'What has been, will be again, what has been done will be done again; there is nothing new under the sun.' (Ecclesiastes 1:9)

We always think we live in a time of change; and today is no different. In our personal lives and in our businesses, we are convinced that the pressures on us are greater than ever before.

This is certainly the case in the investment management world where a large number of pressures have a direct impact on running the business. But as we look at them, it becomes evident that the areas focussed upon by today’s Chief Operating Officer are very similar to those that concerned the Administration Partner 20 or 30 years ago. There certainly are differences: for example, that Partner didn’t have to consider the wide range of derivative-based instruments that need to be handled today. And this is where it gets interesting. To some extent we can look back at history to see what actions have been successful but, as ever, today’s problems have unique features that have no reference point. Added to this, the options for resolving them have multiplied.

Bluerock has extensive experience of consulting within the investment management industry and current feedback from its clients is that there are five issues that most concern investment management firms.

1. Be cost effective

An old issue, but in today’s world the pressures are definitely more intense and the penalties for failure, swift and painful. Companies are having to look at their business processes – covering sales and marketing as well as fund management and operations. Many firms are looking deep within themselves to see both where costs are incurred as well as where income is not being generated.

The costs of running the business are increased both by inefficiencies within the operational process and by a lack of focus on what the firm does well. The desire to provide exotic products to clients may sound good, but the delivery of these in a cost-effective way, which actually generates real profit, is not a simple task. The key often lies in controlling headcount costs and because of this straight-through-processing [including the elimination of trade re-keying] is still high on the agenda for many.

In addition the income that is generated may not always be profitable. The understanding of where profit is created, and where it is lost, enables a firm to choose the client base that it needs and can best serve.
2. Offer sophisticated products

The range of asset classes that are on offer to individuals through independent financial advisors or wealth managers, as well as those on offer to institutions, is growing every day. The pressure to launch new and more sophisticated products is driven both by the need to provide good fund performance as well as by the need to keep up with the competition.

Derivative-based instruments have been around for a long time, but their use and availability is growing. New types of instruments are constantly being developed and used by private banks and institutional fund managers.

Hedge funds are an example of funds using these assets, but wealth managers and increasingly the institutional managers, are offering them to their clients too. These new instruments pose a danger to many firms: the way in which they are processed, the risks that they bring to the client’s portfolio and market liquidity limitations are all new factors where full understanding needs to be developed. The advent of Undertakings for Collective Investments in Transferable Securities (UCITS) 3 – which is only now beginning to hit the life companies and their retail funds – provides an excuse for fund managers to include these in their portfolios.

It has been observed that the firm that spends time considering all the issues around these assets before implementing them in their investment process are the ones that are least likely to experience problems later on. The availability of qualified staff – who actually understand the instruments and their practical operation – should be a primary factor before deciding to go ahead. In Dublin, for example, where so many hedge funds are domiciled and administered, there is a severe shortage of derivative-skilled individuals. We have been told this is a genuine constraint on the ability of administrators to service more clients. The issue is less pronounced in London, but is still significant.

3. Provide better client service

The word ‘better’ may not be wholly correct, but there is certainly a demand for greater client service. Both private and institutional clients are expecting higher quality reporting, more transparent pricing, and more available, knowledgeable staff. At the same time, fees are not changing: indeed they seem to be moving downwards.

As before, the solution typically includes a review of what the company can deliver cost-effectively to its clients; and then wrapping this up as part of the product offering. In most cases the solution to better client service is provided by the increasing army of software service providers who offer more and more functionally rich client management and reporting systems.

Clients (particularly high net worth individuals) are becoming more demanding in terms of the returns they expect from their fund manager as well as the range of products they expect to be offered. Again, a focus on what can be achieved at the same time as providing a good level of service is seen as critical to gaining and retaining clients.

4. Meet increasing regulatory obligations

In the UK and Europe (and indeed in many other countries), regulators are promoting the fair and equal treatment of all customers and a single European market. Many of these changes are driven by European Union (EU)-wide regulation; the UK is already one of the most regulated markets and now other countries are being brought up to a common standard of practice.

The EU Savings Directive was last year’s worry and the advent of Markets in Financial Instruments Directive (MiFID) is a very real concern to many fund managers. It is clear that many of its demands are already covered by current Financial Services Authority rules. However, there are a number of areas where change will be needed – not least the way in which dealings with clients are recorded. The opportunity to review existing working practices to see if they are consistent with the demands of MiFID is an investment worth making as it also allows a firm to see how it could benefit from the marketing opportunities that the directive supports (for example, cross border sales).
But the regulatory burden is only going to get heavier. And the cost of meeting the regulations, and proving they have been met, is an area that often seems to provide little bottom line benefit to the industry. For that reason alone, many firms are looking specifically to see how they can put business and computer systems in place to maximise their efficiency in this area.

5. Think global

The global investment management industry is increasingly crossing local, national and regional boundaries – this is not a new effect but the scale of it is. Clients are demanding access to products that provide returns based upon markets from the four corners of the earth and – although they might not have asked for it – they are increasingly being serviced on a global basis from centres across the world. This brings immense challenges in terms of organisation structure, product development, investment process, distribution channels, communication networks, legal and regulation compliance, risk management, systems integration, data consolidation, etc. etc. etc. The impact of cultural factors is always high on the agenda, both in terms of client needs and the way client servicing is organised and delivered.

The outlook of firms is growing wider and wider as they seek both the scale and the access to skilled resources to handle these challenges more effectively. This in turn brings other issues to the fore since global acquisitions need to be integrated quickly if the benefits sought are to be realised. The size of the prize can be considerable – perhaps in terms of clients, markets, products or cost savings – but overreaching can damage the brand as well as the bottom line and the risk associated with acting globally needs to be understood and then managed appropriately.

The bottom line

The challenges facing the investment management industry may not necessarily be new, and the ways in which companies meet them are ever evolving, but one point does however remain constant. The need to know exactly what you are offering to the market and to focus on doing that – addressing the issues outlined above – is fundamental to success. The Business Development Manager of an investment company who was certain that this has been the key to their firm’s success recently said: “we are providing a service to this segment of the market and we will not attempt to sell to a different area. We know we wouldn’t give them the service that we want to give.”

The counterpoise to this focused view for success is that innovation is undoubtedly vital. Some of the fastest growing investment managers have achieved their success by opening up new markets or creating new products, or – perhaps more accurately – swinging markets away from “traditional” investment areas into a new take on an old strategy, e.g. the rise of liability driven investment. This perhaps summarises the challenge; how to devise a winning strategy in the face of more challenges and more options than ever before.

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