CAPCO JOURNAL

The Capco Institute Journal of Financial Transformation

Value dynamics

Disruptive forces reshaping financial services

Structural challenges

Habits and routines in financial markets

Yuval Millo
Crawford Spence
James Valentin

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The Capco Institute Journal of Financial Transformation

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2025, Edition 61
JOURNAL

Value dynamics

Welcome to the 61st edition of the Journal of Financial Transformation.

I am delighted to announce our new partnership with King's College London, a world-renowned leader in education and research, marking a new chapter in the Journal's long and distinguished history.

In this edition focusing on Value Dynamics, we explore a critical – and ever more pressing – challenge: how institutions across financial services create, distribute and sustain value.

As Professor Crawford Spence, our editor from King's College highlights in his own introduction, the forces shaping value dynamics across financial services are myriad, encompassing technological transformations, secular shifts, political and social structures.

As a firm that has been at the cutting edge of innovation for over 25 years, these value drivers intersect directly with the work Capco does every day, helping our clients around the globe transform their businesses for sustained growth.

The integration of innovative new technologies including generative and agentic AI models, the digitalization of currencies and payments infrastructures, the reimagining of customer experiences, the relentless evolution of market ecosystems, the vital role of culture as a value driver: these imperatives are where we see – first-hand – clear opportunities for our clients' future growth, competitive differentiation and success.

We are excited to share the perspectives and insights of many distinguished contributors drawn from across academia and the financial services industry, in addition to showcasing the practical experiences from Capco's industry, consulting, and technology SMEs.

It is an immense source of pride that Capco continues to champion a creative and entrepreneurial culture, one that draws on the deep domain and capability expertise of thousands of talented individuals around the world.

We do not take our hard-earned status as a trusted advisor lightly, nor our responsibility to make a genuine difference for our clients and customers every single day – placing excellence and integrity at the forefront of everything we do.

I hope the articles in this edition help guide your own organization's journey as you navigate the many complexities and opportunities ahead.

As ever, my greatest thanks and appreciation to our contributors, readers, clients, and teams.

Annie Rowland, Capco CEO

2025, Edition 61

Editor's note

This 61st edition of the Journal of Financial Transformation is the first with a new editorial team in place, and is the product of a formalized collaboration between Capco and King's College London. This collaboration – a leading financial services consultancy and a prestigious academic institution – embodies the Journal's ethos: a balance between academic rigor and practical accessibility.

Traditional academic journals often deal with more prosaic conceptual matters. Even when they focus on more practical concerns, the timelines and mechanics of double-blind peer review processes can mean that the insights that they offer risk being out of date by the time they are published. Conversely, traditional op-ed articles in the financial press are all too often heavy on opinion and pre-conceived ideas and can lack the heft that comes with thoroughly researched pieces of work.

The Journal we've published strikes a vital balance between these two approaches.

This edition has an overarching focus of Value Dynamics. Specifically, the various articles look at how value is created, distributed and sustained across financial services. In turn, the submissions are grouped into three broad themes.

Technological transformations are explored in terms of how these can bolster or hinder value dynamics if not managed effectively. A number of secular shifts are also discussed – these being long-term changes that are impacting value dynamics in the sector. Finally, structural challenges are highlighted that emphasize the importance of sticky, tricky social and behavioral issues that surround the execution of financial services.

Overall, these themes highlight challenges and opportunities in the sector and encourage us to think differently.

It has been a pleasure working on this issue with such a fantastic and diverse array of different contributors.

Professor Crawford Spence
King's College London

Habits and routines
in financial markets[1]

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Abstract

Markets are simultaneously hotbeds of dynamism, innovation, creative destruction, and characterized by habit, routine and inertia. Yet dominant understandings of market activity emphasize the former over the latter. Taking the latter seriously isn't just about being negative but can productively help identify barriers that need to be overcome in order to ensure value creation rather than value destruction. We illustrate this line of thinking through an analysis of the active fund management community in the U.K. and the U.S.

1. Introduction

Financial markets are often portrayed as dynamic arenas of constant innovation, where new technologies, strategies, and players continually reshape the landscape. Yet, beneath this veneer of change lies a paradox: despite compelling evidence of underperformance by many market actors and questionable utility of markets as economic institutions, many financial intermediaries continue to thrive. Why do such practices and costly strategies persist in an industry where competition should, in theory, weed them out? We explore this question by looking beyond traditional economic explanations and into the social and institutional structures that underpin financial decision making.

