South African Investment Management Outlook:

Overcoming structural challenges through deliberate choices

April 2023

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Executive summary

The investment management (IM) industry in South Africa has grown significantly in recent years, driven by a combination of social and economic factors, along with the maturation of the regulatory landscape. South Africa's market infrastructure and the regulatory environment for the industry are widely considered world-class, and continue to evolve. Collectively, this has resulted in a more competitive environment, better products, and a safer environment for clients.

Despite this growth, there are hard-to-ignore structural challenges that will impact the industry in the years to come. From a macro perspective, the global economic landscape, coupled with the challenging political and economic landscape in South Africa threatens the assets under management (AUM) and flow growth in the industry. From an individual market participant perspective, IM companies are finding it harder and harder to distinguish themselves in the market amid high levels of competition and perceived homogeneity of products. Similarly, not all IM companies have invested in data and technology over the past decade to absorb the downward pressures of fees and cost of compliance.

These factors lead to structural changes such as the increased market share of passive investments, a rapid increase in mergers and acquisitions (M&A) transactions, bundle product offerings and industry convergence, among others, which in turn results in a large-scale scramble to compete on experience while underestimating the investment required to do so. In an effort to keep costs low many IM companies equate client experience to servicing or building products based on what they assume clients would want or need, this often leads to failed product launches. While many IM companies compete effectively on the client experience front, many have invested only in either technology or people, without doing the necessary research to understand the client or having invested in the data structure to understand existing client behaviour.

Given these changes, coupled with the challenging environment, ***choosing to choose*** should be the focus of 2023 for IM companies. Market leaders will make a deliberate choice to stop creating product and experience permutations for every single possible client, thereby reducing brand confusion and unnecessary operational expenditure in the process. Market leaders will make deliberate choices regarding which clients they serve (and those they will not serve), and what their unique value proposition is to the market.

There are factors that market leaders need to take into account when making their choices. Choosing client segments involve understanding clients from a behavioural and needs perspective, and responding to the needs of a chosen client segment requires deliberate focus.

There are four major domains to compete in – **performance, experience, product design and innovation**, and **fees**. There are key considerations in each domain, and technology, operating model and regulatory compliance underpins each as a foundational consideration.

Choices, and the reiteration of choices, are crucial at this point of the industry's development to create the next wave of improvement and innovation. Choices as a plural is implied, as the interdependency of choices in this particular industry cannot be ignored, but simultaneously, should be in moderation. Competing on all fronts is not a viable strategy, but choosing to compete in one domain also does not mean wholly ignoring the others.

Change is difficult. Doing things the way they have always been done is comfortable, but it stifles innovation. Our view for 2023 is that the industry will shift into deliberate choices and more market leaders for certain domains will begin to emerge. Given the economic context, and the steady decline of margins under the reality of many perceived homogeneous products, the stage for innovation and improvement is set.

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The South African IM industry has evolved over the past 10 years

The industry has come a long way

The IM industry in South Africa has grown significantly in recent years, driven by a growing middle class and increased financial literacy among investors, clients and new market entrants. Regulation started to create an environment where products are developed responsibly and in the best interest of clients – the split of the Prudential Authority and the Financial Services Conduct Authority and the introduction of key legislation such as the Retail Distribution Review (RDR) and Treating Customers Fairly (TCF) being key contributors. Our market infrastructure and the regulatory environment for the industry are widely considered world-class and continue to evolve. Collectively, this resulted in a more competitive environment, better products, and a safer environment for clients.

Leading investment managers and economists[1] predict that 2023 will be a good year for income investing, with bonds and high-yield equities as potential areas of opportunity. Similarly, many IM companies have created offshore solutions for clients seeking to externalise their money or get exposure to foreign markets. While the SARB has employed measures to limit money leaving the country and requires citizens to declare their foreign investments, there is still scope for investment managers to create innovative offshore solutions to avoid AUM outflow from their business.

While many of these changes required considerable effort in product innovation and heavy investment in technology to remain competitive, the investment made by industry leaders over the past decade will continue to provide resilience in the year to come.

Changes in assets

- The **JSE All Share Index (ALSI)** grew by **99%** over 10 years and reached its highest historical level in 2023.
- Industry **AUM has grown** at a compound annual growth rate (CAGR) of **~10% per year**, and the number of accounts by ~6%, which is significant considering a population growth rate of ~1%.
- The average **fund AUM CAGRs**:

Equity funds: **+7%**
Multi-asset funds: **+13%**
Fixed interest funds: **+6%**
Real estate funds: **-2%** primarily due to COVID-19.

Changes in choice and distribution

- **357 new multi-asset** funds launched, and the **average AUM per fund doubled** over the past 10 years despite all of the new market entrants, indicating a growing preference for solutions, as opposed to singular strategies by clients.
- **Wrapped products and solutions**, grew from **54%** of Linked Investment Service Provider (LISP) flows in 2012, to **65%** in 2022.
- **85% of flows** in 2022 went to **multi-asset and fixed income strategies** which echo the global market sentiment.
- Total AUM allocated to **offshore solutions grew from 6%** in 2012, to **15%** in 2022, which indicates a growing preference for global asset diversification by clients.
- **Independent financial advisers** grew their market share in AUM from **68% in 2012 to 74% in 2022**, and **direct clients from 4% in 2012 to 7% in 2022**.

Developments in governance and operations

- **Retirement fund reform** led to major retirement fund consolidation into umbrella funds, which provide better products at better fees for retail clients.
- The introduction of **Twin peaks and RDR regulation has bolstered the trustworthiness of the sector and the value proposition to clients**, and in-progress regulations such as the **Two-Pot regulation** for retirement funds will continue to improve the landscape for clients.
- **Competition and invest]ment into technology** in the industry lead to improved service delivery levels and investment managers' abilities to remain competitive while charging clients significantly better fees. The all-inclusive **investment cost across all investment and client types** in 2012 was more than **4%**, and is currently below **2%**.

Infographic source: ASISA, SASHARES and FSCA websites, Deloitte Africa analysis, 2023

[1]*Source: "Morgan Stanley: Why 2023 will be a good year for income investors", morganstanley.com, 2023*

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Certain challenges will impact the industry in the years to come

There are some challenges, both on a global and local front, that may test IM companies over the next few years. The winning companies over the next decade will be those who have understood the effect of these challenges on their business and devised winning strategies to combat them or create opportunities from them.

Macro-economic challenges

The challenges

The global economic landscape predicts a challenging 2023

Against the backdrop of record-high inflation in 2022, predicted global real GDP contraction, and large-scale job cuts in the technology sector, financial markets will be influenced adversely, putting pressure on the industry. Global inflation, which was between 3-4% for 2018-2021, more than doubled to 8.75% in 2022 and is expected to come down to 6.6% in 2023. Historically, emerging markets have recovered after recessions, but they typically take longer than their developed counterparts.

The global challenges are amplified in South Africa

The effect of a potential global recession is likely to be amplified in South Africa, as many South Africans delved into savings during the pandemic to survive. South Africa, crippled by rising public debt, is also in its longest downward trend of GDP growth (110 months) since 1945. This downward trend is urged on by rolling blackouts and an energy availability factor below 60%. South Africa also relies on foreign investment, which may dry up during a recession, and as the impacts of grey listing play out. In addition, trade tensions between the United States (US) and China will likely impact South Africa in the year ahead, as South Africa's prominent exporting sectors (e.g., manufacturing) are particularly vulnerable to these tensions. These structural issues make it difficult for the government to implement counter-cyclical policies and finance social programmes, while pursuing a path of fiscal consolidation.

South Africa has one of the lowest savings rates in the world

South Africa's savings rate is below that of most emerging market peers.

Brazil	16.9%
South Korea	13.7%
US	12.4%
Euro area	11.0%
India	10.8%
South Africa	0.5%

While the Gini-coefficient is a straightforward traditional factor to blame for the low savings rate, an important contributing factor is the lack of understanding and resulting trust in perceived opaque investment products.

Key considerations for IM companies

- How have we ensured that our investment strategy and asset allocation mirror market movements, or capitalise on the trends?
- How have we ensured that we are adequately hedged against macroeconomic changes?
- Are we engage proactively with our clients to inform and educate them about the macro-economic environment in a simple enough language to understand?
- How are we positioning ourselves to influence the structural challenges of the economies in which we invest and operate?
- How are we innovating our product offerings and operating environments to potentially improve the savings rate of South Africans, and, through that, enhance our share of the market?

