

When did you last see your strategy?

In the first of two articles about strategy, Michael Clarke considers whether, in a challenging and volatile marketplace, firms have strong enough strategic foundations

Consider three very different stockbrokers. **Broker A** has been established for many years, with a loyal client base. It has always offered a full spectrum of services, from execution-only to discretionary management, at a “good value” third quartile price point. All operations are handled in-house on systems which are old but tried and tested. It offers a wide choice of client access routes, including internet broking, telephone trading and face-to-face meetings. While returns have not been spectacular, Broker A has remained profitable over the last five years with a stable market share.

Broker B is also long-established. It has a narrower product set than Broker A, choosing not to offer XO services. Believing that its clients value high quality personal service, it has been investing in this area as funds permit. It prices its services in the first quartile, but has not benefited as some other brokers have from recent high XO trading volumes. Combined with the costs of

improving client service, this has meant that profitability has been poorer than at Broker A over the last five years. Market share has remained steady.

Broker C is a much more recent arrival, and offers online execution-only broking targeted at high-volume traders. It spent heavily on launch marketing and is growing its share of the XO market with a combination of modern technologies and aggressive pricing. Most operations have been outsourced in an effort to achieve quick launch and to focus on distribution. Trading volumes have been high over the last two years, but profits are yet to be made due to the high costs of launch and ongoing marketing.

Q. Which of these brokers is best positioned to generate superior returns in the future?

The answer is the one with the best strategy. But there is of course insufficient information in these short descriptions to determine which this is – so what further questions might you ask?

Before answering this, let’s remind ourselves what business strategy is.

Virtually all firms have a business plan setting out their financial forecasts for the coming year and perhaps several years beyond. For the immediate future period this forms the budget against which the firm is managed. But this is not a strategy.

How has the business plan been developed? Surely there must have been a strategy behind it? Not necessarily. Figure 1 overleaf may be slightly frivolous, but the truth is that many businesses have just such an incremental approach. Year-on-year change is driven by the need to comply with new regulation, keep up with competitors and hopefully deliver growth. Where necessary to achieve this, new initiatives are bolted onto the side.

In a benign environment this can work reasonably well for a while. And there are times too when the effort needed to respond to mandatory changes is so great that there is little business capacity to do anything else – MiFID compliance was an example of this for many firms. But make no mistake, this is not strategy.

