5 Paths to Growing Asset Management Firm Revenues

Russell Campbell
CEO – Your Second Opinion, LLC
"Better Advice, Better Leadership"

Campbell@YourSecondOpinionLLC.com
www.YourSecondOpinionLLC.com
312-343-0079
@your2ndopinion

CEO Highlights

1. ***Extend the duration and profit of each client relationship by reducing client turnover, and charging fair fees to each client.***
2. ***Capture share, compete with substitutes – beating the competition can build revenues, but also look for opportunities to offer substitutes for seemingly unrelated product classes.***
3. ***Respond to popular trends – use existing, or easily acquired capabilities, to capitalize on current trends.***
4. ***Extend product lines, distribution – extend existing capabilities through organic growth, lift-outs or small acquisitions.***
5. ***New products to the world – real innovation can be challenging but very lucrative.***

"Better advice, better leadership"
For workshops, team and individual coaching
Campbell@YourSecondOpinionLLC.com ; **312-343-0079**

Contents

"Better advice, better leadership"
For workshops, team and individual coaching
Campbell@YourSecondOpinionLLC.com ; 312-343-0079

Introduction

Growth in revenues in the investment management industry has slowed in recent years. The reasons are disputed, but one suggestion is that there has been a shift of cash flow towards unmanaged assets, such as bank deposits and Treasury bills. The result is that the money management industry is reliant on capital market returns for driving growth in revenues.

It is hard to know if this trend will persist. In the meantime, each investment management organization has to do what it can to grow revenues within a sluggish growth environment.

Revenues are one of the most important drivers of the growth of economic value in the long run for an investment management firm. Even in the short-run, revenue growth is critical. The ability to pay incentive compensation, which is an important factor in retaining key staff, rests on revenue stability and growth. Thus focusing on fees, sales and revenues should be a priority for leaders of these firms, and they should always be on the leader's strategic agenda.

Revenue growth is too important to be left in the hands of only the sales staff. Top leadership of the organization has to be personally engaged in the effort to increase revenues, and in addition, leaders need to unite the entire firm around the effort.

This paper addresses the 5 main paths to increasing revenues beginning with retaining and building on your existing client base, and ending with exploring opportunities to introduce entirely new investment products to the world.

If you'd like to discuss the 5 paths in more depth, and their application to your own organization, I would welcome the opportunity.

Russell

Russell Campbell
CEO – Your Second Opinion, LLC
312-343-0079/www.yoursecondopinionllc.com

1. Extend the Duration and Profit of Each Client Relationship

Few firms recognize that client retention is a pathway to grow revenue. There are opportunities to cross-sell, increase fees and get referrals from existing customers that can contribute to growth in revenues and profitability. In order to benefit from these opportunities to enhance revenues, our product offering and client service must be robust. Only then can we look to cross-sell and capture higher fee opportunities.

But we also have to recognize that clients have their own views about fees, and their own needs to consider.

In this section we'll address what our firm can do to capture opportunities to increase fees, and extend the duration of relationships with clients.

A. Is Your Product Robust?

Blackrock, Eaton Vance, and Janus are just a few examples of firms that have recently reviewed, and enhanced, investment processes as a result of disappointing performance. Under pressure from performance issues is not an ideal time to make these changes however.

Instead, firms should review their investment processes continuously. While processes are meant to be stable, the implications of an investment process failure are too great to ignore. Instead of overhauling an investment process under duress, continuously improve the process to sustain investment performance in the long run. Here are 10 tips for investment process review improvements.

- Monitor the effectiveness of interactions between teams which have members in different locations, and redesign the decision-making process if necessary.
- Enhance the contribution, and/or eliminate the distraction of unnecessary communications (e.g. email, meetings).
- Efficiently process the execution of decisions whether large (e.g. risk on/risk off) or small (e.g. adjusting portfolio characteristics).
- Do not permit unusual deviations in risk in one or more portfolios, other than

for investment opportunity, or at a client's request.
- Encourage your portfolio managers to manage time effectively.
- Anticipate, and guard against, behavioral biases in your investment process.
- Avoid having portfolio managers who work on teams together, but who only superficially share a particular investment style.
- Manage client demands on portfolio manager time.
- Scrutinize the performance of exceptions to the stated investment process – are they worth having in the portfolio, or do they introduce unrewarded risks?
- Incorporate a feedback loop from both successes and failures in order to further refine the investment process over time.

B. How is Your Service?

Even if investment performance is outstanding, poor client service may cause client departures. If performance slips, client service stumbles can become the excuse for clients to leave.

Most firms are aware of the importance of this effort, and pay a considerable amount of attention to client needs.

But client service first begins with how a client service team is treated. If your client service team is unhappy or ineffective, it is unlikely that your clients will be happy. The structure of the job, the individuals, their motivations, the team's cohesion and the support they receive from the organization are at the heart of the quality of service that your firm offers to clients.

- What are the firm's expectations for the individual working in client service?
- Any job has to meet a specific set of needs of the firm, and as well, the individual.
- Some individuals may be looking for opportunities for career development. Or they may be quite satisfied with performing their day-to-day tasks, and making a contribution with little interest in career progression. Consideration has to be given to both personality types.

"Better advice, better leadership"
For workshops, team and individual coaching
Campbell@YourSecondOpinionLLC.com ; 312-343-0079

- Some positions have lots of turnover, and this often creates issues for clients.
- If the position has limited upside potential, and the individual is ambitious, they may become disenchanted, leave the position and disrupt service to clients.
- Some job positions are designed so that a reasonably intelligent person can learn and perform the tasks at a highly competent level in a short period. This may frustrate more ambitious staff. A better response might be to redesign the job so that the position does not become a bottleneck for the individual or for the firm. Ideally the firm should be able to lay out a clear path of progression for incumbents who wish to progress in their careers.
- Money may not be enough if someone is deeply dissatisfied with their job. This dissatisfaction will also influence the character of the service provided to clients.
- Employee turnover should be one of the metrics used to judge service quality.
- What is it about your top client service people that really makes them stand out with clients and with internal staff? Try to use the critical competencies of your best people as a standard by which you recruit, retain and promote client service people in the future.
- Evaluating the engagement of staff with the mission of the company is another metric that can be helpful. The results from engagement surveys have demonstrable correlation to financial results.
- The responsiveness of your staff to resolving errors on a timely basis should be a key metric for your client service team.