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[2]Global inflation, which was between 3-4% for 2018-2021, more than doubled to 8.75% in 2022 and is expected to come down to 6.6% in 2023 Source: Statista, IMF WEO Jan 2023
[3]South Africa's high unemployment rate, which was at 24% in 2014, rose to 32.9% by Q4 2022. Source: Statistics South Africa, 2023
[4]SARB in the MPC press release end Jan 2023 noted that they expect 0.3% growth for SA in 2023, with 2 percentage points deducated from growth in 2023 due to loadshedding.
[5]US coal plants had a combined EAF of ~87% in 2009, which increased to ~93% in 2021. Tutuka and Duvha had a combined EAF of ~80% in 2009, which decreased to ~45% in 2021. Source: Mybroadband, Dailyclient, 2023
[6]As interest rates in the US rise, foreign investors may withdraw their money from South Africa to invest in developed economies, particularly the US, where yields and currency strength is more attractive than the South African rand. As the US has the largest and most developed economy, it is often considered a safe haven for clients. In times of uncertainty and volatility, clients may shift their money from riskier assets to the US, increasing demand for the dollar and pushing up its value. The US Dollar Index (DXY) reached 114 in September 2022 per Tradingview.com, which was the highest level since 2002. This narrative could also impact South Africa's economy through a decrease in the value of the rand and a consequent increase in the cost of borrowing for South African businesses and consumers.
[7]Source: Statista, Worldeconomics, 2023

Data and technology challenges

The challenges

Not all IM companies have adequately invested in data and technology

Investing in data and technology continues to be a trend in the industry due to the multitude of use cases that hinge on solid, dependable data. Due to the rapid evolution of the industry over the past decade, compounded by the high volume of M&A transactions, many companies grew faster than operational systems allowed, leading to fragmented datasets.

These fragmented datasets made it difficult for IM companies to provide the client experience required to remain competitive in a margin-pressurised industry, or to respond quickly to change. The incompatibility of technology creates significant client friction, and businesses that operate modern platform architecture typically see a lower impact on their client experience due to fewer integration issues.[8]

As this is a commonly accepted shortcoming of the industry, some IM companies across South Africa have invested in large data warehousing and extensive business intelligence projects over the last decade.[9] In most instances, projects were focused on accumulating and sorting existing datasets into a format to improve current calculations and reporting, but also to set the baseline for further data innovation.Large-scale innovation in client experience, investment models, and reporting is expected over the next decade, especially as many IM companies consolidate their technology landscape to provide better client experience and shareholder returns.

Key considerations for IM companies

- How have we set up our operating and reporting environment to provide great service and reporting to our clients without significant manual intervention (and cost)?
- How have we set up our technology and associated data structures to respond quickly to change?
- Are we carrying a high level of technical debt or running at a high risk of operational loss due to dated systems that do not suit our needs? How do we consider cloud as a mitigating strategy to this?
- How have we linked our data structures to cross-sell and up-sell effectively within the confines of the law, and advise our clients effectively?
- Are we being deliberate in our data and technology investments by resourcing our projects with people with sufficient time and the right skill set and experience? Or are we expecting our existing staff to run transformation projects on top of their day jobs, introducing cost and quality leakage?

[8] *Source: Deloitte Wealth 4.0 survey, 2022*
[9] *Source: Deloitte Africa analysis on listed investment managers and financial institutions' annual financial statements, 2022-2023*

Margin and competitive pressure

The challenges

The IM market is highly competitive and clients perceive products to be homogenous

There are currently in excess of 1,600 funds in South Africa (retail and institutional) and even more segregated mandates; yet, the South African financial market is relatively small compared to the developed world, both from a market capitalisation and stock choice point of view.[10]

Over the past decade, the market has become increasingly cramped, with large funds encountering challenges to buy up enough of an instrument to hold their desired exposures. When analysing the top 20 equity funds in South Africa, the largest holding in most funds is a combination of Naspers and Prosus, with an average of 9.58% held and a standard deviation of 1.4%. The funds' respective top 10 holdings are 20 permutations of the same 25 stocks.[11] While the industry is by no means limited to equity funds, the pattern experienced in the equity fund example is felt throughout the industry. Clients are questioning the distinguishing features and benefits of managers, products, and services alike, which has put pressure on margins as clients are questioning the value they are getting beyond performance and fees.

Leading to: Increased market share of passive investments

The demand for passive investments have increased over the past decade. This trend is driven by the underperformance of actively managed funds[12] relative to their passive counterparts and the lower fees associated with passive investments.

The US stock market exceeds US$40 billion in market capitalisation, with ~7,000 funds, where South Africa, with a stock market capitalisation just above US$1 billion has ~1,600 funds. Similarly, the US has more than 4,000 listed companies, where South Africa only has 264. This creates homogeneity in funds in South Africa, and challenges the fee associated to them.

While the South African move to passive investments is slower than developed economies, there has been a definite increase in the AUM and flows of the South African passives market.

Leading to: A rapid increase in M&A transactions and bundle product offerings, leaving some market participants behind

The number of M&A transactions in the industry increased over the past decade and even more over the past five years. Similarly, many IM companies augmented their current product set with adjacent offerings such as life insurance or banking products. Some have become fully diversified financial services companies offering cross-product discounts, such as Discovery, Sanlam or Old Mutual.

Further consolidation in the industry is expected as companies seek to remain competitive and provide superior value to clients.

Leading to: A large-scale scramble to compete on experience while underestimating the investment required to do so

The focus on client-centricity has become topical across industries over the past decade, and many IM companies want to compete on client experience. However, the level of investment in understanding distinctive client segments and then investing in the process, technology, data, and people to service those segments is mostly underestimated. This leads to many IM companies equating client experience to servicing or building products based on what they assume clients would want or need in an effort to keep costs low, which often leads to failed product launches.

While many IM companies compete effectively on the client experience, many also invest in only technology, or people, without doing the necessary research to understand the client or having invested in the data structure to understand existing client behaviour.

[10]Source: World Bank, Statista, 2023
[11]Source: Fund fact sheets as at December 2022, Deloitte Africa analysis.
[12]According to the S&P Indices Versus Active (SPIVA) South Africa Scorecard, 2023, 95% of active managers underperformed the S&P South Africa 50 index over the five years to end-June 2020

Margin and competitive pressure

The challenges

These combined challenges have created structural industry challenges

The industry has seen many market leaders emerge over the past decade who enabled their competitive positions through deliberate strategic choices. While some decided to compete on fees, others chose performance, experience, product innovation, or a combination of up to two of these. This implies an acceptance that competing on all fronts is not commercially viable, and confusing.

However, many companies did not make a deliberate choice and then, to defend their AUM, tried to compete on all fronts, often leading to mediocre or adverse results due to a lack of resources. As AUM continued to leak, these market laggards resorted to creating unique product permutations for all clients as a defensive strategy, without scaling their operating model. This led to a further diluted focus and high operational costs. Further consequences included confusing or unrefined corporate identities that do not resonate with clients, lack of competitive advantage, mass manual interventions to sustain thousands of product permutations, and friction in teams due to an unclear view of priorities.

Choosing to choose should be the focus of 2023

Considering these challenges, making these strategic choices and being deliberate and strict in acting on them should be the top strategic focus of IM companies for the year to come to solve the structural challenges in the industry.

Key considerations for IM companies

- How are we distinguishing our product beyond performance and fees? Do we give added value to our clients that other IM companies do not?
- As active investment managers, can we use innovative methods to maintain our allocations but charge more competitive fees, such as utilising passives in our portfolio?
- How can we partner with other players in the value chain, or in adjacent industries to create a competitive combined value proposition?
- Do we have capabilities in our organisation that could allow us to sell more than just investment management products, e.g. become a centre of excellence (capability outsourcing) for other IM companies?
- If we are competing on the client experience, how have we ensured that we truly understand clients' needs and invest appropriately?
- Have we understood the real trade off between experience and 'certainty' of performance? How have we determined what clients really want in this regard?
- Have we made a deliberate choice in how we want to distinguish ourselves from competitors?

Tackling 2023 by choosing to choose: How can IM companies distinguish themselves?

Choosing to choose involves a set of sequential choices which should precede any resource allocations

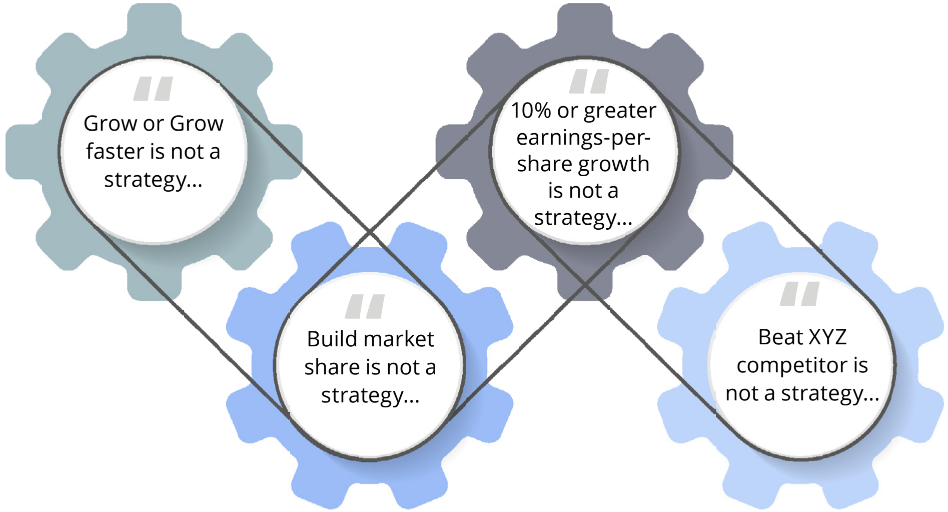
The first choice any company needs to make is setting goals and targets (financial and non-financial), which informs which clients should be targeted to achieve the desired growth or maintenance. What is crucial to understand is that a company's goal may already exclude certain client types from strategic focus. This does not mean that a client will be ignored when there is an inflow, but instead means that the company will not aggressively focus on building value propositions for that client type.[13] What follows a client type decision is a full investigation of the needs and behaviours of a client type, which will inform value proposition design and attributes.

