

Turning a crisis into an opportunity

In the fourth article on a new study, Amin Rajan and Jervis Smith argue that extraordinary times offer an opportunity to create businesses of enduring value

Some of today's asset industry icons emerged from the ashes of the 1929-32 and 1973-74 debacles. Many more will also emerge from the latest bear market, according to a global survey sponsored by Citi and Principal Global investors.

Our respondents have identified four sets of features of a winning business model in today's and tomorrow's investment environment. At least one in three asset managers are implementing these features (see figure).

The first set covers investment capabilities that centre on people talent, fundamental research, disciplined replicable processes and deep insights into asset allocation, cross correlation, and trade offs between risk, returns, liquidity and volatility.

The second set covers alignment of interest between managers and their clients. It means a value-for-money fee structure, meritocratic incentives, transparent compensation systems, transparent execution costs and regular inter-industry cost comparisons.

The third set covers service proposition. It means understanding client needs, selling products that are fit-for-purpose, giving accurate timely information, doing periodic investment reviews, doing regular pulse surveys, and creating internal panels to protect and further client interests.

The fourth set covers capabilities that provide best execution, CRM capabilities, executive capabilities to run alliances, dedicated innovation processes and quality assurance checks on all new products. There is a crying need to identify new investment opportunities.

These business basics put clients at the heart of everything. The genius of the winning model is in the execution of the basics more than in its design.

It enjoins top leaders to formulate a client-centric business strategy, subject it to reality checks, communicate it to all staff, get the necessary buy-in, allocate resources and accountabilities, monitor outcomes, do course corrections and manage external alliances.

Savvy execution is the new silver bullet. Those who have it will survive and thrive. Those who do not will wither and perish.

Sacred cows under attack

Two bear markets in this decade have done what disruptive technologies have done in other industries: weakened the mindset barriers that have long shielded expensive entitlements unrelated to merit.

With prospects of further crises in the pipeline, as shown in our report*, there is a dawning realisation among asset managers that a business model that works only in a bull market is a recipe for disaster, unless it has shock absorbers to cushion the exceptional

drops in gross revenue like the recent one: the falls worldwide have averaged around 35% in 2008, with the prospect of a further 15% in 2009. A lethal combination of market falls and high redemptions have together taken a disproportionate toll. Even though markets have staged a recovery, many are cautious about its sustainability.

Hence, actions have been taken over a wide front. They aim to create a variable cost model by reducing fixed costs, converting as many fixed items into variable ones, and ensuring that variable items move in line with gross revenue, as far as possible. Accordingly, three areas have

houses – by as much as 300 products in some cases – eliminating the sub-scale products. This has been painful; rather than switch into truncated options, many customers have chosen the exit option. As with outsourcing, asset managers now recognise that product pruning has to have a strategic intent that clarifies what the core capabilities of the business are and how they can be best deployed.

Thus, low-hanging fruit, as well as the previously intractable ones, have come within reach. Their success will depend on the speed of the recovery as much as the resolve of business leaders.

A fiduciary heritage?

A new 'moral' environment may well be emerging. Under it, asset managers perceive themselves as the trustees of clients' assets by fostering a fiduciary role on the one hand, and a hard-nosed approach to scale, scope and speed, on the other. Together they aim to create meritocratic cultures via new initiatives on leadership capabilities, service quality and fees.

Taking them in turn, over 45% of the respondents have aimed to improve the quality of their leadership gene pool via in-house training and external recruitment; with just as many planning to do so in future. A further 55% hold all their senior executives accountable for the success of their businesses.

On the client side, two areas have attracted action. The first one aims to improve the quality of day-to-day services. Some 33% of the respondents have implemented changes, with just as many likely to do that in the near future. Clients are increasingly segmented by their needs, with clear service propositions developed for each segment. In some houses, special client protection panels are being set up to ensure that clients are sold products that are fit for purpose.

Improving client proximity has become an important tool for retaining existing assets as much as attracting new assets. Regular 'pulse' surveys have also been initiated to track how clients perceive the delivery of service on the ground. The second area covers the fee structures. 25% of the respondents are reviewing their fee structures to create a better alignment; with the number likely to double in the near future.

Concluding remarks

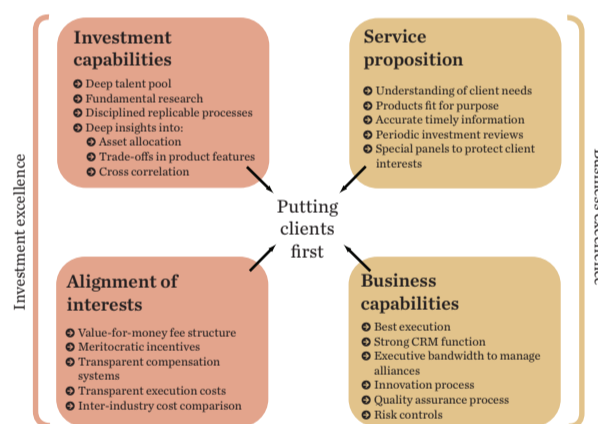
All the above actions aim to promote a small-company mentality in a large-company environment by weeding out old entitlements and fostering new accountabilities. The incidence of these changes, however, is low at this point. Few managers expected the crisis to turn systemic.

The collapse of Lehman Brothers was the catalyst. The initial response was tactical cost cutting. However, the accompanying measures have the potential to turn it into a strategic blueprint that can have a far reaching effect on the future of the industry, if they outlast the next recovery.

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*Future of investment. Available to download for free from www.create-research.co.uk

Four features of a winning business model



Source: Citi/Principal/CREATE Survey 2009

seen significant actions so far.

The first is compensation. Over 50% of the respondents have frozen basic pay, and linked bonuses with either investment performance or business performance, depending upon the staff category. Over time, over 80% expect to use meritocratic bonuses as the most variable component of compensation. These numbers are twice as high as those in the last bear market, according to one of our previous studies.

The second area is non core activities. Over 60% have cut back on travel, entertainment and marketing. More significantly, 38% have outsourced the back office so far: the number will double in future. A further 17% have outsourced manufacturing: the number will quadruple. 20% have outsourced the middle office: the number will double. Outsourcing contracts now typically have a low base fee plus a variable fee linked to the volume of activity.

The third area is product mix. This has been pruned substantially in medium and large