However, it's not only the individual, or the team, that affects a firm's ability to deliver premium client service. Client service people may be dependent on others for information, and they should be confident that information will be available to them as needed. Do your client service people have the support that they need to serve the customer in the best way possible? Sometimes major process improvements are needed to support your client service people with the resources that they need to be responsive and proactive with clients.

C. Cross – sell

Firms like Northern Trust, Legg Mason, Bank of New York and Och Ziff have created dedicated internal groups to proactively seek out, as well as respond to, cross-sell opportunities with current clients. This is both defensive – to protect against client departures, as well as an assertive effort to grow revenues.

D. Fees

Product quality, client service and cross-selling help to extend the duration of the relationship. But it is also important to maximize the profitability of a client relationship while they are with your firm. This is why, at the inception of a firm or a product, decisions about the fees to be charged are critically important. Once a client has been gained, increasing fees is difficult. But this difficulty has to be overcome. Selective increases in fees for existing clients should be pursued when appropriate.

- Review how much each of your clients is paying today in relation to your current fee schedule (s). Do all of your clients pay full fees based on your current fee schedule?
- If there are clients who pay less than full fees, why are these exceptions granted? How often are these discounts reconsidered?
- Does your entire firm understand that every fee discount is a direct reduction of profit? Your firm needs to minimize exceptions, and not allow them to become the rule. The only reason to discount fees is to enhance the long-term economic value of

the firm. Otherwise, why do it?

- Fee discounts based on the size of the client for example also carry additional risks, such as client concentration risk.
- If fees are lower than the fee schedule, then the service provided must be substantially lower as well.
- Why should some clients pay less for the same products or service from your firm? It is only fair to all of your clients that they each pay fair market value for the same services. Some clients also have "most-favored nation" clauses in their agreements with your firm that entitle them to paying the lowest fee available for your product.
- Some firms are superb at asking for, and getting full fees. But these firms should reconsider whether they are charging clients enough. If the investment management firm is an extraordinary generator of alpha, and/or has limited capacity available to investors, then there could be an opportunity to increase fees. Consideration can be given to increasing fees for existing clients, for new clients, or for variations of the product or for new client segments.

E. Fee Pressures

Increasing fees for active portfolio management has its challenges. There have been calls from industry observers for lower active investment management fees, and fee pressure from clients is the result. Some of the pressure is through direct demands for a discounted fee, while other, more clever types, construct complex formulas in an effort to, in their minds, "better align" manager incentives.

I think that this effort to press for lower fees is misguided. But my belief is not going to change the fact that discounting, and complex fee structure demands, persist.

Instead of tilting at windmills like Don Quixote, it's better to try to understand the logic of the demands to reduce investment management fees. Only then can we construct effective answers in response.

Here are 25 implicit assumptions that clients may be making when they insist on demanding lower fees and/or complex fee structures:

1. *"Whatever your fee is, it is too high"*
2. *"Fees for investment management shouldn't be based on a competitive market rate – they should be based on calculable value-added"* (unlike almost every other professional product or service in the world)

3. *"Savings from economies of scale should be passed through to clients"*
4. *"Compensation in the industry is just too high"* (compared to what?)
5. *"Money managers are not aligned with their customers"* (the relationship is not seen as a professional one from the client's perspective)
6. *"Managers should focus on absolute returns because, as they say, you can't eat relative performance"* (If a manager relatively outperforms, but the asset class is in negative territory, that is the responsibility/fault of the money manager)
7. *"All return is beta (market-related), and therefore can be purchased cheaply"*
8. *"Index funds are the baseline for measuring active management fees"* (just like the price of a bicycle should be the baseline measure for the price of a luxury sports car!)
9. *"Since the average money manager underperforms benchmarks, no money manager deserves a premium fee"*
10. *"Small amounts of incremental value over the index on an annualized basis are irrelevant"* (even if the aggregate amount of the client's assets in the long run is significantly higher from adding value in the short run)
11. *"The ability to retreat to cash during prolonged bear markets by active managers is of no value to expert asset-allocating intermediaries like consultants and clients"*
12. *"There is only one right way to manage money in hindsight, and managers must be conflicted because they seem to have done the wrong thing so often"*
13. *"Creating complex fee structures doesn't have any consequences for a portfolio manager's investing actions"*
14. *"Low or complex fee structures won't affect the retention of alpha-generating portfolio management talent in the industry"* (Portfolio managers won't choose to exit the industry and manage only their own money)
15. *"The benchmark isn't client goals, preferences or demands, it is only the index return"*
16. *"Index funds are a better economic answer for allocating capital correctly in the capital markets. The active pursuit of alpha is a wasteful economic activity"*
17. *"Monthly draw-downs are important to long term investors, and portfolio managers should be punished for draw-downs"*
18. *"Managers should not benefit financially from unusual upside returns"*

"Better advice, better leadership"
For workshops, team and individual coaching
Campbell@YourSecondOpinionLLC.com ; 312-343-0079

19. *"Manager fees should be deferred and not paid in cash if not earned in the short run"*
20. *"All client portfolios are identical – clients never request customized portfolios"*
21. *"All clients have the same requirements for reporting, client service and there is no demand for any custom services"*
22. *"Performance fees carry no consequences for the economic value of the firm, and the volatility of performance fees doesn't affect compensation or portfolio talent retention"*
23. *"Firms never get fired, so the fee doesn't need to reflect the likely short term nature of the relationship with the client"*
24. *"Lower management fees don't influence the cost structure of a firm"* (and adjusting the cost structure will have no impact on client service or investment performance)
25. *"I know another firm who charges a lower fee"*

We should be prepared with a rational response to each one of these thoughts or comments as needed.

F. Are Clients Preparing to Leave?

As much as we try to hold onto clients, cross-sell and increase fees, turnover in our clients is a persistent characteristic of our business. Losses of very large clients or intermediaries like distributors, can have lingering effects on the reputation of a firm, in addition to the short term whack to revenues and profits. Firms should try to anticipate at-risk clients by looking for warning signs such as:

- Negative client reactions to poor investment performance, particularly if results are at odds with client expectations for the manager.
- Weakness in client experience – for example, poor or delayed responses to client requests.
- New leadership or new gatekeepers representing client.
- Changes in consultant, or other intermediary/distributor.
- Heavy client reliance on your products/lack of diversification.
- Revisions to preferred asset allocation.
- Need for liquidity.