The key word is choosing – choosing implies picking one element of a strategy over another. Considered from the perspective of an IM company, "We will be client-centric" does not consider a set of choices. However, "We will focus on building a value proposition for segment X as a first priority, and then divert effort to segment Y" is choosing from a set of choices. This allows for the diversion of resources (time, money, people) to the most beneficial segments given specific company goals, and avoids time and effort spent on segments that will not further set goals.

Apart from choosing, it is our opinion that a common misconception in the industry exists where IM companies equate what they sell to the investment product (e.g. the fund, retirement annuity etc.); whereas clients see what they want to buy as much wider than that.

A strategy is a:

coordinated and **integrated** set of **where-to-play, how-to-win, core capability**, and **management system choices** that uniquely meet a consumer's needs creating competitive advantage and superior value for a business.



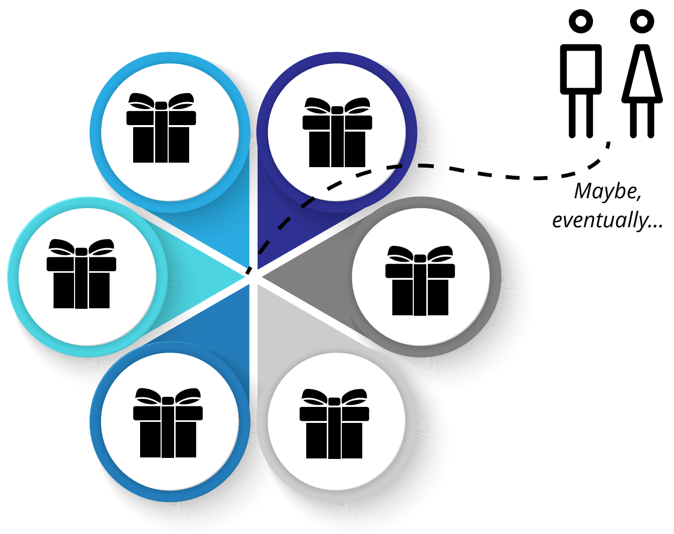
The communication gap[14]

- When asked about their value proposition to clients, IM companies often centre their answers around product attributes and complex financial jargon. They view their fund, retirement product or other savings product as their value proposition to the market.
- When asked regarding what they want to buy from IM companies, clients' responses somewhat centre around performance and fees, but more often around pre-sales and engagement models, servicing and reporting, the IM company's perception in the market or among their peers, and access to benefits (tangible or intangible) that are associated with the IM company. They view the fund plus everything that comes with it as a holistic value proposition. **That being said, different client types value different combinations of these needs, and the choice of client will therefore inform what the IM company should invest into.**
- **The result: Clients and IM companies 'miss each other'. There is not necessarily a perfect correlation between best-performing fund or investment manager and flows, and historically IM companies struggle to understand 'why'.**

[13]As an example, the South African retail fund market has ~R1 trillion AUM. Should a large IM company have an AUM growth target of R900 billion and a consequent ~R10 billion revenue growth target over the next three years, it is unlikely that choosing to invest aggressively in retail fund value propositions will yield the desired growth – a 90% market share would be required in three years. It may make more sense to divert effort and resources to institutional solutions, or adjacent product types beyond the retail fund market to achieve the desired growth.
[14]Deloitte primary research on a sample of 120 clients and 35 IM companies in 2019-2020 via interviews.

The communication gap

Common industry approach: Product push mentality



"I make a product and gamble on whether my client would end up buying it, because I think I know what they want."

Winning industry approach: Customer need mentality

"I have to ask my client what they want, and then adapt my value proposition, otherwise they will just buy from someone else."

In the South African context, where there are, for example, over 800 multi-asset funds, and infinitely more product wraps and distribution channels through which to receive them, IM companies have to make sure their value proposition to clients is clear, and in a language their clients understand, to create competitive advantage in the market. IM companies must bridge the communication gap with their target clients. This entails that the industry would need to reassess how they look at value propositions and existing industry value chains. In turn, their value proposition design, in conjunction with chosen client targets, will inform where resources should be diverted to in the coming years.

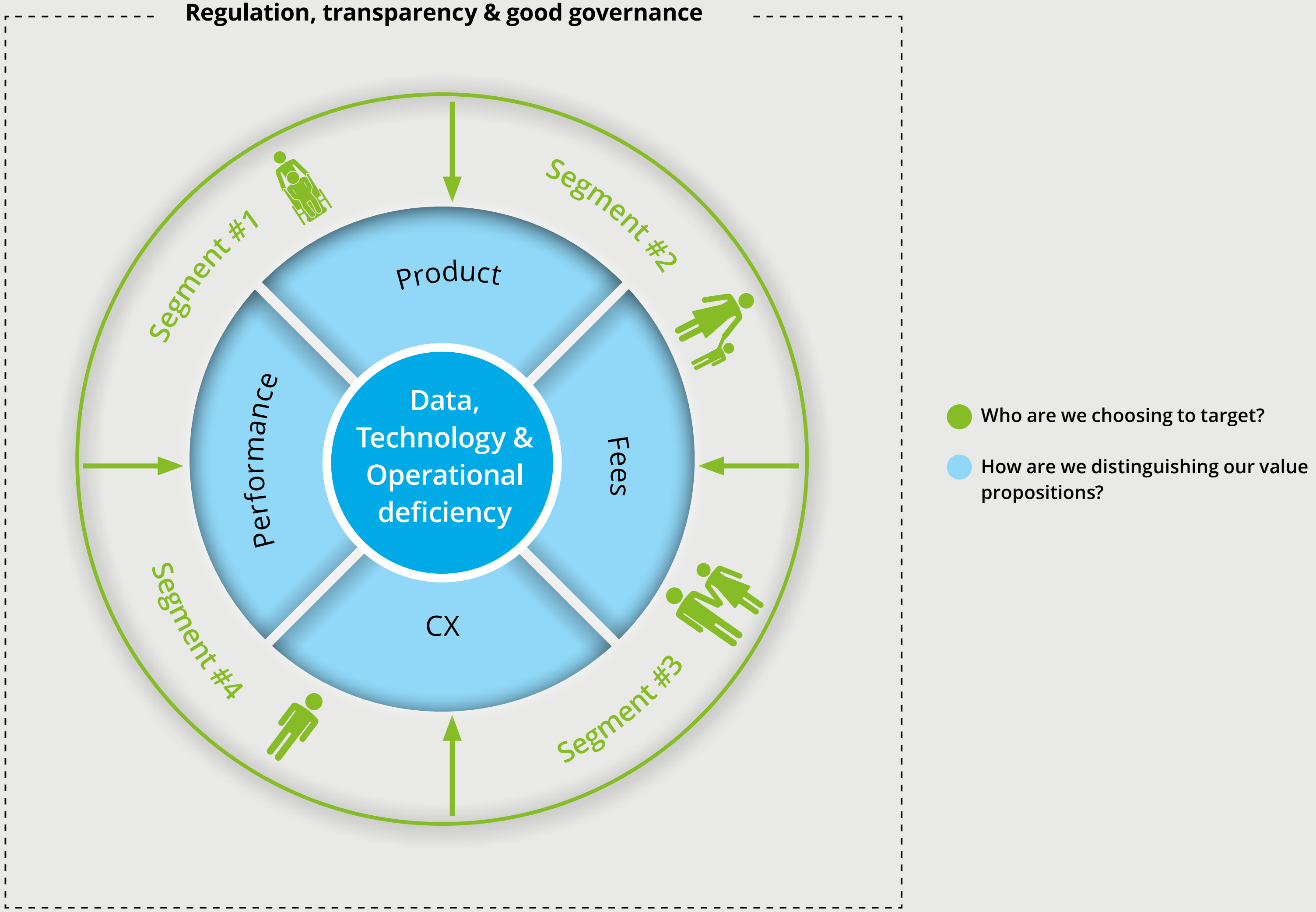
In our experience, companies often neglect the deliberate process of setting and reassessing these strategic choices, which has led to many of the structural challenges experienced in the industry. This does not only manifest through the absence of a strategy, as a strategy often exists, but the strategy often does not contain deliberate choices, but rather all-inclusive statements.

While it is no simple feat, market leaders over the next decade will make a deliberate choice about the clients they target and design value propositions for them based on resource and effort to the most profitable ventures.

Key considerations for IM companies

- How can we rethink our strategy to enable our choices to be clear?
- How can we improve the communication of our strategy both internally and externally?
- To what extent are our actions consistent with the strategy? Why?
- Do we understand that industry performance is not just a given and that we have a role to play in shaping market attractiveness?