Rather than treating markets as purely rational systems, we argue that they function, not unlike other social fields, through a continuous shaping by entrenched relationships, long-standing traditions and power structures that resist change. While markets share many structural features with longstanding institutions – exhibiting inertia as well as bursts of innovation – recognizing the underlying social forces can help financial professionals adapt more creatively and position themselves to seize emerging opportunities. This is not to say that markets are not rational at all, merely that rationality is bounded [Simon (1990)] in certain ways. Moreover, the limits of rationality are not merely due to cognitive capacity or behavioral factors à la behavioral economics; market behavior is influenced by social dynamics as well.

[1] This article is derived from the authors' recent book, Inertia: Purposeful Inefficiencies in Financial Markets, Columbia University Press, 2025

Understanding these dynamics helps explain a number of phenomena that continue to puzzle commentators, such as:

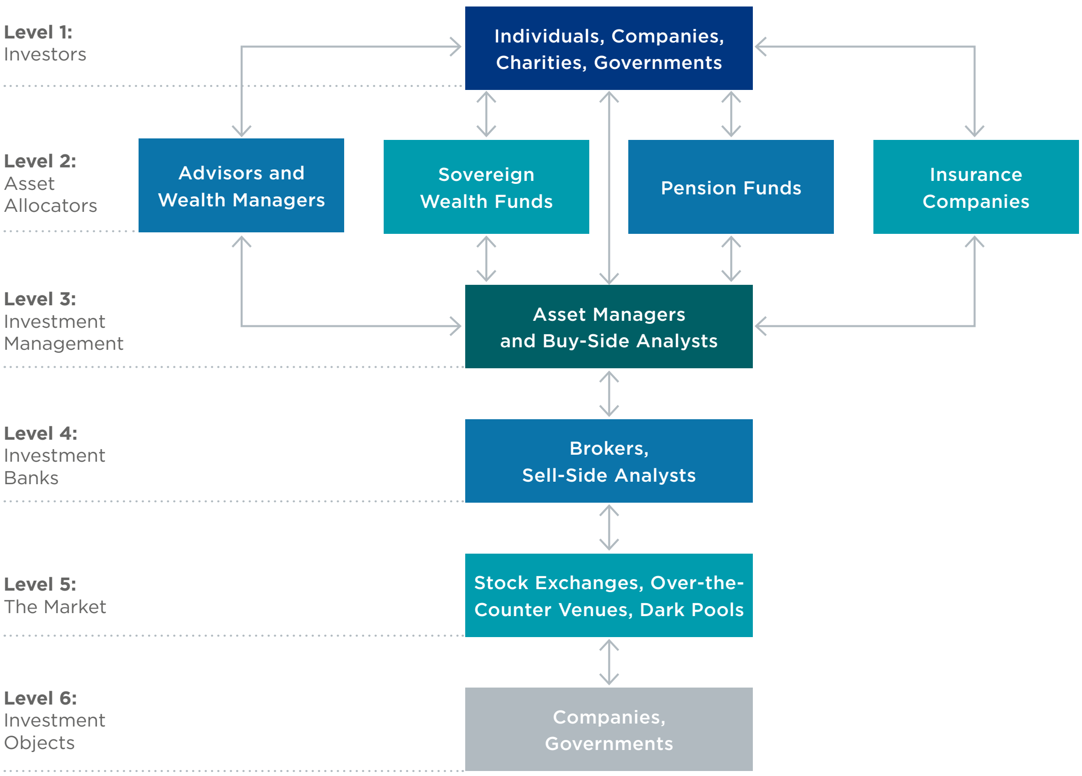
- Why active fund management still retains such a dominant position despite the longstanding case against it
- Why technology has not revolutionized financial decision making as expected
- Why financial professionals often operate in ways that contradict their economic interests.

2. Methods

To understand the persistence of financial intermediaries and the social structures that support them, we drew on extensive qualitative research. The study involved in-depth interviews with both buy-side and the sell-side investment professionals across key financial hubs, including New York, London, and Chicago. We spoke to 70 professionals across the different sites, conducting interviews that generally lasted about an hour. Participants were located at levels 3 and 4 in the investment chain (see Figure 1 below). This included portfolio managers, hedge fund analysts, investment bankers, and equity researchers, providing a comprehensive view of the inner workings of investment decision making.

