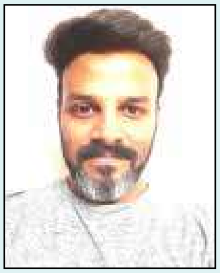
Cost reduction techniques in Mutual Fund Industry



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What is cost reduction:

Cost reduction is achievement of real and permanent reduction in unit cost of products manufactured. Cost reduction does not accept any standard or budget but continuously challenges the set standards with an objective to excavate savings buried in standards.

When does cost reduction become necessary in financial services industry?

Cost reduction becomes necessary when the business is not able to pass on the rise in input costs to end consumers. Below are some of the factors:

- Increase in competition leading to competitive pricing: Once a product is launched successfully and it is able to demonstrate a healthy demand within market, few other players try to participate in the product pie by either tapping into untapped markets of by trying to offer competitive rates in case the there is further scope for adding more customers.
- Inflationary pressures leading to increase in material and labour costs: Inflationary pressures due to supply chain disruptions may lead to increase in input cost of material/ labour. In case where market of a product is saturated or in case where the end prices of products are capped by governments/ regulators, passing on the rise in input costs to end consumers is not an option.

Cost reduction techniques used in mutual fund industry:

In mutual fund industry most products provided by different service providers are by and large comparable. Taking an example of a mutual fund administration outsourcing, services will be largely bucketed between trade booking, reconciliation, valuation, NAV calculation and dissemination and last regulatory reporting (which would include various set of reports mandated by regulators from investor education and disclosure perspective like monthly portfolios and financial statements).

Most of the industry participants have strategically been aiming to reduce their manual touches in the NAV life cycle by having clients to provide various inputs like trades and capital subscription/redemption in a straight through manner. For smaller mutual funds many of the input channels prescribed by their fund administrators, translates into significant technology investments and as a result, for want of right kind of capital the ideal product designs never see light of the day and the administrators are left with no other choice but to develop some tactical automations in order to manage the non-standard client inputs. Cost reduction techniques used by the service providers include some of the following:

1) Tactical automation tools – Use of macros and user defined tools to process repetitive steps. Management of some of the bigger organisations has started emphasizing on learning and using some of the digital operations tools like Alteryx and Xceptor to name a few.
2) Time and motions study – Middle management is expected to measure the actual production hours and study the variances with standards. Various tools like time sheets (automated or manual) are used across various organisations to track the actual production time of resources.
3) Activity based modelling – Products are broken down into smaller pieces in order to achieve optimum resource allocation. Within the product chain, easier activities are given to lesser tenured resources and complex are given to tenured resources. This way management is able to ensure that they have right talent to complexity matching and as resources gain in experience, they are moved to higher complexity products.
4) Focus on locational advantage – Many organizations have a global foot print and use lower cost locations to source voluminous transactions that aren't discretionary in nature.

Areas of focus

1) Role of regulators: While some of these techniques have now been around for a quite some time and the incremental yield of these techniques is diminishing, organizations will have to find some out of box solutions to manage the pressure on cost that is exerted by receding top line. Regulators will have to play a lead role in ensuring that the fund administration and fund management industry remains healthy as the globe stairs at once crisis after another (COVID, war etc). Regulators typically define minimum disclosures needed for investor protection but rarely we see regulators assume a role of bringing together all the industry participants to define requirements that are standard in nature which can help make the product design optimum. Also, the penalties imposed on players for not following regulations should be ploughed back to the players who are ensuring adherence to regulations by helping set a pot that can contribute to the overall technology investments required for making the product flow more straight through. There is a need for regulators to analyse the key administration cost and re-evaluate if some of the mandated disclosures are adding value to investor education. Redundant disclosures can be identified and done away with there by further helping improve the product design.
2) Creating culture of cost optimisation: Management needs to create a system of identifying good versus bad costs and go after bad costs with incentives tagged to reduction and elimination of bad costs. One will have to be less reliant on pricing to be able to stay profitable and hence businesses will need to have a clear sense of which costs to keep and which ones to eliminate in order to stay in the race.