Choosing to choose involves a set of sequential choices which should precede any resource allocations



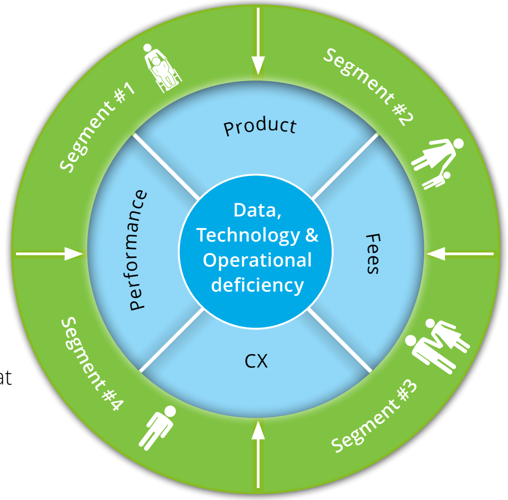
Source: Deloitte Africa analysis, based on the Cascading Choices methodology, applied to IM companies

What should IM companies consider when choosing client segments?

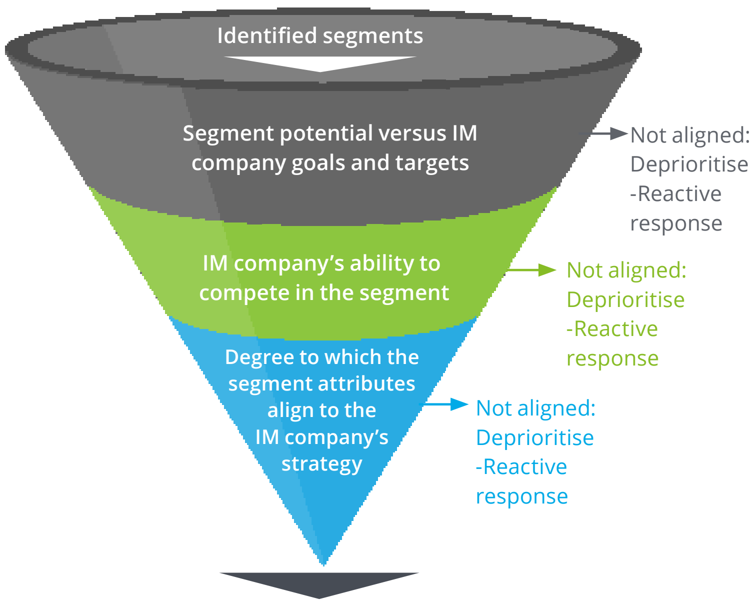
Segmenting clients based on income and age is simply not good enough anymore – bridging the communication gap is crucial

Historically, IM companies over-invested in compliance and operational skill sets. Up to 80% of staff costs and/or project costs[15] were allocated to these domains, and companies mistakenly assumed that high investment in technology can circumvent an investment in client understanding. While compliance, operations, and technology are important, investment in different functional skill sets and projects is required to understand clients. Client centricity fails when it is added as an afterthought to existing projects and added to the day jobs of existing personnel without the required upskill and capacity creation.

Client mindsets have matured over the past decade. More than 70% of South Africans have steady internet access, compared to 40% a decade ago.[16] The level of financial literacy increased by more than 20% over the last decade.[17] The South African retirement fund market has consolidated from over 5,000 active funds a decade ago to less than 1,500 active funds in 2022, as many of the assets transferred to large umbrella funds.[18] Our research has shown that clients have no issue switching investment managers or providers to get what they want. Over the last year, one-third of clients moved over 20% of their business to providers that met their needs. Over the next two years, 44% plan to do so.[19] At the same time, the number of available investment products and new market entrants have increased exponentially over the past decade creating a perfect storm of margin pressure.



Choosing segments is a methodological process



Target client segments

Source: Deloitte Africa Analysis

There are common misconceptions in the industry that drive incorrect client engagement, one being that older clients prefer paper-based interaction and younger clients prefer technological engagement.[20] Similarly, traditional segmentation of income, age and gender assumes all people in said segment think, spend and act in the same way. There are many instances where similar behaviour is displayed by people who are of different races, genders, income groups and ages.

True client centricity involves understanding clients' attributes (e.g., income, age) as well as behaviours and needs; and at which point it can be influenced responsibly, cognisant of the IM company's ability to compete. This applies to retail and institutional clients, intermediaries, and other value chain participants that can be viewed as clients. While overarching themes have become clear over the last decade, such as the the need for simplicity, transparency, and alignment of needs and products, it will be the priority of market leaders over the next decade to invest in understanding which themes apply to their chosen segments in order to win.

Key considerations for IM companies

- How have we chosen the behavioural segments that we are going to target and which we will have a reactive response[21] to?
- Do we recognise that each segment will require a separate effort to target based on our current state? How have we determined which segments will yield the best benefit against our goals with the least required effort?
- How have we invested to understand the needs and behaviours of the clients we are targeting? Do we understand what they value from a product, functional and emotional perspective and does our value proposition mirror that? If not, how have we estimated the resources which are needed to understand?
- What is our view on where current and future opportunities may influence this segmentation and choices? Where do we think the next wave of AUM is coming from?

[15] *Analysis of financial statements (incl. segment reports) of listed IM companies.*
[16] *Source: World Bank Data, 2023*
[17] *Source: The Citizen, 2023*
[18] *Source: FSCA website, 2023*
[19] *Source: Deloitte Wealth 4.0 survey, 2022*
[20] *Deloitte Africa primary research on a sample of 120 clients and 35 IM companies in 2019-2020 via interviews found that in many instances, the inverse is true.*
[21] *Reactive response implies that AUM from a said client type is accepted and the client segment is serviced against current standard terms and conditions, but no large-scale investments will be made to create bespoke service and product offerings for the segment as a whole.*

What should IM companies consider when choosing to distinguish on performance?

Focusing purely on performance entails achieving consistent performance above peers, acquiring clients based on this consistent performance, and putting the agenda of achieving that performance above other projects in the company.

Typically, this strategy requires high investment into a competent investment team of portfolio managers, analysts and traders with a track record of understanding the market and a superior ability to analyse data and see patterns. Through analysis of high-performing actively managed funds or discretionary portfolios, clients with an affinity[22] for performance are often willing to pay a premium for high performance and are more lenient on potential servicing delays, as long as the performance follows, and the net benefit after fees exceed those of competitors.

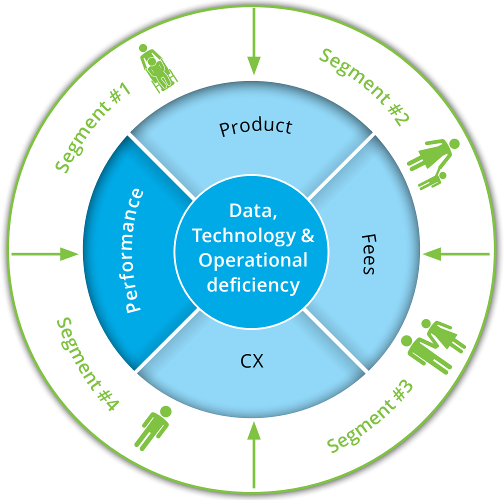
Performance is hard to excel at consistently. Actively managed funds have mostly underperformed relative to their passive counterparts, and high executive remuneration in active asset managers of underperforming[23] funds, has been topical in South Africa over the past decade. Distinguishing on performance therefore requires an investment in more than traditional mechanical systems and fundamental analysis, especially considering the level of effect that sentiment and emotion had on market performance over the past five years.

Sentiment can influence the market and create demand for products even when fundamental analysis points in the opposite direction.

While some investment managers have employed artificial intelligence, such as natural language processing, social media listening and other quantitative methods to estimate client sentiment, many have not yet invested in these technologies to anticipate the market. One likely reason for not doing so is that it is not an exact science. Much of client sentiment is driven by emotion evoked by economic reports, trade wars, and global events, and to generate returns. This requires investment managers to invest in understanding emotions, psychology, and the perception of risk in the market.

Practically, investment managers should ensure they incorporate sentiment sufficiently in their models, and invest enough time and effort scouring for information to respond to changes in sentiment over time. This may mean that investment managers need to augment their current teams with skilled psychologists, data analysts or other non-traditional skill sets, or partner with third-party providers that provide solutions in this domain.

While the crypto market is still relatively young, the movement in many of the available cryptocurrencies is driven directly by client sentiment, communicated primarily on Discord servers, Reddit or Twitter. Global investments into Crypto, Web3, and the Metaverse have soared over the last past years, with some investment managers making lucrative investments into virtual assets. Unfortunately, many large fund managers, who did not have their finger on the pulse with regard to cryptos, have made significant losses when there have been declines in crypto prices.



When sentiment overshadows logic

A global example of sentiment influencing prices in the opposite direction of any rational fundamental analysis has been GameStop in the US. The GameStop saga, where the price of shares soared by 820% as a response to posts in a Reddit thread, forced the New York Stock Exchange to suspend trading on the stock amid the rally. This price surge led to one of the largest short squeezes in modern history, which resulted in investment managers (particularly hedge fund managers) losing more than US$3.3 billion in less than 2 months. The most prevalent reason for this was due to the sentiment of Redditors to redistribute wealth and perceived anger at the way the US government handled the 2008 recession. As a response to this, many investment managers have built monitoring systems into their models to be able to better pre-empt when an event such as this may occur, based on stock trading volumes,. Still, some large funds had to close their doors.