Strategy bridges the gap between the high level aims of the firm and its

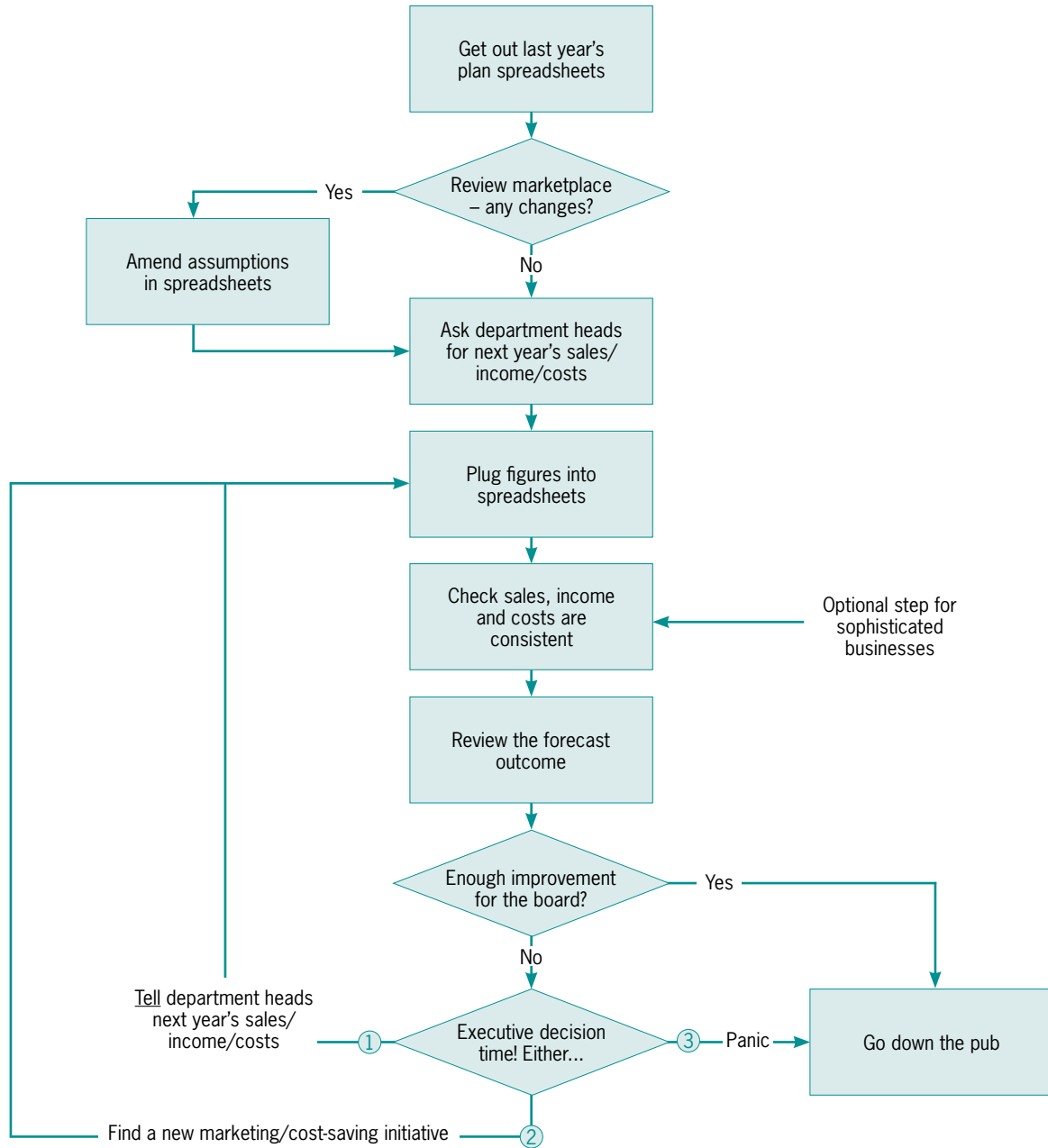


Figure 1: the business planning process

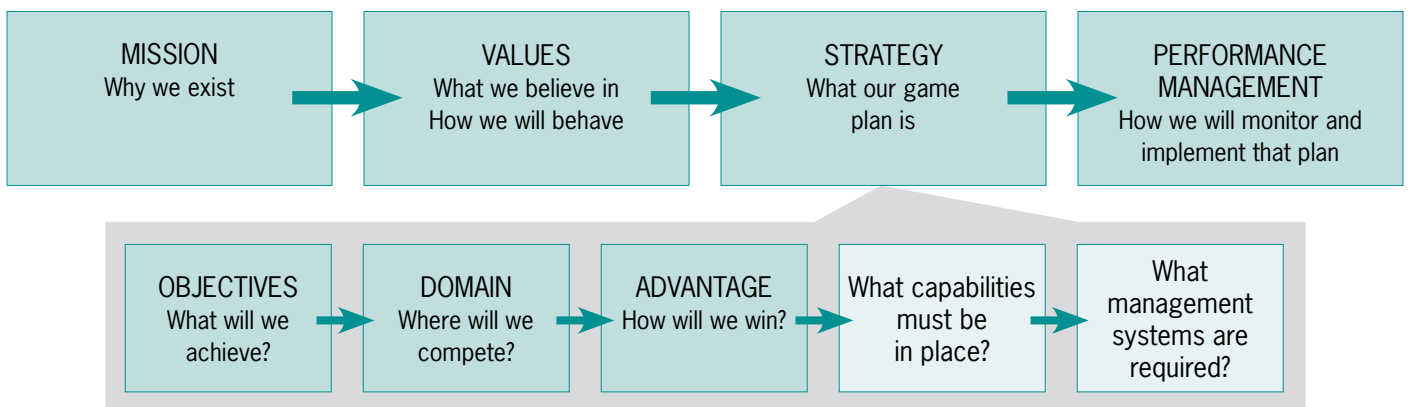


Figure 2: the role of business strategy

“Research has consistently shown that businesses with clear, focused, fact-based strategies generate superior returns and are better prepared for market changes”

day-to-day operations (see Figure 2). It starts with a clear understanding of what is to be achieved: specific measurable objectives over a defined timescale – for example “increase economic profit to £x by 2015”, or “grow the value of the business to £y in five years”.

