In early March we invited clients for a roundtable discussion with professionals from the banking, investment management and exchange communities, to discuss the challenges and opportunities that are arising from the enforced restructuring of markets and market operators.

The participants looked at the opportunities for growth across these sectors, the disruptors to the capital markets industry and how the structure of businesses are likely to change as a result of these dynamics.

**New market structure, new market participants**

Automation of the trading environment has continued to increase across asset classes, making the data that informs investment and trading decisions ever more important. This is a global phenomenon with a continuous stream of new entrants. For example, Chinese e-commerce company Alibaba are actively mining data assets and have become the single largest fund distributor in the country.

Alongside the rise in passive investment, there is a ‘war’ to be an aggregator, intermediary, owner and originator of data over and above the underlying technology — which increasingly becomes federalised and commoditised to a point that it conveys little advantage.

The prevalence of passive investments is also changing the profile of intra-day markets, as using benchmark and ‘smart beta’ asset weighting has led to spikes of activity at market close and closing auctions. This could have the effect of reducing liquidity and continuous trading.

Regulation has had a detrimental impact on risk taking, either through the increased capital costs required by banks to participate in market activity, or through the fear of being fined, or even imprisoned as a result of making a decision.

There are still plenty of markets ripe for growth and development. Fuel, food and water markets will all change significantly as they mature — and that will need to be accounted for across buy- and sell-side business models.

Consequently, opportunities are opening up in the market for new entrants, or existing participants with the flexibility to fill the gaps in service provision.

**Sell-side: In a tight spot**

Banks are in the least flexible position and face the greatest risk, with a combination of regulation and zero interest rates impacting their business models. Consequently consolidation in ‘less typical’ ways could develop with outsourcing and smart-sourcing bringing non-bank and banks into more significant alliances.

The industry segment is most under pressure from macro factors — the low interest rate environment, a structured move away from bank lending toward capital raising via the markets in Europe, and the effect of quantitative easing upon secondary markets.

A certain amount of apprehension around risk taking, with concern that a wrong decision could result in a fine or prison makes firms very cautious about innovation.
Buy-side: constrained but with prospects
The buy-side is seen as under cost and margin pressure from regulation, directly from the increased operational requirements of MiFID II and indirectly by sell-side capital requirements, which limited the activity of banks as key partners to the asset managers.

Although concerns about the withdrawal of sell-side liquidity are affecting investment firms, the buy-side could potentially fill the liquidity gap, making inventories support market activity more effectively, within the comfort zone of end investors.

The buy-side has engaged with broader data sources as they become available, particularly as a supplement to investment decisions. Fundamental research of a firm can now be supported by a detailed view of the individuals that run a firm, based on their social media profiles. Hedge funds are tracking real-time news feeds — and the speed at which they are broadly disseminated.

However, buy-side firms still find the correlation of large and disparate sources of data challenging. Reduced market activity in some areas has created a need for data to fill in the gaps, for example where price making was less prevalent. Looking further ahead, the rising interest in non-financial investment instruments will mean buy-side firms will be adapting to new product offerings for investors and the surrounding ecosystem to support risk and trading in those instruments.

Consequences
Exchanges are in a position to expand to fill this gap between buy and sell-side, the trusted owners of data. They are able to move into new asset classes, as well as providing the benchmarks for passive investment. Technology is critical in their capacity to step into the gaps opening in the markets.

Utilities could be developed to take costs out of banking. The industry could also hit a tipping point with higher costs and higher burdens — processes could be broken out and run separately by utilities. Analytics are needed to make sense of the data that is available and exchanges are able to offer services built on value-added data services. Intercontinental Exchange high revenues in this area, twinned with its acquisition of Interactive Data, support this. Such acquisitions provide more non-transaction revenue as the transaction business is commoditised, while having that data enables product creation.

Technologies such as fuzzy matching could potentially be used to match orders for similar fixed income securities, if a direct match for a portfolio manager’s request is not available, breaking in to the over-the-counter market.

Yet this turbulent atmosphere for all capital market firms is belied by the capacity of the market to change.

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