Key considerations for IM companies

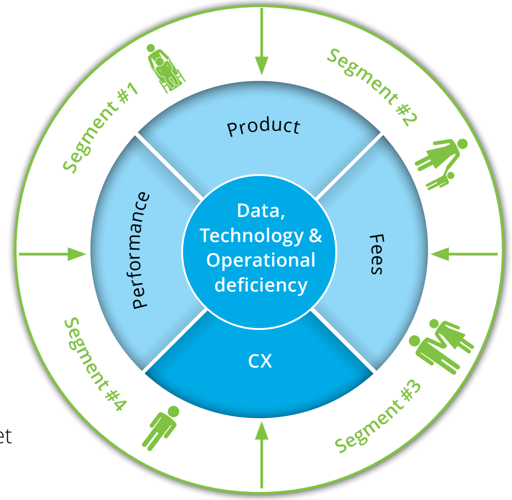
- Is our performance consistently good enough to truly be able to compete on performance?
- What makes our investment strategy great, so that we can achieve high performance and differentiate ourselves from existing products in the market?
- How are we securing top talent? Will the remuneration component of our retention strategy be accepted by clients?
- How have we ensured that our investment team has the right mix of quantitative and qualitative skills to respond to market shifts?
- What have we put in place to augment our fundamental models with qualitative solutions that can process mass sentiment changes at a fast pace? Have we set aside the right resources and skills to obtain or build the solution?
- How have we engineered our strategy to survive when our performance may be lacking?

[22]*Source: Deloitte Africa analysis, 2023*

[23]*Footnote: According to the S&P Indices Versus Active (SPIVA) South Africa Scorecard, 2023, 95% of active managers underperformed the S&P South Africa 50 index over the five years to end-June 2020.*

What should IM companies consider when choosing to distinguish on experience?

Focusing purely on experience entails putting the chosen client segments and their experience needs above any other agenda.



These needs can range from pre-sale engagement and relationship management, to servicing, communication and beyond. Typically, the focus on customer experience is coupled with the emphasis on product innovation, as clients often cognitively couple additional benefits with experience.

Experience does not equate to servicing

Many companies make the mistake of equating experience to servicing. While servicing[24] influences most client segments' behaviour, it is hardly the sole reason a client decides to stay with, or leave, an IM company. Similarly, by the time a client experiences an IM company's servicing, the IM company has already lost many prospective clients that decided to leave for a competitor before choosing to buy. Investing in servicing only, assuming a 10% market share, means that the investment will not benefit 90% of the market or influence their buying decision.

Market leaders co-create desired experience with clients

In addition to a robust client understanding and segmentation effort, market leaders have incorporated clients into experience design and feature prioritisation to let clients design the products they want to buy. While the method is more time consuming, the process is often augmented with sentiment analysis across internal and external datasets to make the primary interviews as efficient as possible.

A 2020 Deloitte survey across 200 IM companies[25] highlighted that 38% of those surveyed did not include extensive client engagement when designing servicing, and 91% saw a significant decline in AUM in the past five years. The highest decline in AUM was experienced in the mutual fund industry, where coincidentally, the highest level of perceived homogeneity exists. 31% of those surveyed centred their experience design process entirely around their client, and unanimously saw an increase in AUM since changes in experience were launched to the market.

How can an IM company practically go about incorporating client feedback in experience design and product innovation? Methods may include:

- Surveys and primary interviews
- Co-creation through an engagement method that the client prefers
- User testing
- Community building*
- Customer feedback mechanisms
- Data analysis

** As an example, the crypto community as a collective has been exceptional at this. Crypto projects often have continuous engagement with their entire ecosystem through Discord servers and on Twitter, incorporating client feedback on products as well as experience and engagement as products and projects are created and innovated.*

[24] *Defined as post-sale operational engagement, such as the operational processing and communications around contributions and withdrawals and account queries.*
[25] *Deloitte Center for Financial Services, 2020 survey of 200 IM firms*

Good engagement requires more than being responsive and distributing marketing materials

Clients have different relationship management and engagement needs, depending on their segments. While all clients do not necessarily need a high calibre relationship manager, or a digital platform, designing the engagement experience per segment requires a high level of understanding of each segment's wants and needs.

The following represents major shifts in client requirements over the past decade:

Shift 1: The ideal institutional client manager is now a highly educated, well compensated executive
A major industry shift is that institutional client managers for large institutional accounts are increasingly well compensated and educated. Perhaps a decade ago, it was seen as an operational function by some. Market leaders understand that client relationship managers need to build trust with clients and draw and keep them with the IM company. Generating trust is not only a soft skill; it is a mix of empathy, proactivity, and technical aptitude. In addition to soft skills, many institutional client managers in 2023 working at a market-leading IM company are required to have a CFA qualification and look after a manageable amount of clients. A market leader in this space is NinetyOne, who aggressively invests into top talent for their institutional client teams and consequently converts billions of institutional assets across the globe.[26]

Shift 2: Retail clients require the ability to engage with IM companies themselves, not just through brokers
As many retail clients have become increasingly financially savvy and autonomous, with a need for fast and accurate relationship management through digital engagement, old ways of working, such as being forced to engage through an intermediary or having to work through a general call centre, has caused many clients to change providers. While some clients still do value the old methods of engagement, 40% of clients say digital access has become a greater priority. In addition, 55% of executives expect digital interaction will be the norm in two years, and 59% of clients say their preferred channel will be mobile apps.[27]

Shift 3: Clients require bespoke engagement, irrespective of their AUM
As the universe of available IM companies in South Africa is incredibly vast and highly competitive, clients have realised that they can be more demanding of interaction channels. Those who prefer digital engagement, expect quality digital engagement. Those expecting in-person engagement demand a high level of quality out of the engagement. The biggest challenge for IM companies will be understanding which of those clients they want to focus on given their operational abilities. A market leader in this domain is Glacier, who allows clients to create multitudes of different permutations on their platform, and continues to be the LISP market leader.[28]

The top 4 areas of experience clients want IM companies to focus on.
Through our engagement with industry value chain participants over the past decade, in addition to psychological factors and cognitive biases, the following considerations form the base of all client experience design in this sector. **What clients require from IM companies and other engagements regarding their savings.**[29]

Empathy:

Understand and empathise with clients' concerns, needs, and goals to provide advice and guidance. This requires active listening, a show of compassion and emotionally intelligent interactions. It also requires engaging at a cadence and through a channel that meets client needs.

Trustworthiness:

Be trustworthy and maintain the highest ethical standards so that clients feel confident and secure in entrusting their investments.

Industry competence:

Match the method of engagement, along with the distribution of material or fringe benefits, such as access to courses and webinars, to the client's preferences and level of financial literacy. For example, in an institutional context, this makes the feedback loop much more efficient, as relationship managers can respond to technical questions on the spot; and in a retail context, this avoids a situation where generic material on financial literacy is distributed to a financially literate person.

Proactivity and responsiveness:

Pre-empt client actions and emotions through personal knowledge augmented by data analysis and then respond proactively in line with client-preferred channels. This requires access to analysis methods and systematic prompts, along with understanding the psychological factors that influence how clients perceive risks and personal or world events. Executing this ask requires teamwork across the IM company's operating model and requires teams and team leaders to have a manageable allocation of clients.

[26] Primary Deloitte research among institutional investors and roleplayers in South Africa, on a sample of 120 clients and 35 IM companies in 2019-2020 via interviews
[27] Deloitte Wealth 4.0 survey 2022, applied to South Africa.
[28] As per latest ASISA LISP data, December 2022, ASISA website
[29] Per Deloitte Africa primary research, on a sample of 120 clients and 35 IM companies in 2019-2020 via interviews, all cients do not necessarily distinguish all value chain participants from another. In the same way an IM company considers these, an intermediary could as well.

Improving servicing equals replatforming for many IM companies, but it does not have to

Quality post-sale servicing remains a table stakes item in a successful value proposition from a dual perspective: 1) effective servicing keeps operational costs low and 2) it acts as a powerful mechanism for retail clients, as the level of servicing does have an impact on existing client satisfaction levels.

As sizeable multinational platform providers have started to implement their Africa expansion strategies, many policy/client and investment administration platform transformations have launched in the South African market in the last 5 years. These projects have been at the forefront of how the industry has been trying to deliver value to its clients as IM companies try to capitalise on clients' increased adoption of technology. However, the cost and effort of these projects are often underestimated, and many projects exceed their allocated costs and timelines.[30] While South Africa may be a minor contributor to global AUM, the regulatory environment is sophisticated, with mature requirements; and there are many divergent client segments with different servicing requirements that require custom builds.

This broad set of additional requirements is further exacerbated by the fact that most IM companies in South Africa have a complicated legacy system architecture and data integrations, as regulation between different financial services products overlap. Yet, separate companies and data records are maintained with limited ability to share. For those who see replatforming as the only option, the biggest challenge will be at least, to maintain service levels while transitioning. While transitioning to a different platform and re-engineering processes is taxing on operational staff, requirements and processes should be continuously evaluated for necessity and client fit. A replatforming exercise is an excellent opportunity to rationalise duplicated or non-value additive products.