Firms should make an effort to anticipate potential changes in client needs, respond to client concerns when possible, be prepared with other investment products when clients' needs shift, and keep clients informed about these other alternatives.

G. Reputation

Another reason that clients may remove money from your firm is because of a reputational issue.

The firm's reputation or brand may be affected for example, when a firm is acquired or merges with another firm. Regulatory issues or lawsuits may draw negative attention as well. For brand or reputational issues consider the following:

- Communicate to clients, prospects and intermediaries the fact that suppliers and providers to your firm are continuing to do business with your firm.
- If related companies such as sister firms or a holding company can demonstrate their financial commitment to your firm, this can also help to rebuild your reputation by demonstrating your organization's strength.
- Remaining clients can also be a great resource for restoring more positive word-of-mouth.
- Target small to midsize intermediaries and distributors to rekindle sales momentum.
- You may need to replace at least some of your sales staff. Their credibility will have been damaged by the negative impact on the firm's reputation, and they may

have a hard time re-gaining trust with clients and prospects.

- Remember that there are many potential clients out there. If reputational issues persist, use the time productively to explore new distribution channels, new client segments, new geographies and new prospects.

2. Capture Share, Compete with Substitutes

Another path to growing revenues is to compete effectively and gain market share within the boundaries of your current capabilities and market opportunities. A related effort could be to seek to replace products in client portfolios which share product characteristics with your own products. For example, if a client wants equity risk in their portfolio, there are many different types of products to consider.

A. Stick to Fundamentals

I like the concept of no-bake cookies. You don't have to worry about the risk of burning the cookies, and these treats taste great. Just get the ingredients right and you're fine.

Similarly, I like to focus my attention on the essential ingredients of the investment management business because you can easily identify them, and the risk is small that they'll change very much. Executing these efficiently can help any firm to compete better.

- *Leading teams is a core leadership skill*. But a portfolio management team may respond very differently to a leader than would other kinds of teams. Leaders have to adjust their approach. A team may be comprised of one Einstein and a supporting cast, for example, which means that the leader may need to adjust their style to be more effective.
- *Adding more portfolio management and sales talent is an excellent way to add economic value to the firm*. Sometimes we lose sight of the role of talent in our rush to produce and distribute product, and then we are surprised when results don't meet expectations.
- *Poor investment performance leads to losses of assets, revenues*. Losing talent is one contributor to poor investment performance. We need to have organizations that appreciate, support, reward, and celebrate exceptional portfolio management talent.
- *Continuously improve investment processes*. Your investment processes should be continuously improved to stay ahead of the competition, structural market changes, and long-term client needs. Don't wait for disastrous investment performance to strike before making changes.
- *Many investment products fall short of client expectations*. Free lunches in investing still don't persist. Many currently trendy investment strategies carry unanticipated risks, and are likely to have more modest than expected returns. New product development efforts should more carefully consider future risks to clients and the firm.
- *Clients and their advisers assume that almost all investment return as beta*. Avoid being categorized as a me-too beta product, and continually pursue more alpha strategies.
- *There is no shortage of opportunity*. Marketing efforts can be stepped up by continuously searching for new distribution channels for your products. In the U.S. alone for example, there are

500 consulting firms and 60 databases which gather money manager information, as well as numerous addressable client segments.

- *Clients are more alike than different*. Clients have similar needs everywhere. Their willingness to accept various risks and regulation then determine how they choose to meet their needs. Focus first on fundamental client needs, then create ways to deliver on those needs. Product packaging will be irrelevant if client needs are not being met.
- *You too can have a global brand*. Local brands travel well. Local brands can transcend borders via networking, referrals, intermediaries, local support and media.
- *Solutions (aka bundling) are expensive for clients*. Solutions come and go, but products remain. Solutions will eventually be reverse-engineered by clients and intermediaries and prices will fall. But there will always be a need for top notch product providers.
- *Lousy client service continues to be widespread*. If your firm had a team jersey would your clients wear it? Few firms understand what client service means from each client's perspective. Everyone talks about service but few deliver in ways that are acceptable and appreciated.
- *Niches are bigger than you think*. The Grand Canyon is a niche too. Opportunities can often be found in the newly emerging, overlooked, neglected, ossified and changing.
- *Global liquid wealth is still growing*. Not everyone in the world is retiring (at least not all at the same time). While ageing demographics in developed markets mean that de-accumulation products are rising in importance, there will be continuing global demand for accumulation products.
- *Scale businesses are good for a few firms - but not many*. Index funds, ETFs, core fixed income are examples of businesses that will inevitably be driven towards zero marginal economic profit. To gain efficiency, focus on mass customization instead of just pure scale to meet varying needs.
- *Do it yourself*. Joint ventures and partnering of front office activities are temporary – odds are very good that the relationship will fall apart. The early benefits usually disappear, and the relationship limits the ability of the firm to build economic value for itself.

"Better advice, better leadership"
For workshops, team and individual coaching
Campbell@YourSecondOpinionLLC.com ; 312-343-0079

- *Technology is too important to be left to the IT department*. Invest in technology mainly to create more economic value for your firm.
- *Meeting regulatory demands is expensive, but change is often the catalyst for new product development*. Changing regulation opens windows of opportunity for new products and marketing.

B. Building Blocks for Sales Leadership

Many firms struggle with trying to increase sales. In larger firms, you hire sales managers, who in turn hire salespeople with track records of sales success. In a smaller firm, you are either directly hiring sales staff, or you are personally responsible for sales. In spite of your efforts to have the right people in place, there may be a missing ingredient, and sales just don't materialize. Here are some suggestions of where to find that switch that triggers higher sales.

First, bring together your investment staff and salespeople on a regular basis to formally discuss your products and their characteristics. It's important to reconcile the market's perceptions, with what your investment people believe to be true about the product. There may be small changes that can be made in the investment process, or even just its description, that can alter a product's appeal to prospective clients. Not all issues can be reconciled this way, and in some cases, your people in sales and investments have to agree to disagree. Historic performance is one example of something that can't be changed.

But even without unanimous in-house agreement, products don't have to be perfect to be successful in the market - if effectively sold. Evidence shows that the top performing products are not consistently the biggest winners in garnering new assets.