The interviews were conducted over several years, with a focus on uncovering not just explicit decision making processes but also the implicit norms, habits, and social networks that shape financial behavior. Additionally, ethnographic observations of industry conferences, earnings calls, and private networking events helped reveal the underlying social dynamics that quantitative data alone cannot capture.

Figure 1: The investment chain adapted from Arjaliès et al. (2017)



This methodological approach allows for a richer, more nuanced understanding of how and why certain practices exist in investment decision making even when such practices don't always result in the production of value.

3. Theorizing financial intermediaries

Financial intermediaries play an essential role in markets by facilitating transactions, offering investment advice, and helping to allocate capital efficiently. However, their persistence cannot be explained solely in terms of economic utility. Instead, financial professionals operate within a network of relationships and institutional norms that shape their behavior.

Drawing from the work of sociologists Pierre Bourdieu (2005) and Marc Granovetter (1985), we posit that financial markets function as social fields where decisions are influenced as much by relationships and traditions as by rational analysis.

- **Granovetter's Theory of Embeddedness:** Economic actions are embedded in networks of personal relationships, meaning that financial professionals often rely on long-standing ties rather than objective data.
- **Bourdieu's Concept of Habitus:** Professionals internalize industry norms and develop ingrained ways of thinking that shape their decision making, making change difficult even when it is rationally warranted.

These frameworks help explain why habits and routines often drive investment decision making, nested as these are in a complex web of social expectations, career incentives, and institutional pressures.

4. Active fund management and underperformance

For decades, the efficacy of active fund management has been under scrutiny, with a growing body of research challenging its value proposition. Critiques of active fund management have abounded since the 1970s. Charles Ellis's "Winning a Loser's Game" (1975) was one of the first to articulate the case against stock picking. William Sharpe's (1991) analysis is equally well cited and, of course, there is the series of books written by Jack Bogle, Vanguard's founder, or Burton Malkiel's A Random Walk Down Wall Street (2019), all of which make the case for long-term investments in passive, low-cost index funds rather than more costly actively managed portfolios. More recently, SPIVA data is routinely used to demonstrate just how few active managers beat their relevant benchmarks over specific time periods, geographies, and strategies. Even with mounting evidence that active managers struggle to outperform passive index funds over any time frame, they continue to attract significant capital. This paradox also highlights the potential for innovative managers to differentiate themselves, provided they align their strategies with well-founded research and deeper client relationships. The reasons for this, we suggest based on our interviews, are deeply social rather than economic and often revolve around relationships between the buy side and the sell side who, collectively, comprise the active investment community.

Relationships sometimes matter more than performance: Buy-side firms maintain long-term relationships with sell-side analysts, even if their stock recommendations do not consistently yield better returns. Indeed, buy-side firms often complain about the value produced by some sell-side researchers, even when they keep these sell-side researchers on their broker list. They may do this for a number of reasons:

1. They have longstanding relationships with counterparts whom they don't want to see kicked onto a garbage heap: ("We hire people that we like. A lot. That is not corruption. It is just human," fund manager, Chicago.)
2. The advice of some sell-side analysts is not considered valuable, but they are kept on the roster because of the other services that their firm provides, such as execution, non-deal roadshows, and access to IPOs.
3. Buy-side analysts tend to have more interaction with sell-side analysts than portfolio managers do, yet the portfolio managers make the decision about which analysts to reward with commissions. Where buy-side analysts might be better positioned to determine which sell-side analysts truly provide more meaningful insights, their views are often overridden by their portfolio managers.
4. Some sell-side analysts persist in networks simply because they have the longest tenure among the group, even though their research may not yield insights.
5. While buy-side firms often complain about the value brought by the sell side, the sell side simultaneously complain that the buy side should listen to them more when it comes to stock recommendations. There are often internal status struggles on the buy side that involve showing colleagues that one is not beholden to the external sell-side research. So in order to save face or exercise agency, perfectly good suggestions from sell-side researchers may be overlooked or contradicted.

These dynamics speak to the broader point that financial markets are not just economic systems but social fields where change is constrained by ingrained habits, professional loyalties, and institutional pressures.