Improving service levels alone, however, does not warrant a replatforming exercise. Partnerships with fintech companies and business process outsourcing are front of mind for IM companies not seeking to make a large technological investment. Like choosing a platform provider, this process requires the IM company to stay true to their and their client segments' requirements and consider elements such as culture fit and way of work, as well as financial metrics, when choosing the right provider to partner with.

While it is also comfortable to partner with a singular partner to solve the whole suite of processes within the IM company, it is key to remain cognisant that the ideal solution for IM companies and their clients may be a combination of partners.

Key considerations for IM companies

- Which components of experience do our target segments value? What is their current behaviour and emotions and how does our client journey incorporate it? Have we apportioned our investment into the highest value items, i.e. where we are currently losing the most significant components of our target segment?[30]
- How have we ensured that our experience team has the right mix of skills to respond to the requirements of target segment? For example, if the segment values personal engagement with a relationship manager with a high level of financial understanding, do we have the correct type of person employed with the right allocation of clients to provide that engagement?
- How have we designed our engagement models and methods to account for shifts in client needs? How have we engineered them to accommodate for 'human' behaviour, i.e. the psychological patterns or cognitive biases of our targeted clients?
- What makes our brand fit with what our clients value? Do we need to relaunch or split our brand (in the case of divergent client preferences)? Does our brand centre on table stakes or have we evolved with client preferences?
- How have we engineered a strategy to prevent client leakage in instances where our experience may be lacking?

[30]*Per Deloitte Africa analysis, all segments do not value the same experience. Some segments may value a 24/7 dedicated relationship management function more than a fast operational processing team, or a sleek digital app. Investments into experience should be driven by what target segments value and not what competitors are doing.*

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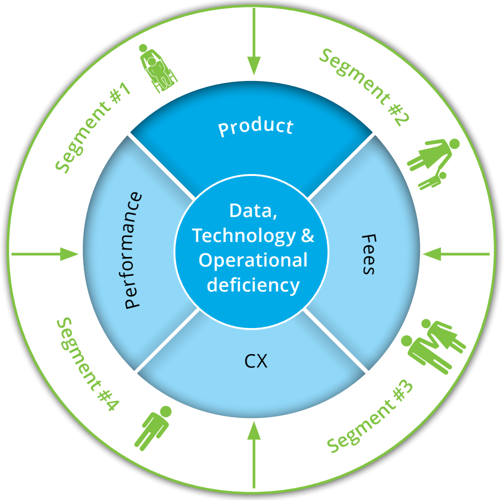
What should IM companies consider when choosing to distinguish on product design and innovation?

Focusing purely on product design and innovation entails creating products and services in the market at price points that mimic the client's perception of value and provides a solution to an unmet or partially met need.



As a product forms part of the cohesive value proposition of the IM company to the market, product design and innovation is often coupled with experience design as a strategic choice.

While some clients seek stability after the economic woes of 2020 and beyond, there has also been an increase in client demand for alternatives and environmental, social and governance (ESG) focused products. Based on the Deloitte Wealth 4.0 survey, 67% of clients want to invest in alternatives like private equity (PE) and 49% in initial public offerings (IPOs), creating a market demand for the democratisation of alternatives and other similar product innovations. Product innovation is however not limited to alternatives or ESG. Innovation may come in the form of intelligent pricing, product bundling, process innovation, partnerships with other value chain participants, or other industries entirely.

Potential innovation through the democratisation of alternatives

In recent years, there has been a growing focus on alternative investments. This shift has been driven by clients' needs to diversify and generate better returns, as well as an increase in the alternative investment allocation allowance of retirement funds. Globally, alternatives have grown, but the same growth has not necessarily followed suit in South Africa.[31] That does however not mean that there are no opportunities. There is just some work to do, and market leaders have recognised that. In our opinion, the key aspects to solve are securing pipelines to suitable investments, ensuring the right level of education at client level, creating the infrastructure required to service these investment types at competitive fees, and brokering the right partnerships to create combined innovative products.

Alternative asset managers have altered their way of managing assets and increased accessibility into the industry in the last decade:

Trend 1 — Blended teams to create return over the duration of the investment

Traditional PE and venture capital (VC) managers focus on the pre-deal and deal stage and typically have an investment banking background. Market leaders have started to invest into a more blended team skill set to add value in the underlying companies for the duration of the investment.

Trend 2 — Democratise alternatives to give access to retail investors within confines of regulation

Market leaders have found a way to innovate products to allow for smaller investment amounts into alternatives. For example, Fedgroup launched impact investing in the last decade, allowing retail investors access to alternatives such as solar panel investments, which previously was unattainable. Similarly, VC democratisation business, Simple Capital, aims to democratise investments into startups, allowing investors to invest with payments as little as R10,000.

Trend 3 — Easy-access to derivatives, crypto or fractional share purchases

There have been notable innovations in the democratisation of derivatives trading, crypto trading, and fractional share purchases, especially from 2020 onwards. The two largest crypto exchanges in South Africa, Valar and Luno, have multi-million dollar daily trading volumes as of January 2023.[32]

[31] *Per the 2022 SAVCA Private Equity Industry Survey, PE had a relatively low level of performance compared to other asset classes, citing the effect of war, sanctions, Covid-19 lockdowns and negative economic conditions as the leading reasons. Pre-2004, private equity funds returned, in rand terms, in excess of 35% IRR, but returns slumped significantly to the current status quo, where 10-year pooled IRR is 7.7%, 5-year is 2.6% and 3-year is 1.2%. In dollar terms, these are 0.3%, 0.6% and 0.6% respectively. Funds under R1bn seem to perform better than funds over R1bn, which is likely due to the availability of perceived at-scale investments in South Africa. These performance figures are on average 30% less than major indices such as the CAPPED SWIX TRI and SA INC TRI. Source: SAVCA & Riscura 2022 report, SAVCA website*

[32] *Source: Coinmarketcap, 2023*

Potential innovation through smart pricing, product bundling or partnerships

As market leaders have made increasingly large investments in technology and data over the past decade, the wealth of product and client data in analysable format has created a perfect scenario for smart pricing, product bundling, on-sell and upsell, along with collaboration with partners to create holistic value propositions for clients.

Collaborations within the value chain of the industry or across industries have become the norm. For example, early partnerships of large IM and diverse financial services companies with telecommunications companies recognised the distribution and transacting capability available through cellular networks; and in return, were able to secure large business flows through a large established distribution channel. Similarly, companies like Discovery combine a full suite of financial services products into one with partnerships across the Vitality[33] programme; or Sanlam Group through their Reality[34] programme.

For companies that want to continue innovating, or start innovating on this front, it is key to ringfence sufficient continued investment in these capabilities (people, process, and technology) to create the right decision-making and financial models to prompt when added benefit can be introduced in a particular client segment's journey. A key consideration remains the target segment's needs and the gaps currently experienced and how to best address them; and the availability of data which requires continuous assessment.

Potential innovation through the introduction of smart ESG frameworks and related messaging

The Deloitte Wealth 4.0 survey highlighted that 34% of clients will seek ESG investing and transacting advice over the next two years. Four out of ten IM companies believe that clients expect them to know about social impact investing and transacting and to offer ESG products and services. Over the past decade, ESG investing significantly impacted the industry as more and more clients become aware of the potential risks associated with traditional investments, such as environmental degradation and social injustice. Their requirement for ESG investments is either self-imposed or in the case of institutional investors, self-imposed or imposed through underlying client pressures to seek investments that align with their values and promote positive change.

This shift has led to a growing demand for investment products that incorporate ESG criteria, e.g. the United Nations' Principles for Responsible Investment or the Global Reporting Initiative. Some industry players, such as Impax Asset Management, Fedgroup Impact Investing or Calvert Research and Management, deliberately chose to have a specific ESG focus.[35]

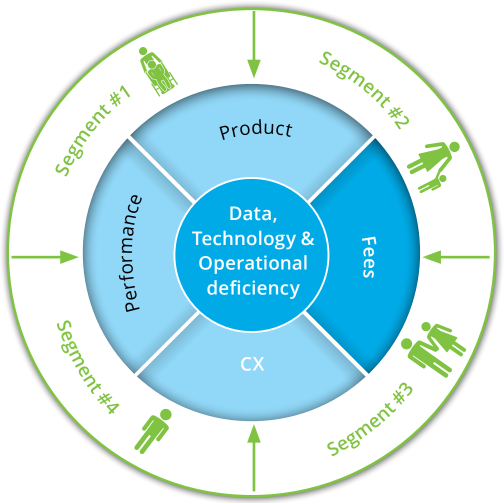
As a result, more IM companies incorporate ESG criteria into their investment processes, and many are launching new products to meet this growing demand. In addition, many leading companies invest in proprietary ESG evaluation frameworks, that incorporate the best elements of major frameworks into their process. That being said, as the widespread adoption of ESG processes into investment processes is still in the early stages, existing guidelines are not mutually exclusive. There are concerns around consistent application, standardisation, and implementation of the criteria.

