Improving margins:

Institutional investors get serious about cost

KPMG International

kpmg.com

Costs are rising, overall productivity is falling, and margins are coming under pressure. Here's how the world's leading institutional investors are using tactical cost savings to kick off transformative cost outcomes that have measurable and sustainable impact on margins.

It's easy to lose track of cost discipline when markets are frothy and Assets under management (AUM) is growing faster than it can be invested. But now markets have shifted and many asset managers and pension plans are starting to find their cost bases are growing faster than their AUM. Managing expenses has become a top priority for many institutional asset management boards, CFOs and executives.

Consider this: Over the past three years, the leading industry participants have eked out compounded AUM growth of just 6 percent — the vast majority of which has been driven by asset class diversification. Over the same period, people related salary and benefit costs have increased by 12 percent.[1] Vendor spend has grown by 13 percent. Similar data isn't available regarding compliance-related spend, but there is a good chance that related expenditure has also increased by over 10 percent.

With margins under pressure in recent months, many asset managers have responded with some level of cost-cutting exercise. Internally-driven and focused on the immediate response, most of these initiatives focus on direct cost containment — more often than not, characterized by sudden spending freezes. Yet, in no time, costs have a tendency to quietly creep back up. Without changes to the underlying cost structure, the savings simply aren't sustainable.

Pulling the right cost levers

Today, many institutional investors have started to explore a range of tactical cost optimization levers aimed at realigning their existing cost structures. Focus of these initiatives falls into three broad areas of consideration:

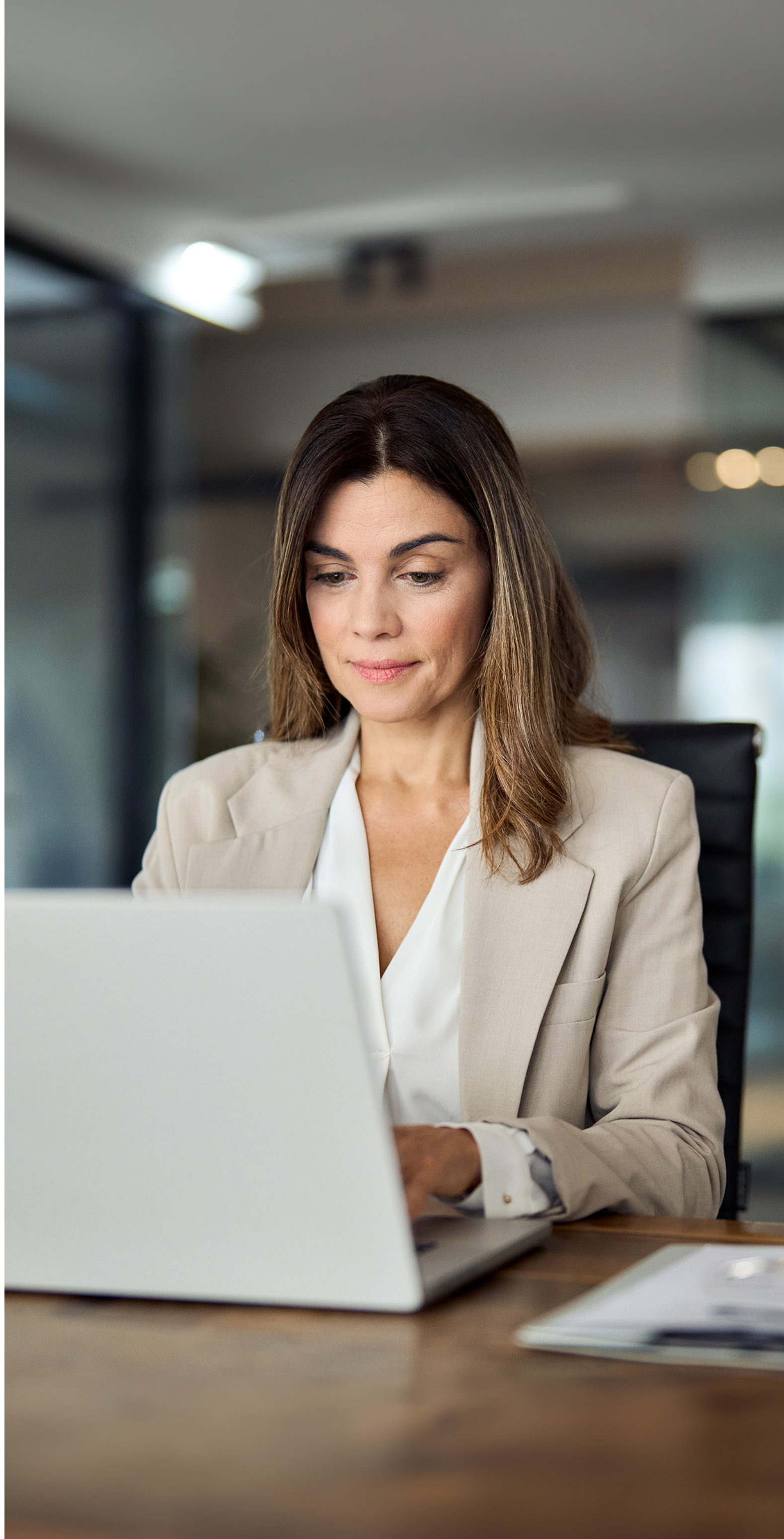
- **Budget Reviews**

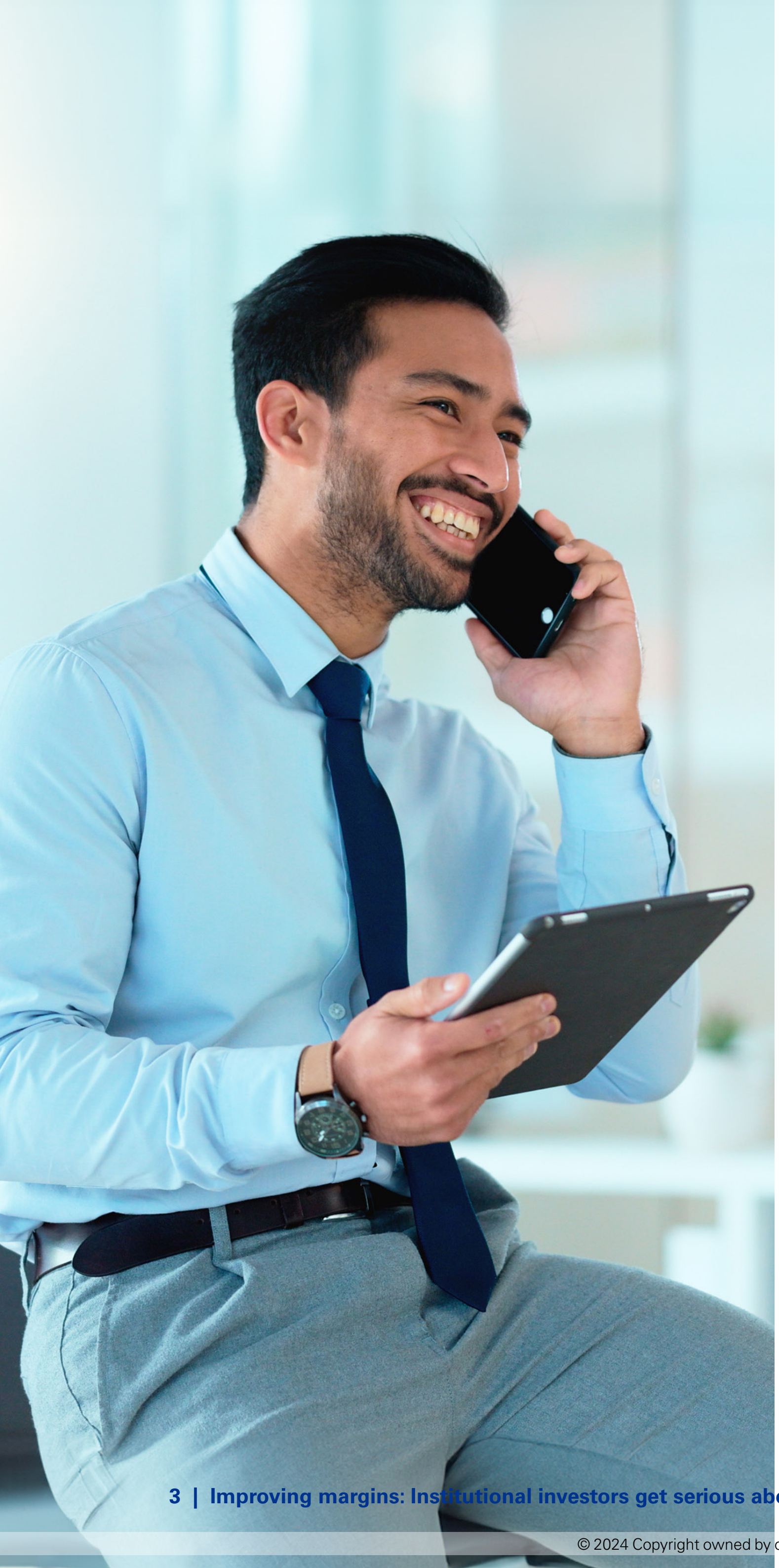
  The intent being, just because we spent it last year, doesn't mean we need to spend it this year. Institutional investors are carefully reassessing their budgets based on actual utilization and realigning forecasts accordingly; discretionary budgets are a great place to start. Some investors are exploring budget optimization by, for example, closing open headcounts after a set period of time. Institutional investors are also eliminating budget lines completely, particularly for items that have been deemed by the business as no longer required (old software licenses, for example). That is also allowing the business to reallocate that to new and emerging needs that may not have been forecasted.