5. The role of conformity and consensus

Another key theme is the tension between differentiation and conformity in financial markets. On the one hand, investment professionals need to stand out to justify their fees and attract clients. On the other hand, they must conform to industry norms and expectations to maintain credibility.

- Sell-side analysts are expected to provide differentiated views but must also conform with market consensus to maintain credibility.
- Buy-side managers claim to seek unique insights but often rely on aggregated consensus estimates when making decisions.

This duality creates a system where genuine innovation is constrained, and the status quo is reinforced. While industry norms sometimes reward those who play it safe, the growing emphasis on data-driven insights and niche strategies suggests that those willing to push boundaries may find new avenues for outperformance and differentiation.

This scenario is broadly consistent with the Bourdieu's (2005) insight that "excellence in most societies means playing in accordance with the rules of the game." While we like to lionize rule breakers and mavericks when it comes to financial markets or business leaders in general (think of the pedestals that Ray Dalio, Jamie Dimon or Larry Fink are routinely put on), the rule-breaking maverick is less common than the popular imagination suggests. Most professionals become successful within specific fields by decoding the formal and informal rules of the game and playing in accordance with them. Quite often, those formal and informal rules of the game are in conflict with each other.

5.1 The pressure to conform in financial markets

The investment industry is built on an inherent contradiction: while differentiation is necessary to attract attention, diverging too far from the consensus carries significant career risks. Fund managers and analysts operate within a framework where deviation from the accepted wisdom can lead to professional isolation, reputational damage, or even job loss.

- **Career risk and the safety of consensus:** Many portfolio managers and analysts fear that making bold, contrarian calls, especially those that turn out to be wrong, can lead to career-ending consequences. As a result, they often hedge their views, aligning closely with the market consensus to avoid standing out too much.
- **Institutional pressures to follow the herd:** Large asset management firms and investment banks have established research methodologies that reinforce collective thinking. Analysts working within these institutions are incentivized to align their forecasts with consensus estimates, as significant deviations could raise questions about their judgment. Where analysts produce estimates that are more than 5 or 10% out of consensus, they might be asked to adjust them accordingly. After a while, they start to self-discipline in this respect.
- **Media and public perception:** Financial news outlets play a critical role in shaping industry sentiment. Analysts who go against the prevailing market view may struggle to gain visibility or credibility, while those who confirm existing narratives are more likely to be quoted and promoted.

5.2 The role of earnings consensus and forecasting

Sell-side analysts are frequently judged on their ability to forecast earnings accurately. However, rather than truly independent analysis, much of this forecasting process involves clustering around a consensus number. This is because:

- Investment banks and brokerage firms often pressure their analysts to align with their corporate clients to maintain good relationships and ensure future investment banking revenue.
- Analysts who consistently deviate from consensus may be viewed as unreliable or contrarian for the sake of it, rather than insightful.
- Market participants often focus on the consensus estimate rather than the range of estimates, further discouraging deviation.
- Analysts are often given too many stocks to cover to realistically have a differentiated view for each and therefore “hug the consensus” to avoid exposing their ignorance about neglected stocks within their coverage.

5.3 The social reinforcement of market narratives

Beyond formal structures, social interactions among financial professionals reinforce conformity. Informal networks, industry conferences, and even social media platforms create an echo chamber where dominant ideas are repeated and validated.

- **The power of networking:** Senior professionals often mentor younger analysts and fund managers, passing down entrenched beliefs and reinforcing established investment philosophies.
- **Reputation and influence:** A strong track record of aligning with consensus while making only modest, incremental adjustments is often rewarded with credibility and career advancement.
- **Groupthink and market cycles:** In bull markets, positive narratives gain momentum, while in bear markets, pessimism spreads rapidly. Market participants reinforce each other's views, leading to cycles of euphoria and panic.

Despite the problems created by consensus-driven decision making, financial professionals continue to operate within this framework because it offers stability, reduces risk, and aligns with industry incentives. This inertia creates a system where genuine innovation is rare, and the status quo is reinforced. Contra dominant media images such as that of the "star fund manager," the financial industry often rewards those who play it safe, leading to a cycle where analysts and fund managers perpetuate existing narratives rather than challenging them.

6. Technological resistance and the myth of innovation

One might expect technology to disrupt financial markets more thoroughly, and indeed, pockets of genuine innovation do exist, ranging from advanced analytics platforms to AI-driven research tools. However, our research reveals that technology adoption often remains selective and geared toward efficiency rather than full-scale transformation.