Key considerations for IM companies

- What makes our product innovation capability and outputs excellent and unique enough to be able to compete on product design and innovation? Have we determined which areas potentially need some work?
- How have we determined which products our target segments require and value, or where our current propositions lack against our target segments' requirements?
- Once we design a new or innovative product, how have we planned the teams required to successfully launch the product to the market? How have we ensured that we have the right mix of design and operational skills? How will we design the experience surrounding the product? Who can we partner with to create a well-priced competitive proposition? How can we leverage our existing distribution networks or adjacent offerings to cross-sell and upsell?
- How have we designed our products to account for shifts in client needs? Have we thought about which products potentially need to be rationalised?
- How do our data warehouses, models and technology support us with innovation in pricing, partnerships and cross-/upsell?

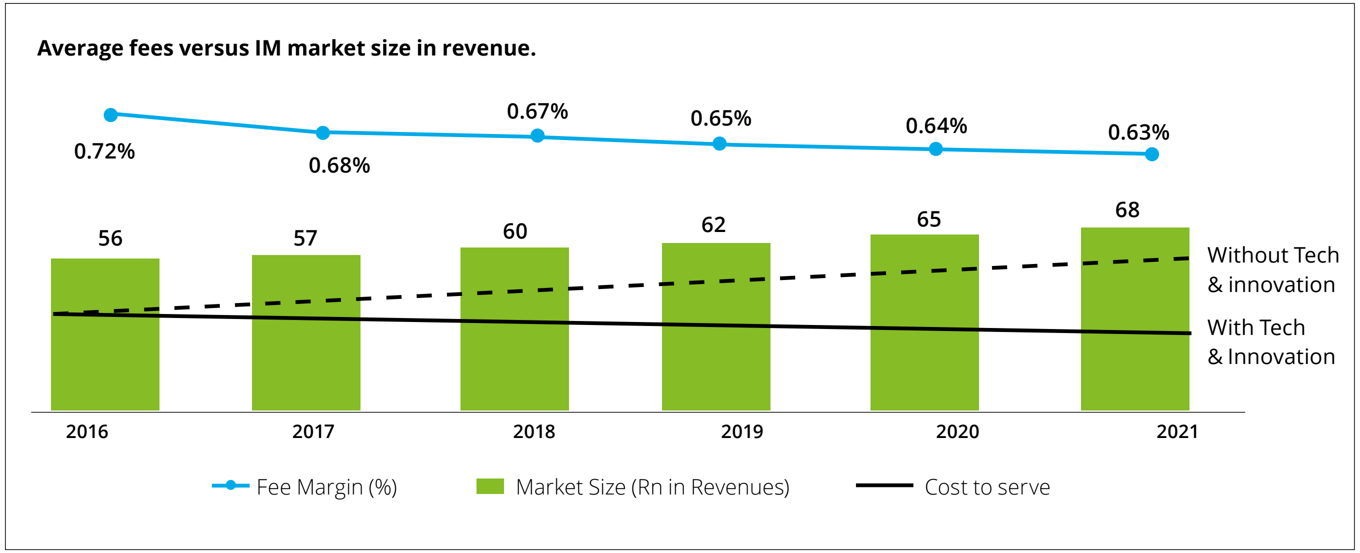
[33]*Source: Discovery website (www.discovery.co.za/vitality), 2023*
[34]*Source: Sanlam website (www.sanlamreality.co.za), 2023*
[35]*Source: Impax, Fedgroup and Calvert websites, respectively, accessed March 2023*

What should IM companies consider when choosing to distinguish on fees?



Focusing purely on fees entails offering lower fees than competitors for similar products, making a product more attractive to cost-conscious clients, or creating a narrative where the transparency around fees and value allows a client to easily match the fees they pay to the value they receive. Currently, in the South African market, only 37% of clients are happy with the fees they spend on their investment products, and only 36% are happy with their fee structures. Even fewer (25%) understand how IM companies are compensated.[36] While not understanding does not necessarily imply that fees need to decrease in all scenarios, it does mean that the perception of value versus costs is not aligned between companies and their clients.

Margin pressures have been top of mind for most companies over the last decade, and regulatory changes such as RDR and ASISA's EAC standard, along with publicity surrounding fees, have spotlighted fees and executive compensation. In response, most market participants have tried to recoup fee losses through alternative channels, have opted for operating model and technology streamlining, or have restructured their fund investments to comprise a component of passives for resident JSE Top 40 holdings.



Source: Bottom-up market size research by Deloitte[37]

Some of the largest compound annual growth rate increases in retail flows to products in South Africa have been market participants who focused aggressively on driving a narrative regarding fees and innovation. Sygnia Asset Management, as an example, has aggressively pushed the cost and innovation agenda in the market and in return seen large inflows. As an added example, the Sygnia 4th industrial revolution fund launched in 2016, just as the topic of the fourth industrial revolution started to become "mainstream', while marked as a high-risk fund with the associated volatility, has been one of the largest growing and most talked about funds in South Africa on social media leading to an overload of demand. While there are funds that do have arguably better performance, the influx of investment into the fund has been partially due to the narrative surrounding the fund – global exposure, access to technology and innovation which is potentially going to transform the world in the future – factors which evidently influence client behaviour.

[36] *Deloitte Wealth 4.0 survey, 2022*
[37] *Underlying sources include Nedbank CIB, FSCA, SARB, ASISA, Council of Medical Schemes, PIC Annual Report, Alexander Forbes Surveys, Annual Financial Reports, as at 2021, combined with Deloitte Africa analysis.*
** As per Sygnia financial statements, that shows consistent double-digit compound annual growth rates in AUM since inception.*

While these strategies provided relief in the late 2010s, the mass entry of fintech companies and new IM companies without the burden of legacy costs and technologies have put renewed pressure on the more established market participants. Therefore, competing on pure fees is a race to the bottom and not a viable strategy on its own – it is rather choosing to distinguish on fees as the deliberate act of matching the target client segment's perception of value to the fee charged.

This involves continuous consideration of the target segment perception of value, constant streamlining of technology investments and operational overheads and teamwork with the experienced team to ensure appropriate messaging and sentiment.

Key considerations for IM companies

- What makes our operational and technological infrastructure good enough to consider competing on fees? Even if we had to match our current fees with additional value, what does our business case look like?
- If we want to compete on fees, are we targeting a price-sensitive client segment? How price-sensitive is this client segment?
- How does our current fee structure match the fees that target segments are willing to pay for the value they perceive? What is missing from our value proposition to charge fees we perceive to be fair? What do we need to do to invest in building additional features into our value proposition?
- Are there partnership opportunities available to us to become more efficient (e.g. business process outsourcing or partnerships with fintech companies)?
- Could we explore smart pricing strategies and product innovation to spread the cost to serve among multiple product types, or create messaging that creates a perception of value?
- How do we continuously ensure to allocate resources efficiently in the company to minimise overheads and inefficiencies? Where are the bottlenecks in our company? Have we performed a robust activity analysis?

Why is focusing on technology, operating model optimisation and regulatory compliance table stakes?

Data, technology, and operating model optimisation provide the base required for all competitive domains

When considering the domains of competitive advantage, i.e., performance, fees, experience, and product design and innovation, data and technology have become enabling capabilities across all the fields; and regulatory compliance has become a non-negotiable. As such:

- Competing on performance is impossible without sufficient investment in technological systems and data analysis to augment analysts
- Competing on fees requires large-scale technological efficiencies such as robotics process automation and straight-through processing to reduce overheads
- Competing on experience requires data to analyse behaviour and design experience, enable relationship managers to be proactive; it requires digital interfaces for clients who value them; it requires technological platforms to service and provide reporting to clients
- Competing on product design and innovation requires data and technology to build innovation models for pricing and cross-/upsell and to integrate with potential partners.

Across all these domains, regulatory requirements must be adhered to, to have the license to compete. A decade ago, having a digital front end with basic functionality was a competitive advantage. In 2023, it is table stakes, a foundational requirement across all the competitive domains. While all IM companies have not invested adequately in data, technology, and effortless regulatory compliance, it is not advisable that all project budgets should go towards these items in the absence of investment. It is essential to distribute resources in line with chosen client segments, given existing realities, instead of copying competitors under the guise of "best practice".[38]

While there is still room for considerable optimisation and technological improvements in the industry, the strides made in the past decade have enabled the industry to persevere despite significant margin pressures.

Over the past decade, remarkable operating models, technology and data transformations have emerged that have created the base from which to compete for many market leaders. Examples of these have included:

- Machine learning models and data dashboards providing real-time analysis of client and distribution channel behaviour, allowing investment managers to pre-empt behaviour and proactively act to influence behaviour, as well as provide meaningful input into individualised value proposition design
- Data structures and reporting providing a lookthrough of product wrappers and combinations to evaluate portfolios down to security level and holistically evaluate exposure to manage instruments within individual actively and across portfolios to provide the best advice to clients
- Application of robotics or business process outsourcing to eliminate routine tasks such as the population of standard certificates, regulatory submissions, or reporting, requiring operational staff only to review
- Structuring data flows to proactively allow investment managers to be compliant with likely regulations by considering lessons learnt from developed market counterparts.