There are many examples of imperfect yet successful products across all industries. Many of the market leaders in many product and service categories do not have the best product by objective standards. However, they lead their category by having a total offering that exceeds the competition. Even if your investment product has a blemish or two, there are ways to create a fulfilling offering for clients. Many of the largest fund managers have brand names that carry them through times of investment underperformance, for example. Smaller managers, or those firms with less prominent brands can improve their positioning by offering access to portfolio managers to be perceived as more strongly service oriented.

Another way to invigorate sales efforts is to first understand why your current clients hired you in the first place, and why they remain clients. This understanding can offer clues as to your firm's appeal to particular market segments. For example, clients who are inclined to hire more aggressive investors, may not care about volatility in your investment results, if longer term returns are strong.

But you may find that the market appetite for your core investment products is slow at a moment in time. Consultants, distributors or certain geographies may have particular preferences. Use this time to explore possible product extensions arising from your core capabilities, towards new distribution channels and new geographic regions for additional sales.

Next, examine the competencies of your sales staff. Believe it or not, not everyone asked, or even hired to sell, likes selling. If they don't want to sell, they won't. And yelling at them or providing attractive incentives won't help.

If you press these reluctant salespeople, they'll give you 100 excuses why clients are not buying your product. Your salespeople have to have a desire to sell in their heart, and it's up to you to identify and confirm that you have these people at all times.

You also have to be realistic that only a minority of your sales force will meet your expectations. Relying on past sales successes to identify talent isn't always effective. People's personal goals sometimes change over time, and people can burn out.

Here are some additional suggestions:

- Set goals for your salespeople. The expectations will then be clear, and conversations about progress can be more centered.
- Assess the burden of administrative tasks that occupy your sales staff. Cut these tasks away from your salespeople in order to simplify their life, and free up their time to sell.
- Sometimes people who really don't want to sell will bury themselves in administration.

They will resist if you try to pull them away from this work. Then you'll know that they should not be in sales at all.

- The rewards for sales results should be clear, and any incentive program should not also include disincentives for your salespeople. Sounds obvious, but I see it all the time. Examples of this include caps on incentives, or no incentive for particular products.
- It is easy to be sidetracked by talkative prospects, or worse, people without hiring authority, or even influence. It is important to have your salespeople focused on the most likely, next client for your product.
- Lastly, simple and regular reporting of key drivers such as the number and quality of contacts and next steps for pipeline reports can help to keep everyone aligned.

C. Rebooting a Salesperson

To be honest I haven't heard anyone say “Try rebooting” for some time. It used to be the first answer that you heard from your tech support person when you told them that you were having problems with your computer – after they asked you if the computer was plugged in!

But rebooting is what we need when we have a previously successful salesperson who is currently underperforming. There are many training programs that help sales staff to improve, but I have yet to see a program that specifically addresses a fall-off in sales results, and how to recover from it. Perhaps the reason for the absence of such training is that the reasons for declining sales performance are so diverse. Here are some examples of what can drag sales performance down:

Firm issues:

- The firm’s reputation has been tarnished.
- A merger or acquisition has caused prospective clients to step back from considering your firm.
- Investment underperformance.

Structural issues:

- Poor sales management.
- Incentive compensation inadequate.

“Better advice, better leadership”
For workshops, team and individual coaching
Campbell@YourSecondOpinionLLC.com ; 312-343-0079

- Little recognition/nonmonetary rewards.
- Deterioration in the work environment.
- Lack of support from portfolio managers or other internal sources.

Individual issues:

- Personal problems.
- Job fatigue.
- Satisfied with current situation – not motivated to do more.
- Responsible for new or unfamiliar products, channels, geographies

Clearly these are very different issues and each requires a different response:

- A weakening in the firm's reputation or a merger/acquisition requires a broader response by the firm, and extra support for the salespeople
- If investment underperformance has been persistent or is slowly recovering, your salespeople may be not only fatigued, but they may also have exhausted their reservoir of trust with prospects.
- Sales management effectiveness should be reviewed.
- Often incentive pay calculations are not transparent. The majority of a salesperson's incentive pay should be easy for them to calculate, in order to act as a motivator.
- Lack of recognition and deterioration in the work environment affects all staff, and needs to be broadly addressed.
- Access to portfolio managers, support from other staff and access to needed information has to be continuously maintained.
- If the salesperson has personal issues, often all you can do is to listen and be supportive, and be patient.
- Job fatigue - you may have to negotiate with the individual, and remove them from sales.
- If the salesperson is comfortable at a new lower level of performance, they may have to be replaced.
- New or unfamiliar products, channels and geographies may require additional specialized sales people.

D. Competing With Substitutes

Our discussion thus far has focused on taking market share from direct competitors. And there are increasing numbers of opportunities to win business from close investment substitutes within asset classes. For example, some buyers and intermediaries are moving away from a reliance on style boxes.

Clients are considering a broader range of products to meet their needs, which has also expanded the possibilities for product sales. I have been in the room when a client decided to use a go - anywhere fund instead of making an investment in private equity. Why? Because both investments had significant exposure to equities. The go anywhere fund also offered superior liquidity, and the assurance that the moneys would be quickly invested. In spite of their important differences, the client focused instead on the similarities of the two products, and how each contributed to meeting their overall goals.

Therefore, the key to taking share from substitutes is having a deep understanding of what answers or solutions your products are providing for clients. Long short equity might be an absolute return product competing with other absolute return products, or it might be considered by a client as an alternative for long only equity. Increasingly, clients are considering the contributions to overall returns and risk using factor analysis.

3. Respond to Popular Trends

The popular press loves, and most attention is paid to, finding and following current trends. In recent years, popular products have offered many opportunities for money managers. The popularity of these trends may fizzle, but participating opportunistically, or making small investments in capabilities may contribute to business value in the long run, and the compensation pool in the short run.

Not all firms will choose to capitalize on these opportunities, but ignoring current trends increases the burden on their other growth initiatives.

Having the right capabilities available in the right channels at the right time is helpful. But leaders can also make measured enhancements to current capabilities in order to participate in currently popular products.

It is not only product trends that are worthwhile following. Marketing efforts can also follow trends. Fast growing client segments, intermediaries and distributors can often offer opportunities to firms choosing to capitalize on them.