> **"The financial industry's resistance to change is partly accidental, partly purposeful.**

- **Technology is used for efficiency, not strategy:** While active management firms embrace tools for managing workflows and tracking clients, they are skeptical about replacing human judgment with algorithms. Customer relationship management systems have been integrated into buy-side and sell-side firms in recent years. This helps with logging interactions with clients and ensuring more accurate billing and compliance practices, but there is more resistance to technology when it comes to improving investment decision making, at least among the more seasoned bottom-up stock pickers.
- **Small data over big data:** Fund managers prioritize qualitative insights from industry relationships over statistical models, even when empirical research shows that data-driven approaches outperform human intuition. Again, this is a reflection of our sample, which was primarily those using fundamental analysis. However, the attachments that individuals have to fundamental analysis and uncovering unique nuggets of information from industry sources are potentially more a product of how analysts and portfolio managers have been trained rather than they are the outcome of any sober reflection of what leads to better investment outcomes.

- **Fear of disruption:** Many professionals view technological disruption as a threat to their status and income, leading to selective adoption of innovations that do not challenge their authority. This is not unique to fund management or equity research, of course, and has been demonstrated across a number of different financial domains, including both financial audit and tax. Indeed, resistance to technological innovation is to be entirely expected from anyone whose job is potentially threatened by it.

These factors explain why, despite the availability of powerful machine learning models that are routinely used by high frequency and algorithmic trading firms, many investment decisions are still made based on human judgment and traditional analysis. We are not suggesting that the former are more effective than the latter so much as the reasons for remaining attached to existing ways of doing things often have more to do with what people are actually comfortable with rather than what works best.

7. If you can't beat them, join them: the rise of passive investing

Fight or flight are common psychodynamic reactions to an external threat. We see both of these in the active investment community when they talk about the rise of passive investing, which we were told represents the most significant challenge to the active investment community in decades, which our interviewees responded to with a mix of denial, recognition, and adaptation.

7.1 The psychological and institutional response

One of the most striking aspects of the rise of passive investing is the cognitive dissonance it has created within the active investment community. Many fund managers and analysts who have built their careers on the premise of skill-based investing wrestle with reconciling the evidence supporting passive strategies. Yet, this very shift presents a chance for active managers to refine their offerings by leveraging technology, sharpening their focus on specialized niches, and better articulating the distinct value they can offer investors.

- **Cognitive dissonance:** Many professionals in active management acknowledge that index funds are a superior investment choice for most people. Yet, because their own careers depend on the belief that active investing adds value, they often find ways to rationalize their continued involvement in the industry.
- **Institutional justifications:** Active fund managers frequently argue that they are necessary to maintain market efficiency. The claim is that without active managers attempting to identify mispriced securities, markets would become inefficient. However, this justification ignores the fact that the majority of active managers do not outperform their benchmarks, raising questions about their actual contribution to price discovery.
- **The fear of obsolescence:** The shift toward passive investing is an existential threat to many financial professionals, particularly those who rely on the fees generated from active fund management. As a result, firms and individuals often resist acknowledging the full implications of the passive revolution.

7.2 Rebranding and strategic adaptation

Rather than admitting defeat, the active investment industry has responded by reframing its services in ways that make them appear distinct from traditional active management.

- **Smart beta and factor investing:** Many active managers now market their funds as "smart beta" or "factor-based" strategies. These approaches still involve systematic investing based on factors such as value, momentum, and quality but are presented as a more sophisticated alternative to traditional indexing. In reality, these strategies share more in common with passive investing than with traditional active management as they have very low tracking errors.
- **Private markets and alternative assets:** As public market investing becomes increasingly dominated by index funds, many active managers have shifted their focus to private equity, venture capital, and hedge fund strategies. The argument is that inefficiencies are greater in these markets, providing more opportunities for active managers to add value. However, these investments also come with higher fees, more risk, and less transparency, making it difficult to assess whether they genuinely outperform over time on a risk-adjusted basis.
- **The myth of "customized solutions":** Some firms now market their active strategies as "personalized" or "customized" solutions for high-net-worth individuals and institutional investors. By framing their services as bespoke and exclusive, they seek to justify their fees, even if the core principles of their investment approach remain unchanged.