[38]*As an example, assuming a particular IM company has no digital customer relationship management (CRM) messaging system, the solution is not to look at competitors and acquire one. The targeted client segment may have a preference for paper-based communication, and therefore the funds to create a digital CRM messaging system could rather be rerouted to a more value adding project.*

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Being proactively compliant creates the trust most clients view as non-negotiable

Large-scale collapses and fraudulent schemes, such as Mirror Trading International[39], have proven that some client segments have little regard for reputation or track record and would still invest if the messaging and promises of returns are good enough. However, to most clients, reputation and regulatory compliance is non-negotiable, particularly in the institutional client market, where regulatory requirements of their own often bind clients.

While regulatory compliance is table stakes, there are opportunities to make the cost of compliance minimal through technology and business process outsourcing, creating less of a burden on clients. Market leaders have closely watched UK and European counterparts to anticipate future regulations and proactively engage local regulators on the topic through industry bodies.

Since the financial crisis, numerous regulatory amendments have been introduced in the industry. For example, the enactment of the Financial Sector Regulation Act ('FSRA') represented an overhaul of the entire financial regulation system, in which South African financial regulation was divided into prudential regulation and conduct regulation, with two separate regulatory bodies, under the Twin Peaks model. Similarly, the promulgation of the Protection of Personal Information Act (PoPIA), to protect individuals' constitutional right to privacy, Foreign Account Tax Compliance Act (FATCA), Solvency Assessment and Management (SAM) and Treating Customers Fairly (TCF) required investment managers to invest heavily to comply.

After COVID-19, the rise of cryptocurrencies and the collapse of fraudulent organisations, the Financial Intelligence Centre Act has been amended considerably in the past two years. Most of the changes were in response to the legislative holes discovered by the Financial Action Task Force. The changes included previously excluded financial sector ecosystem players, such as dealers in crypto assets and boards of executors as Accountable Institutions, as defined, to combat the financing of terrorism and countering proliferation financing supervision.[40]

An additional upcoming change to the regulatory landscape in the industry is to pension fund regulations with the introduction of the "Two pot system". In essence, the system seeks to strike a balance between two problems: maximising retirement savings by minimising early withdrawals; and allowing for early access to retirement savings to address unforeseen events, such as COVID-19's financial consequences. As these changes are not yet in effect, the investment management industry has time to respond and adapt to these, but it is our view that the impact on current administration systems should not be understated. More complicated tax calculations and increased transaction volumes will place a burden on administrators to fulfil client requests, and the fact that liquidity is available to clients may lead to requests for retirement-fund backed lending.

While current regulatory compliance and acting in the client's best interest is table stakes, some IM companies are seeing future regulatory change as an area for competitive advantage. In our experience, an organisation needs to understand the rationale behind regulation, how it can become an opportunity in the business and how to position it as such to its key stakeholders. Considering the industry's competitiveness, IM companies would have to continue to consider how they can build their business to absorb regulatory shocks without an increase in infrastructure and servicing costs.

Key considerations for IM companies

- How do our data, digital and technology investments, along with our operating model, allow us to have the base required to compete in our chosen segments?
- How does our method of prioritisation account for the most critical items and set aside sufficient resources for the gaps identified? Are there potential partners or quick wins we can capitalise on immediately?
- Are we keeping a close enough eye on regulatory developments both locally and abroad to avoid being caught off-guard?
- What can we do to convert future regulation into a potential competitive advantage? How are we driving the right relationships to capitalise on this responsibly and ethically?

[39] *Source: Moneyweb, FSCA, Chainanalysis, 2023*
[40] *Source: Businesstech.co.za, 2023*

Conclusion

Choices, or combinations thereof, on the client segment and value proposition front, will look different for each company based on their goals, targets, and purpose.

There is no right or wrong answer – it is about making the right choice for the chosen client segment, given the company's as-is context. Choices, and the reiteration of choices, are crucial at this point of the industry's development to create the next wave of improvement and innovation. Choices as a plural are implied, as the interdependency of choices in this particular industry cannot be ignored, but simultaneously, should be in moderation. Competing on all fronts is not a viable strategy, but choosing to compete on one front also does not mean wholly ignoring the others.

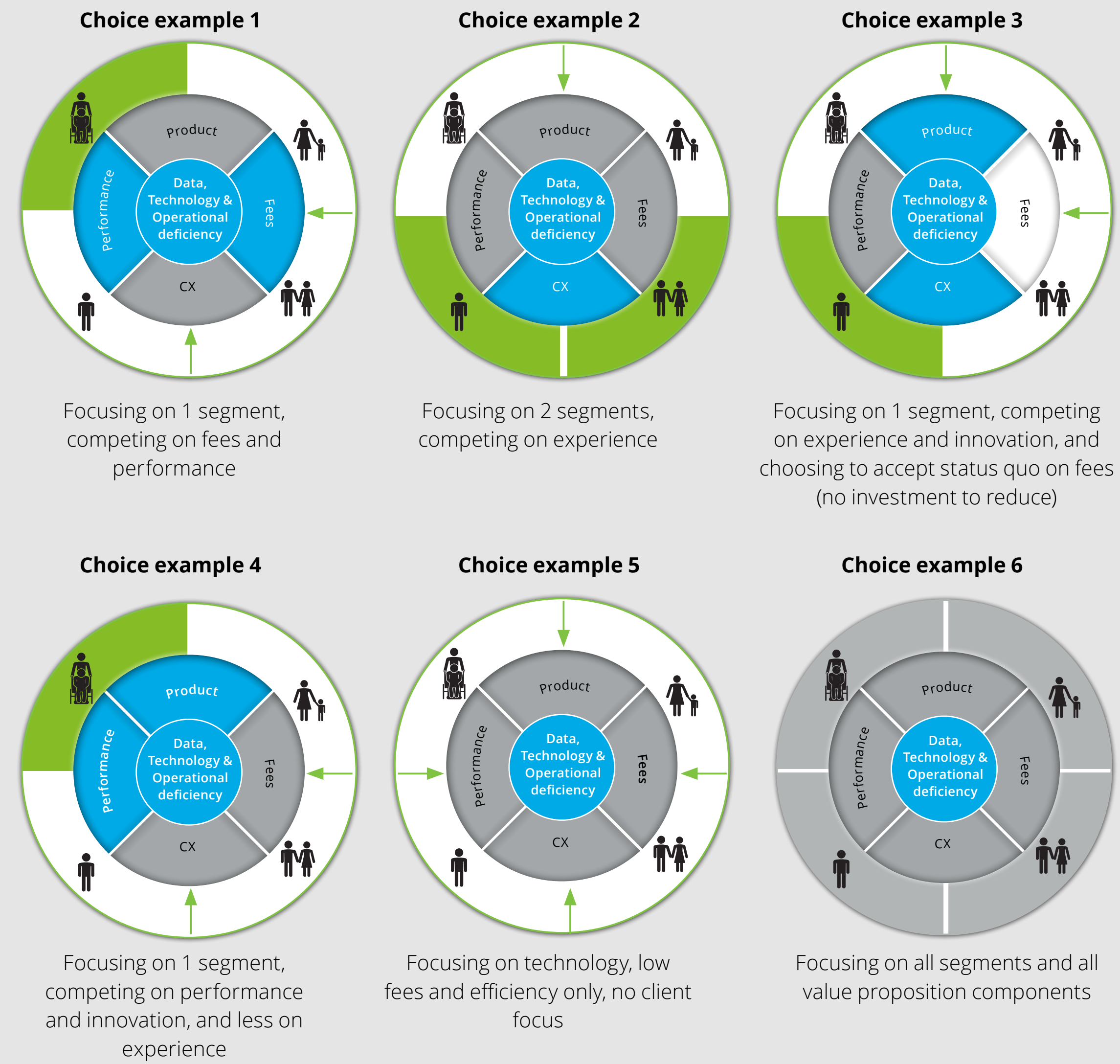
A company and its products cannot have a great experience but have -50% returns per year. Similarly, there is no point in a fund internal rate of return (IRR) of 75%, but no competent distribution channel to distribute the product. Rather, investment should be allocated to the focus areas that make strategic sense over the long term, while simultaneously recognising that solving the challenges that arise from choices will require a change in the way of working and potentially a change in resource allocation.

Technology and regulation are table stakes. Competing on performance, fees, experience or product innovation all require a level of technological investment. Similarly, reputation and regulatory compliance is seen as a non-negotiable. These are table stakes to be able to participate in the industry.

Change is difficult. Doing things the way they have always been done is comfortable; but it stifles innovation. Similarly, embarking on new projects, but ignoring lessons learnt from doing things the way they have been done is not optimal either. The trick is to find a healthy balance between the two by introducing incremental change and complementing teams with new talent, partners or providers that have the necessary deep industry knowledge to design and build solutions that are practical.

Our view for 2023 is that the industry will shift into deliberate choices and more market leaders for certain domains will begin to emerge. Given the economic context and the steady decline of margins under the reality of many perceived homogeneous products, the stage for innovation and improvement is set.

Choices will look different between different IM companies, depending on their strategy



Targeted investment, targeted results (green)
Targeted investment, targeted results (blue)
Medium investment, average results
Low to no investment, reactive results

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