A. Accelerate Sales Quickly

Other firms are winning mandates and growing their assets under management in your areas of investment expertise. Is your firm also winning its share of mandates? I don't care how many times you've tried to kick start sales before, it's a great time to try again. Here are ten steps to boost sales of your investment products in the short run.

1. Tell everyone in your firm directly that the current sales slump is unacceptable. Facing reality may be uncomfortable, but making people a little anxious inspires productivity and creativity according to research.

2. Set a sales goal that has a 50/50 chance of being achieved. This strikes the right balance between a goal being too easy and too ambitious.

3. Your employees will do what they want to do. What they want to do will be based on avoiding pain and gaining pleasure. Make it easier for them to get on-board with your goals by adjusting or replacing their sources of pain and pleasure.

4. The skeptics in your firm will doubt that your goals can be achieved. Offer evidence that it can be done to turn the mood from pessimism towards optimism.

5. What capabilities (investment, marketing) do you have, or can you acquire easily, that will resonate with prospective clients? Identify your next most likely client.

6. What did you used to do that was successful in driving sales in the past? Many firms have forgotten good lessons from the past. Consider reviving what you stopped doing, and try it again.

7. What are outsiders telling you, or yelling at you to do? Have you been ignoring or rationalizing away their requests? Pay attention and consider giving them what they want.

8. Allocate as much of your firm's resources as possible to the best sales opportunities.

9. What behaviors have to change (even if attitudes don't)? Wield the carrots and sticks to elicit the behaviors from your people to achieve your firm's ambitious goal. You don't need to change who they are - just what they do.

10. Celebrate small wins to build momentum.

B. Lift-Outs of Product Teams

Ideally you want to be able to organically grow revenues when conditions are right for your product or client segment. But some firms have more ambitious growth plans. There are several ways to accelerate growth through acquisitions of new capabilities.

Some firms choose to make acquisitions of entire firms with the desired capabilities. However, acquisitions may not be possible to finance. Even if the right acquisition can be financed, and is available at an opportune time for the buyer, there may be competitors for the same property, and this may make the acquisition too expensive. Finding the right fit and being successful after the acquisition is completed, are not issues to overlook either.

A team lift-out offers another route to gain capabilities quickly. In many ways, a lift-out a better answer than an outright acquisition.

Where can you find lift-outs?

- There are many general and specialty recruiting firms who can access teams.
- But the majority of lift-outs occur with the teams and buyers connecting directly.
- Look for lift-outs where teams;
    - are part of organizations that have duplicate capabilities, or where the organization has indicated a new direction via their resource allocations.
    - represent a minor part of the overall organization.
    - have been very successful but that may not be receiving their fair share of the economic value that they are creating.
    - are looking for better distribution.
    - are part of firms that have been recently acquired.
    - are being encouraged to become involved in the larger organization.
    - are having resources not supplied (e.g. across the board expense cuts) or withdrawn from them (e.g. less support from marketing).

"Better advice, better leadership"
For workshops, team and individual coaching
Campbell@YourSecondOpinionLLC.com ; 312-343-0079

4. Extend Product Lines, Distribution

Using an equity capability across multiple market capitalization sizes is an often – seen product extension, and introducing shorting, derivatives and/or leverage and creating an alternative strategy is yet another possibility. Sometimes only a small addition of investment staff is needed to make a big difference in revenue growth.

There are marketing advantages for many larger management firms who choose to add new product lines. For example, a manager who is already approved by major consulting firms or similar intermediaries, will have an easier time introducing new products than a brand-new standalone manager. A product line extension often benefits from having overlaps in people and process, which facilitates getting 3rd party approval for the new capability.

But you can't always be certain that the new product will get a free pass just because the firm's other products have already been approved, or placed on a buy list. The people/teams involved, processes, and track record usually need to be affirmed. This new capability cannot be a weak sister of the core capability. It must have the supporting resources and investment results on its own to be credible.

To set the right tone for the struggle to come in launching a product extension, it may be helpful for the sales team to think of the new product as a start - up – sure, one with some advantages over a pure start - up - but still fighting to gain recognition as an independent capability.

There is another, perhaps surprising, challenge awaiting money managers seeking to extend their product lines. Often the selection of a new product arises from the manager's own preference or skills. But market demand for a product capability may evaporate unexpectedly. You may miss the wave. There are multi-year trends towards certain asset classes, and away from others. Investment management leaders may then be disappointed by how long it takes to gain traction for a new capability even when it is a product extension. On the other hand, some firms have historically made a virtue of introducing new products counter-cyclically, and they expect that success will be slow in coming.

You may also find that your strongest distribution channels are indifferent to your new product. However, there are other intermediaries to talk to, as well as new distribution channels, and new geographies to consider.

The big picture is always daunting. There are 10's of 1000's of competitors, and more than 100,000 investment products. We know that the market for investment products and services is ultracompetitive, and it is very difficult to differentiate a product offering. I've sat on the opposite side of the table from salespeople selling new products many times as an intermediary, adviser to pension funds and as a client, and the response to the new product is no thanks, 99% of the time.

But we often ignore these challenges when it's our own product.

I believe that it is essential to put all of the potential negatives of our new product on the table, and then address them one by one. Spinning the marketing story better can help, but making fundamental changes in the product usually works even better. Some things can't be changed, but sometimes there are ways to adapt the product offering if salespeople and portfolio managers work together. Here are some of the issues that should be considered with a product extension:

- Is the product category hot – if so, how long will it last? A new product may garner some interest, and it can realize high fees - if competitors are few. But interest in the product category may wane quickly.
- If the product category is not hot – how long are you prepared to wait? Some firms make a practice of introducing products when they are out of favor rather than jumping on trends, but this takes resources and a willingness to be patient.
- Do you know where specifically, the product category is hot or not? In which geographic regions, in which client segments, in which distribution channels or through which intermediaries? So many firms launch products with only a vague idea of who will buy it. It is essential to target your efforts and pivot your approach as needed.
- Has the product category peaked and is demand now cooling off? Even a better mousetrap may be ignored. Clients and their advisors are likely to stick with what they know in your product class, as they spend their time ramping up their knowledge of the next new thing that they are moving into.
- Does your firm have a brand, and the operational and risk management support expected by clients these days? If not, look for ways to leverage your partners and connections.
- Is the investment process description robust? Often I have been asked to help firms to accelerate sales when the core investment process description is in tatters. While sometimes it is the investment process that has crumbled and needs to be revitalized, often it is just that no-one has focused on messaging recently.

