc.
- Identifying Customer retention rate and Life Time Value of a customer
- Evaluating unit economics and path to profitability
- Understanding management quality in terms of vision, integrity, corporate governance, prudent capital allocation, etc.

The bottom line is that in order to identify the prince amongst the toads, the framework should be able to unlock insights into their potential for growth, market disruption, and long-term viability.

III. Changing contours of talent

Talent is, undoubtedly, the key driver of success in the investment management industry. But as technology becomes an integral part of the investment industry, there will be a direct impact on human resources engaged in the industry. Select examples include:

- Mundane tasks like data gathering or maintaining financial models will become automated
- Generative Artificial Intelligence could potentially first assist in and then replace, report writing
- Common heuristics, thumb rules, and basic analytics can be easily coded into model



- Advanced tools can be used to identify data patterns in a more efficient and optimal manner Quant/ rule-based/ factor investing schemes will be able to manage funds at significantly lower costs than active managers, thereby mitigating the pressure on fees earned
- Fintechs offering Robo-advisory, stock baskets, DIY investing strategies, etc., are challenging incumbents for the wallet share of younger investors

To meet the expectations of their customers, the investing industry would need to diversify its talent pool by inviting data analysts, programmers & coders, cybersecurity experts, UX designers, etc., to join their team of investment professionals. And to succeed in that landscape, fundamental analysts and investors would need to develop new skills to stay relevant.

Strong fundamental and investing knowledge without any understanding of data analytics, basic programming, Artificial Intelligence and Machine Learning would be a handicap, restricting one's ability to interact with and use new fintech tools. On the other hand, mere technical knowledge without any fundamental base would be equivalent to driving a race car without any safety gear. Those who have a good understanding of fundamental investing and technology will thus have brighter prospects. Thus, continuous upskilling, adaptability, and collaborative abilities will become crucial for firms focused on thriving and delivering superior client experiences in an increasingly competitive landscape.

As the global and domestic investment management industries prepare for an influx of technology, you must be agile and focus on adopting innovation at the earliest possible juncture. Strong foundation of investing principles powered by the smart use of technology could give you an edge against old and new competitors. Human or Artificial Intelligence both have their own limitations but a marriage of the two will pave the path for future ready firms.

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