- **Procurement**

  In times of material system growth, you often need to spend money to make money. Now is the time to go back and right-size that spend to align to a very different current (and future) reality. Institutional investors are assessing their current utilization of systems and outsourced services and then using that information in their next contract negotiations. Many institutional investors are also rationalizing their vendors (particularly system, application and data vendors across the front, middle and back-office functions). There is also greater use of consumption and policy management techniques to improve control over costs on a go-forward basis.

[1] KPMG Analysis & industry research 2023





- **Resource optimization**

  People are always seen as client's most valuable resource. They are also ordinarily the greatest expense. During times of growth, many institutional investors competed for talent. Nobody wanted to let rare capability go, even if it wasn't optimally productive. Today, many institutional investors are looking at their resource productivity and workforce plans to identify high and low performers and to realign their capabilities to actual current and emerging needs. They are looking to optimize role productivity by reducing duplication and aligning utilization. And they are looking across their spans and layers more strategically to assess where value is being generated.

Moving from tactical to transformative

Tactical cost optimization levers are a great way to score quick wins and achieve longer-term tactical savings. But the real money comes when you start to fundamentally change your cost structures through more transformative activities. Operating models will likely need to be disrupted. Difficult questions should be asked — and answered.

When KPMG professionals work with leading institutional investors to explore and execute transformative cost savings initiatives, they look holistically at their people, processes and technologies and — using extensive benchmarking data and deep experience — work to refine and redesign their operating models from the ground up. This isn't about digitizing the current model but rather about making it more productive, efficient and responsive to change.

Some of the biggest cost saving opportunities are driven through operating model simplification. As one might expect, new technologies and tools have allowed the modernization and simplification of middle and back-office activities. Some of the more agile institutions are starting to consider how they might simplify processes and models in the front office.