- Are the needed distribution elements in place? One firm that I assisted, wanted to increase distribution of their funds, and they used a third party marketer in a fast-growing client segment. But this particular client segment is difficult to access and is slow to adopt new products. Another firm was attempting to broaden the distribution of its funds without offering any compensation to distributors. A third firm focused on their own direct sales efforts, but the hard reality was that the bulk of their sales came from intermediaries.
- Is everyone in your firm on the same page with respect to the future of the product? Do they all acknowledge the challenges and are they prepared to work together for success? Uniting behind a product launch is a requirement.
- Are there numerous competitors in the product category? Your product may be terrific but if there is lots of competition, getting your voice heard may be a challenge.
- Are there close substitutes for the product? There has been a persistent trend towards using products as substitutes for each other when they share common factors. Your competition may be from other asset classes, as well as from all of your usual passive and active direct competitors. As an example, how many different ways are there to get exposure to equity beta? All of these ways are substitutes from a client's perspective.
- Are you willing to discount fees too aggressively and/or frequently to win business? I have met too many firms with average to solid growth in revenues but with shrinking profitability. Fee discounts have to increase the economic value of the firm.
- Even if you have a better mouse trap will anyone notice? How will you get exposure to high-potential buyers?
- Is this a product that is actually needed or is it a me-too idea? Most new products are me-too. Many firms over-estimate how different their product is, from the client's perspective.
- Are intermediaries and clients satisficing? No client honestly expects to buy the absolute best product available, because it is very difficult to identify the best in advance. If existing products in your category meet most of the key hurdles or criteria, it

will be tough to break through. Look for prospective clients who recognize and need the advantages of your product.

- Do you recognize that your competition is much deeper and broader than ever before? Some of my clients have been very successful in the past, and they confidently launch a new, but not especially great product. They overestimate the goodwill that they have. In fact the softness of the interest in their new product should alert them to the risk that their reputation has faded for their core products as well.
- Has your firm changed in ways that are noticeable to prospects and intermediaries? For example, every firm has to deal with succession or even replacing staff who leave. Most firms downplay the impact of any changes, but clients and prospects may reset the investment performance clock to zero. Change means that continuity has been broken which raises concerns about future investment performance.
- Is your firm's reputation tainted in some way? Think like a start-up. Market to family and friends, gather allies and think small.

5. New Products to the World

A. Finding Them

In 2005, W. Chan Kim and Renee Mauborgne released a book called *Blue Ocean Strategy: How To Create Uncontested Market Space And Make The Competition Irrelevant*. This book spurred a revolution in thinking about strategy and innovation. It is worthwhile to take a look back at such an important book that still resonates today, and consider what *Blue Ocean Strategy* means for leaders of investment management firms now, and for the future.

There are numerous examples of applications of *Blue Ocean Strategy* in the investment management business. In the past, *Blue Oceans* in our industry would have included index funds, ETFs, hedge funds, risk parity, the Yale model, and CIO Outsourcing. At a minimum, leaders should be aware of how their competitors are using *Blue Ocean* thinking to develop their own business.

But not all of the ideas of *Blue Ocean Strategy* are fully applicable to the investment management business. We are in a professional service industry that is highly competitive, and this creates some differences in applying the techniques in comparison to many other businesses. But there are still plenty of insights that are prompted by considering *Blue Ocean Strategy* that leaders find helpful.

Complements to Innovation

While innovation is important, we should remember that innovation is only one of five paths for increasing revenues. The other four paths are; extending the duration of each client relationship and maximizing current profitability from them, capturing share from direct competitors as well as product substitutes, responding to popular trends using internal capabilities, and extending product lines and distribution.

Few firms want to risk their company's future on just one path such as innovation. Most firms have a base of revenues that needs to be supported, if only to fund the development of a more innovative strategy. It is also possible to create defensible positions within the industry using one or more of the 4 other revenue drivers.

Strategic Planning

Generally, initiatives should be driven from the bottom-up by the same people who will lead the implementation to ensure engagement and success. Leaders should be involved mainly via setting goals, making major decisions and arbitrating strategic conflicts.

Resource allocation is one of the key outputs from these planning efforts. I have worked with organizations to allocate resources by examining short term and long term profitability, interconnections between activities, and finally identifying high risk/high return options for the future.

The authors of *Blue Ocean Strategy* are largely dismissive of traditional approaches to planning. They minimize the importance of the need to be entrepreneurial, to be a learning organization and to seek bold new ideas. But thinking like a start-up in our highly competitive industry, reviewing the firm's own past successes and failures using after-action reviews, and copying the good ideas of other firms, all have merit.

I do agree however, with the authors' negative views on surveying customers, benchmarking and trend-following for driving innovation.

Surveying customers to elicit new ideas doesn't work. If you'd asked customers of horse-drawn wagons what they wanted, they would have likely said, "better horses and wagons". Don't ask customers and others what they want. Instead observe what they do, and craft your product offer around their needs, not wants.

Benchmarking is also ineffective. Benchmarking is not only a moving target, but firms have different business models and accounting conventions, which makes benchmarking difficult. Even if benchmarking can be done, beating a benchmark only makes you above average (which isn't good enough to win client mandates).

Lastly, the vast majority of major management consulting firms openly promote trend-following. Instead of just finding and following obvious trends, we could choose instead to consider how the trend will play out, and anticipate the end game. Thinking about the disappearance of DB plans is an example. Working backwards from the end of this trend may offer insights about how to win.

An alternative is that we could choose to focus on the fundamentals of our own unique business, and ignore current fads and trends.

Finally we could choose to try to anticipate the counter-trend that will inevitably occur.

Competitive Factors

In order to capture innovation, *Blue Ocean Strategy* suggests first identifying the factors which are truly most important to customers. These factors can then be emphasized, de-emphasized, or possibly added or entirely eliminated to develop an entirely new product with a superior combination of features, benefits and at a different price point.

Factors which appear to be driving investment product selection these days that could be considered include:

- Liquidity
- Leverage
- Income
- Fees
- Exposure to equity beta
- Branding, size of firm
- ...and others

I think that any factors so identified should be re-considered regularly, because they change over time. For example, the demand for equity beta was much higher prior to the Great Recession. A new wave of academic research, or even a shift in regulation (e.g. money market funds) may also prompt new opportunities. Base your analysis on what clients are, or might be, willing to pay for.