7.3 The future of active investing in a passive world

Despite the continued growth of passive investing, active management is unlikely to disappear entirely. However, the industry is being forced to evolve in response to changing market realities.

- **Hybrid models:** Some firms are embracing hybrid approaches that combine passive strategies with selective active management. These models attempt to capture the cost efficiency of passive investing while still allowing for some level of discretionary decision making.
- **Regulatory pressures:** Governments and regulatory bodies are increasingly scrutinizing the fees charged by active managers, particularly in retirement and pension plans. Greater transparency may force more active funds to justify their costs or lower their fees.
- **A shift toward niche strategies:** While broad-based active management struggles to justify itself, specialized strategies, such as thematic investing, ESG (environmental, social, and governance) investing, and quantitative approaches, may offer a path forward. These strategies attempt to appeal to investors who are looking for more than just market returns.

Ultimately, the rise of passive investing is not just a financial shift – it represents a fundamental challenge to the ideology of active management. The way the industry has responded to this challenge reveals much about the nature of purposeful inertia: rather than embracing change, entrenched groups find ways to reframe, adapt, and justify their continued relevance.

8. Purposeful inertia: the key takeaway

The financial industry's resistance to change is partly accidental, partly purposeful. Finance, like many other fields, relies on routines and habits to provide consistency and stability. Part of this is unconscious and taken for granted. However, many aspects of continuity are more conscious in orientation. Financial professionals invest significant effort into maintaining existing structures because these structures serve their interests. This "purposeful inertia" is evident in:

- Continued survival of underperforming active managers
- Reliance on outdated, often "follow-the-herd" research practices
- Resistance to fully embracing technological advancements.

Understanding these dynamics is crucial for anyone working in financial markets, as it reveals both the resilience and the overlooked potential for improvement that exist side by side. By recognizing purposeful inertia, professionals can more effectively identify where genuine innovation is both feasible and urgent, positioning themselves and their organizations to thrive.

9. Implications for financial professionals

This article is not a standard critique of the active fund management community and their advisors in investment banks. Such critiques tend to emanate from a conceptual position that is effectively some variation of the efficient markets hypothesis [Fama (1970)]. As stated above, the position we start from here is not one of economics and efficient markets, but a sociological standpoint that views markets as embedded in social networks [Bourdieu (2005); Granovetter (1985)]. From this point of view, active fund management is often ineffective because of the inertia that characterizes social networks in finance and because the future is generally impossible to predict, not because prices already accurately reflect fundamental values.

For those working in financial services, the insights offered by this study are both a critique and a call to action. Recognizing the power of social structures can help professionals navigate career decisions, understand market inefficiencies, and anticipate where true disruption might occur. Firms that genuinely embrace innovation and challenge ingrained habits may be better positioned for long-term success. In practical terms, financial professionals who embrace a culture of measured experimentation, using data-driven methods, forging deeper client connections and questioning entrenched practices, stand to benefit. Indeed, by balancing tradition with innovation, institutions can remain competitive in a market that is potentially receptive to new approaches.

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About Capco

Capco, a Wipro company, is a global management and technology consultancy specializing in driving transformation in the financial services and energy industries. Capco operates at the intersection of business and technology by combining innovative thinking with unrivalled industry knowledge to fast-track digital initiatives for banking and payments, capital markets, wealth and asset management, insurance, and the energy sector. Capco's cutting-edge ingenuity is brought to life through its award-winning Be Yourself At Work culture and diverse talent.

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King's Business School is a triple-accredited business school in the heart of London. It ranks amongst the top 10 business schools for research in the UK, based on the Research Excellence Framework 2021, and is consistently ranked in the top ten in the UK for business by the Times and Sunday Times Good University Guide, the Complete University Guide and the Times Higher Global University rankings.

The School advances world-leading education and research across four knowledge frontiers: (1) developing a modern workplace, (2) creating sustainable and socially responsible business, (3) Improving health and public services organisation and (4) strengthening economic and financial systems.

It is the ninth faculty of King's College London, leveraging interdisciplinary potential across the College. It drives pioneering thinking and engages the limitless energies of the city's businesses, policymakers, entrepreneurs and change-makers. King's Business School puts its commitment to drive positive change at the heart of its life-changing research and "London as a classroom" experiential education.

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