Next there are key decisions to be made:

- Which markets – or market segments – should we compete in?
- What products and services should we offer?
- How will we price these compared with the market?
- How will we distribute them and deliver them operationally?
- How will we do all this in a way that profitably makes the most of our strengths and is hard for competitors to copy?

The answers to these questions will be different for every firm, and the UK private client market is big and diverse enough to allow more than one strategy to succeed. But it's vital to have a strategy, which means making conscious choices in each case – and for these to be good choices, the firm needs an accurate, detailed understanding of:

- Marketplace economics and trends;
- The competitive landscape;
- What clients really want, and most importantly are prepared to pay for;
- The firm's own unique strengths and characteristics, including where value is currently being created and destroyed.

Getting reliable, objective data to inform all these areas, and then using it to make sound strategic choices, takes time which firms rarely feel they can spare, and research, analysis and strategy development skills which firms often do not have – which is one reason why strategy is so often skated over or taken for granted.

Does strategy matter? Yes, very much. Research has consistently shown that businesses with clear, focused, fact-based strategies generate superior returns and are better prepared for market changes. As well as (crucially) targeting the

firm's resources at what really matters, a sound strategy well executed throughout the firm can reinforce its brand identity with its clients, protect against superficial imitation by competitors, provide boundaries within which employee entrepreneurship can flourish, and give a clear framework for identifying and responding to market change.

Let's look back at our three fictional brokers and see what additional questions we might ask to test their strategic robustness.

On the face of it **Broker A** has performed best of the three. But is its comprehensive offering a conscious and informed choice, or simply a legacy of the past? Does it understand the profitability of all its products, distribution channels and market segments, including the ownership cost of its old IT systems? It is likely that some of these areas will be destroying value. If market share is static despite relatively low pricing, then is its offering poorly promoted to or not well regarded by potential new clients – and if it has both a disadvantaged offering and a relatively high cost base, is it already lagging behind its competitors?

Broker B has chosen to limit its product offering and to develop a distinctive reputation aligned with its target client preferences. Stable market share despite premium pricing suggests an advantaged product offering. But how well-researched is its client knowledge? Is its investment in service quality focused on what clients will pay for? Does it really have all the competencies necessary to deliver high quality service better than its competitors, while still maintaining good profitability?

Broker C has also chosen a more focused approach, and business volumes are growing. But does it know that its target market segment is large enough, loyal enough and profitable enough to generate adequate returns? Has it segmented the market finely enough to identify and market to the most profitable clients and minimise acquisition costs?

HOW CAN I TELL WHEN MY FIRM HAS A STRATEGY?

- It has clear objectives, which its employees understand and share;
- It understands the markets it competes in, and has clear views of how they are likely to develop (and how it plans to respond);
- It has a distinctive approach to its markets, which permeates everything it does, is recognised by and attractive to its target clients, and is difficult for competitors to copy;
- It is equally clear about what it has decided not to do, and is not distracted by initiatives which run counter to its strategy, even where these may offer short-term profits.

How will the firm stand up to price pressure from other competitors? How does it plan to control its outsourcing costs and service delivery?

Finally, we might ask all the brokers how well their chosen strategy is informing their approach to key industry issues such as European harmonisation, growing investor sophistication, deployment of new IT technologies and prioritisation of limited development budgets.

It is the firms that are implementing clear strategies based on accurately understanding both their marketplace and their own strengths that will be able to answer all these questions convincingly – and consequently have the best chance of future success. ■

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