Solutions to Pain

Sources of pain are also a fruitful area for exploring new ideas. Volatility, excessive fees, and underperformance are common pain points for clients.

Pain can be alleviated by offering broader solutions. Target date funds, LDI and financial planning are all examples of total solutions.

Looking Across Boundaries

Blue Ocean Strategy further suggests that there are six boundaries of competition that can be crossed to open up new opportunities. These include looking:

- **Across alternative industries** – An example might be a bank CD that converts to an annuity under certain conditions.
- **Across strategic groups** – There are groups of firms which share characteristics including newer groups like hedge funds, or even CIO outsourcers. There are examples of members of one of these groups partnering in the development of innovative products with members of another strategic group. But what about partnering with firms in other industries to create entirely new kinds of investment products?
- **Across buyer groups** – What are the common threads in investment selection across all client segments when they choose passive or active, public or private, domestic or international investments? How can we use this knowledge to craft product offerings that are appeal to the broadest possible audience of potential clients? Examples could include creating products that reduce the risk of underperformance (e.g. low tracking error), offering liquidity at times when it is generally unavailable (e.g. guarantees), a low degree of correlation with other asset classes - especially during bear markets (e.g. linked to Treasuries,

gold) and so on. We should also consider the many participants that are involved in product purchases. Our industry has consultants, gatekeepers, boards, trustees, managers of managers and so on. For example, do consultants prefer different product characteristics for their CIO outsourcing programs and could their preferences drive new product design for other client segments?

- **Across complementary product and service offerings** – A product example could be a private equity fund that places un-invested cash in small cap public companies.
- **Across the functional-emotional orientation of an industry** - Offering an actively managed fund-of-index-funds or ETFs using a star asset allocator, could invigorate demand further for these commodity products and also increase fee revenues.
- **Across time** – an example of this could be a liquid private equity fund where liquidity is guaranteed.

Non – Customers

Blue Ocean Strategy suggests that noncustomers of the industry may be the best sources of insight into innovation. Mass affluent customers who generally buy CDs, younger investors who have been shocked out of participating in investing by the volatility of the stock market, or institutional investors who are trying to exit their pension obligations are examples of noncustomers.

There are still many noncustomers of hedge funds because of concerns about liquidity, high fees, worries about another Madoff or lack of familiarity with the brands. Positioning a long-only product as an alternative to a long-short/hedge fund product may be a successful strategy to appeal to these noncustomers.

Liquid alts and active ETFs are other examples of products that may prove appealing to a wider basis of customers.

"Better advice, better leadership"
For workshops, team and individual coaching
Campbell@YourSecondOpinionLLC.com ; 312-343-0079

B. Seeding Them

Seed capital is often needed to fund an initial portfolio of securities for a new investment product. The funding may be needed, for example, for a product that is entirely new to the firm, or to establish a product using an existing investment capability of the firm, but in another country. Seeding or funding a portfolio allows firms to test all of their infrastructure including investment process, trading, risk management, operations, reporting, and also to establish an investment performance record prior to launching a new product to a broader market.

The need for seed capital has increased because of the development of new portfolio management capabilities, the need to access distribution in new geographic regions and new channels, as well as the insistence by intermediaries on multiyear track records.

We all recognize that the cost of seed capital is high. However, we also need to explicitly recognize that the value of the seed capital invested is also very high, because the risk of success or failure is large. Just like a call option, volatility increases the value of an opportunity. Any capital charges assessed to seed capital usage, should therefore also include the call option value of a seed capital investment. The result is that the capital charge or real cost of funding is often less than first thought.

Sourcing seed capital from clients for new products is a cheaper alternative, but this requires very healthy client relationships. And the only new products that clients may be interested in seeding are generally extensions of the core capabilities of the money manager.

How long should seed capital be deployed? Some firms have created guidelines about how long they will seed a new opportunity. These guidelines may consider:

- A target amount of external assets or revenues within a fixed period – e.g. attaining breakeven profitability within 3 years
- Acceptability of revisions to initial outlook for growth – e.g. due to a change in market conditions or client preferences
- Availability of investable assets – sometimes an asset class' popularity erodes the availability of assets in which to invest
- Negative feedback from intermediaries such as institutional consultants or managers-of-managers
- Promises made to seeders to return money at a definite time
- Unanticipated complexity – delays in regulatory approvals, for example

- Alternative uses of resources – people, money, as well as time
- Opportunity cost of capital – e.g. what other products are being starved for resources in order to fund a particular new product
- Poor market timing of launch in retrospect

Breaching these guidelines could lead to closing down the capability.

But secondary impacts are important to consider as well. What happens to the credibility of your sales force if a capability is closed? What about the engagement of your portfolio managers? How will they feel if they led the development of the new product, and they really want to continue to manage this product?

Seed capital is similar to adding fertilizer to a garden, as it provides a helpful boost to a new investment product. But the accelerant is intended to be temporary as the product is expected to attract assets from clients.

C. Challenges

Developing truly innovative products requires extraordinary insight, and/or luck. Another alternative is to identify firms that have a successful track record of innovation, and then, copy them. In this highly competitive business, copying adept competitors can be a successful strategy.

Acquiring new talent via M&A, lift-outs or even by hiring individuals may also facilitate new product innovation. Within the limits of your resources, the larger the portfolio of these opportunities that you can fund, the better. Many firms have significant portfolios of seed capital investments in new products.

There are many considerations when pursuing true innovation though, including;

- Does your firm have the talents/skills for break through innovation?
- Is your firm ready to not only pursue, but also implement, and succeed with disruptive product innovation?
- Will your firm solicit independent external verification of the robustness of your product? Products may carry risks that are hidden from their developers.
- Is your firm prepared for the lengthy ramp-up time required for an innovative product or service?

- Are you prepared for the need for missionary work to educate prospective clients about the benefits?
- Legal and compliance concerns are also likely to slow your efforts, and increase the expense of introduction to the market.
- It is very important to have input from areas such as IT and operations early in the process of creating a disruptive product, as it is likely that structural changes in the firm will be required to support the new product.
- How much can you afford to invest in ground-breaking innovation? Short-term profitability may be unlikely even if long-term profitability may be substantial. Introducing a new product also has the potential of cannibalizing your existing business, but this should be of lesser consideration given the competitiveness of this business.