Similarly, many organizations are looking at their operating models and asking how they might make better use of automation technologies, AI and digital platforms to help their people become more efficient, productive and agile. They are reconsidering activities which are core differentiators to their business and whether they should be outsourced, insourced or performed on a hybrid basis. These funds are redesigning their operating models with efficiency at the core.

The virtuous cycle of cost optimization

While these actions — tactical and transformative — are fantastic ways to right-size the cost structure, KPMG professionals believe that the leaders of tomorrow will be those who use their early quick wins to create continuous transformation.

In part, this is about using your experience from the initial cycle of cost optimization to identify new opportunities (like, for example, using your findings from a data rationalization program to rethink how data is used and accessed across the organization, thereby leading to a change in cost structure). Initial transformative saving initiatives can also help embed new, more agile ways of working across the back and middle office in particular.

It's also about investment dollars. Nobody wants to expend finite resources looking to identify and realize cost savings. Productivity leaders, therefore, are looking at this as a long-term reinvestment program where savings harvested from quick wins are channeled back into future (more valuable) transformation productivity initiatives. In the medium term well-structured reinvestment programs can become self-funded with demonstratable ROI.

What does it take?

Operationalizing this flywheel of sustainable cost improvement isn't easy. Ultimately, the true success of this type of cost transformation program can be influenced by five key drivers:

01 Culture

Transformation is all about doing things differently. Organizations that are culturally open to change, agile in spirit and focused on their strategic goals tend to absorb change faster and create more value.

02 Cost consciousness /awareness

Similarly, organizations that are able to engage their employees in the cost narrative of the organization are often those that demonstrate better overall control over cost — in both good times and bad.

03 Practical implementation roadmap

The journey to a more efficient operating model can be long and complex. The most successful organizations are generally those that break the journey down into practical steps that build towards the ultimate goal.

04 Nothing is sacred mindset

Asset managers don't like the idea of cost optimization in the front office. But that is where many of the more significant cost savings often originate. Successful organizations look at every aspect of their business.

05 Executive sponsorship

Change of this scale and complexity requires clear vision and continuous encouragement from the very top of the organization. Cost optimization needs to be owned by the C-suite, not by accounting.

The long-term strategic win

If one thing is clear, it's that the future is uncertain. Institutional investors with the most efficient and productive cost structures and operating models are expected to have the agility and flexibility needed to adapt quickly to opportunities and to respond to challenges in the market as they arise. Those with overburdened cost structures will likely find it increasingly difficult to maneuver.

KPMG professionals believe it is time for institutional investors to get serious about transforming their cost structures. At the end of the day, this is more about long-term growth than it is about short-term margins.

Acknowledgements

David Bardsley
Head of Wealth & Asset Management Advisory
KPMG in Canada
E: davidbardsley@kpmg.ca

Contacts

Karim Haji
Global Head of Financial Services,
KPMG International
E: karim.haji@kpmg.co.uk

Andrew Weir
Global Head of Asset Management and Real Estate,
KPMG International
E: andrew.weir@kpmg.com

Greg Williams
Head of Asset Management Americas region, and Partner,
KPMG in the US
E: gregorylwilliams@kpmg.com

Chrystelle Veekmans
Head of Asset Management EMA region and Partner,
KPMG in Luxemborg
E: chrystelle.veeckmans@kpmg.lu

Geri McMahon
Global Head of ESG for Asset Management
KPMG International
E: gerimcmahon@kpmg.com.au

James Suglia
Global Head of Asset Management Advisory
KPMG International
E: jsuglia@kpmg.com

John Cho
Global Institutional Investors Group Lead, Deal Advisory
KPMG in Canada
E: johncho@kpmg.ca

Some or all of the services described herein may not be permissible for KPMG audit clients and their affiliates or related entities.

kpmg.com

Designed by Evalueserve.

Publication name: Improving margins: Institutional investors get serious about cost
Publication number: 139105-G
Publication date: January 2024