Whenever discussions turn to new-product development, investment characteristics tend to dominate. Once everyone is satisfied with the investment thesis, planning usually turns to the mechanics of launching and operating the new product. There is so much more to consider, and the answers are not easy to find.

1. There must be an adequate amount of capacity to support the investments made by the new product as it grows and to accommodate other copycat products as other firms introduce them. Creating a secondary market was possible in mortgage loans because of the enormous size of the home loan market. Creating a secondary market in emerging market microloans may be intriguing, but limits on capacity might make it challenging to invest in this asset class for the near future.
2. There should be at least the possibility of many highly differentiated competitors. Commodity products such as index funds and ETFs, require economies of scale as marginal costs and fees will eventually drift towards zero. This means that only the largest and most successful players will be able to compete. In many other asset classes however, there is a wider range of investment styles available, which allows for more vendors and higher fees. Examples today include hedge funds and small-cap.
3. The product must offer liquidity to investors, particularly as interest in the product or asset class grows.

For example, in the early years of institutional real estate investment, it was very difficult to liquidate large holdings in commercial buildings. An asset class may be attractive, but if everyone heads for the exits at the same time, or there is a credit crunch, the inability to liquidate will cause investors to think twice about investing in the asset class in the future.

4. Ideally, a new product should create its own demand. ETFs popularity for example, is in part lifted by investors using these vehicles to supplement their traditional portfolio strategies e.g. portfolio completion, asset allocation.
5. Expected results should be broadly consistent with the actual realized results. For example, portfolio insurance was widely adopted in the mid to late 1980s in the throes of a bull market. It was a product that was perfectly reasonable, that became entirely unreasonable, when it helped to accelerate a market downturn.
   The use of market circuit breakers to arrest the market downturn also meant that portfolio insurance was unable to meet its promise of preserving portfolio values.
6. What if the product promises a fabulous return to the direct beneficiary, but the source of value is from nonparticipants or secondary beneficiaries? For example, fixed life annuities or reverse home mortgages could cause a backlash if they more widely adopted. You cannot just meet current direct customer needs, as you have to think of how the dramatic expansion of the product will affect others. Robbing Peter to pay Paul is a cliché that fits here.
7. Clients buy based on expectations, for not only the actual return, but also the pattern of expected performance. What if the pattern diverges from expectations? For example, what if low volatility strategies or high dividend strategies begin to persistently underperform over a long time?
8. What if risk estimates are flawed? No one talked about fat tails in equity returns until the last decade. In other less liquid markets, risk may not follow normal return patterns and customers may suffer unpleasant surprises, which negatively affect a firm's brand.
9. Sometimes the elimination of old risks gives life to new

risks. For example, insurance companies protect against catastrophic loss. However, what if the insurance company fails or the guarantor of a structured product doesn't meet their obligations?

10. Fees need to be high, especially at first, in order to offset start-up costs and the risks of introducing a new product.
11. Finally consider any changes in regulation or client preference that could render products obsolete or unpopular.

"Better advice, better leadership"
For workshops, team and individual coaching
Campbell@YourSecondOpinionLLC.com ; **312-343-0079**

Conclusion

This paper has discussed 5 primary paths to grow revenues. Each has its merits, but some firms choose to focus on a subset of the 5, for various reasons. The more of these paths that a firm selects the more opportunity there is to be successful in growing revenues, increasing the economic value of the firm and creating a sustainable organization.

Some of the major challenges of each of these paths to increased revenues were addressed. But each firm, each product and each initiative is different.

If you'd like to discuss the 5 paths in more depth, and their application to your own organization, I would welcome the opportunity.

"Better advice, better leadership"
For workshops, team and individual coaching
Campbell@YourSecondOpinionLLC.com ; 312-343-0079

Authors Bio

Russell Campbell is the CEO of Your Second Opinion, LLC, a management consulting firm offering expert advice to leaders of investment management firms. He writes a weekly subscription newsletter for leaders, and also works one-on-one and with leadership teams on critical issues.

Russell has led 5 investment groups in his career. Prior to establishing his own firm, Russell was the CEO of The Marco Consulting Group, one of the largest institutional investment consulting firms, with a significant CIO outsourcing business. Previously, he was the EVP of AMCORE Bank, and led the Wealth Management Group which was one of the 60 largest bank wealth managers in the U.S.. Russell was the President and CEO of ABN AMRO Asset Management Holdings, Inc., which managed $75 billion in assets, and was the U.S. investment management affiliate of ABN AMRO Bank. Russell was promoted to this position after having been the CEO of ABN AMRO Asset Management Canada, Inc. He was previously a Vice – President and Partner of Beutel Goodman, Inc., one of Canada's largest investment counseling firms. His first leadership position was as Vice – President, Bank of Nova Scotia where he led the investment management of the Bank's own pension fund, and a family office portfolio.

Earlier in his career, he worked as a pension investment consultant, in institutional equity sales and managed a portfolio of precious metals.

Russell has an MBA in Investment Finance and Marketing from York University, and he has a BA in Industrial Relations from McGill University. He also attended the Advanced Management Program at INSEAD in France.

He has earned the Chartered Financial Analyst designation, and has attended both the Financial Analyst's Seminar and the Investment Management Workshop. Russell has also acquired the Certified Financial Planner ™ certification. He previously held Series 7 and 24.

Russell has been a director of several for-profit and not for profit boards, and he is a member of numerous non-profit, civic and industry organizations.

He is quoted frequently in the media and has been a speaker at many industry conferences.

Russell Campbell
CEO – Your Second Opinion, LLC

Campbell@YourSecondOpinionLLC.com
www.YourSecondOpinionLLC.com
312-343-0079
@your2ndopinion

Your Second Opinion, LLC is a registered investment adviser. This workbook is only intended for the use of other registered investment advisers, clients and interested prospective clients residing in states in which the adviser is qualified to provide investment advisory services. This report is limited to providing general information pertaining to advisory services, together with additional information, publications and links. No attempt is made to furnish personalized investment advice or services through this report. Past investment performance is no guarantee of future results.

Your Second Opinion, LLC expressly disclaims all warranties of any kind, whether expressed or implied to the full extent permitted under applicable laws, relating to your use of this report.