



Finding the best way forward

In the second of two articles about strategy, Michael Clarke looks more closely at the building blocks of strategy development and strategic advantage in the private client market

“What’s the point of it all?” Not (this time) the despairing cry of a Chief Executive considering the latest wave of regulation, but the first question that the board of any APCIMS member firm should be asking. “What are we trying to achieve?”

From the 1980s onwards, the standard reply for a shareholder-owned enterprise became “to maximise shareholder value”. The concept of shareholder value has evolved over the years and it is increasingly recognised that shareholders’ interests are best served by acknowledging the importance of all the business’s stakeholders, but value-generation remains central to satisfying all of these constituencies.

So what is the role of strategy in creating value for a stockbroker or wealth manager? Let’s start by establishing the theoretical framework. In a nutshell:

1. There are (only) two possible ways to create value: operate in an economically profitable market; and/or have an

2. There are (only) two sources of competitive advantage: a differentiated offering; and/or lower costs.

What do each of these statements mean for private client firms?

Profitable markets

An economically profitable market is one that over time generates an average post-tax return higher than the participants’ cost of capital. There are large differences in the long-run profitability of different markets, so market choice is important.

Of course, existing firms are already established in their core stockbroking or wealth management markets, determined usually by the skills and interests of their original founders. An innovative competitor might introduce a new offering or business model sufficiently revolutionary to redefine the market, but so far private-client market profitability has been shaped by broader forces and it’s hard for an individual firm

to do very much about industry economics.

What every firm can and should do, though, is identify which of its markets (and segments within its markets) have superior profitability, also taking into account whether these segments are growing or declining. A simple high level segmentation might be by product (e.g. XO/advisory/discretionary) or by customer (e.g. retail/institutional and, within this, by value of assets owned), but there may be more subtle and insightful approaches, perhaps by value chain activity (e.g. distribution, investment management, trading, settlement, custody...), customer behaviour or business model. And increasing the level of detail pays big dividends: what is it that makes a particular microsegment so profitable, and how can this help the firm better understand its strengths and focus its resources more effectively? A firm may also seek out attractive adjacent markets into which it could move – a recent example might be Hargreaves Lansdown’s move into employer-sponsored pensions and investments.

A market analysis might be summarised in a 2x2 chart such as Figure 1, where each market/segment is represented by a bubble with area proportional to its total revenue. Arrows show expected movement over time.

In this fictional example A, B and C are the firm's core markets, with D a profitable, growing niche and E a currently unprofitable but fast-growing new segment. The analysis highlights the threats to the firm of long-term shrinkage and profit reduction in core markets A and B, and the particular need to ensure that the firm is (or can be) operating profitably in C and E.

Comparison with the profitability of the firm's own activities, similarly segmented, can reveal much about a firm's competitive strengths and shortfalls.

But finding attractive markets is less than half the story. While different markets offer different returns, there are generally greater differences between the best and worst performers in each market. Even in an unattractive market a well-positioned competitor can perform strongly, so understanding the firm's unique strengths and where and how these can generate the most competitive advantage is at the heart of effective strategy.

Differentiation advantage

There are many ways in which a firm's product and service offering may be positively differentiated from those of its competitors. A few examples might be the strength of its brand, the design of its products, the capability of its relationship managers, the reliability of its dealing system, the usability of its online services or the pedigrees and performances of its investment managers.

Naturally, the strategic value of the differentiation depends entirely upon the extent to which it is perceived and valued by the clients targeted. It is extremely difficult for a firm to view the competitive position of its offering objectively, and strategy development needs to be based on regular, reliable client feedback and market research. Ultimately, the acid test is the firm's price positioning and market share. **Unless your firm can either price in line with competitors and grow**

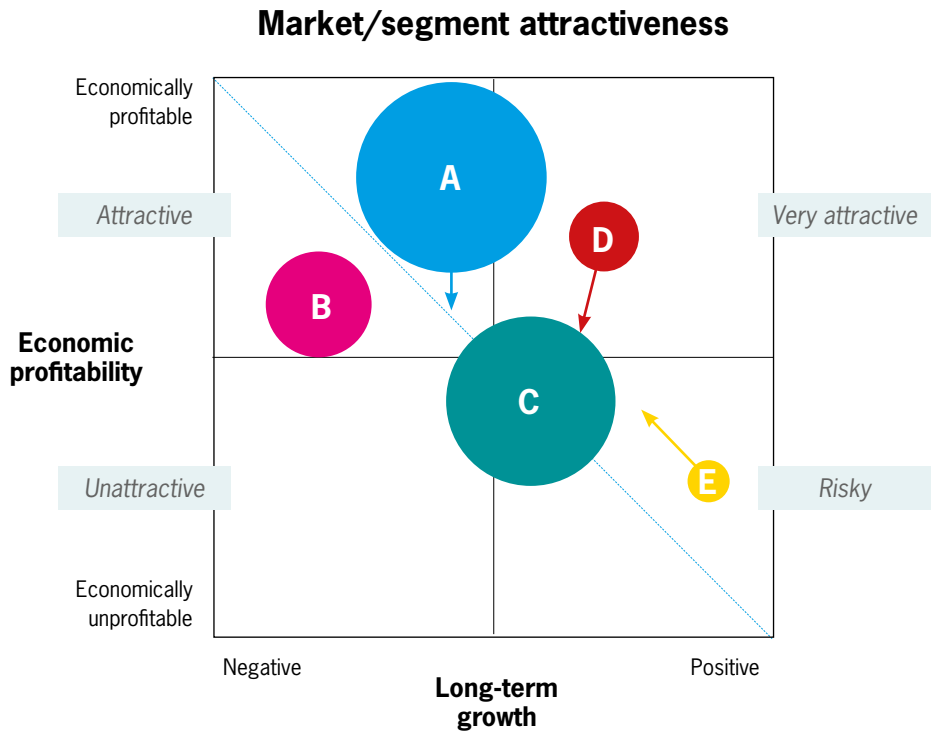


Fig. 1 – Market/segment attractiveness (bubble area proportional to market revenue)

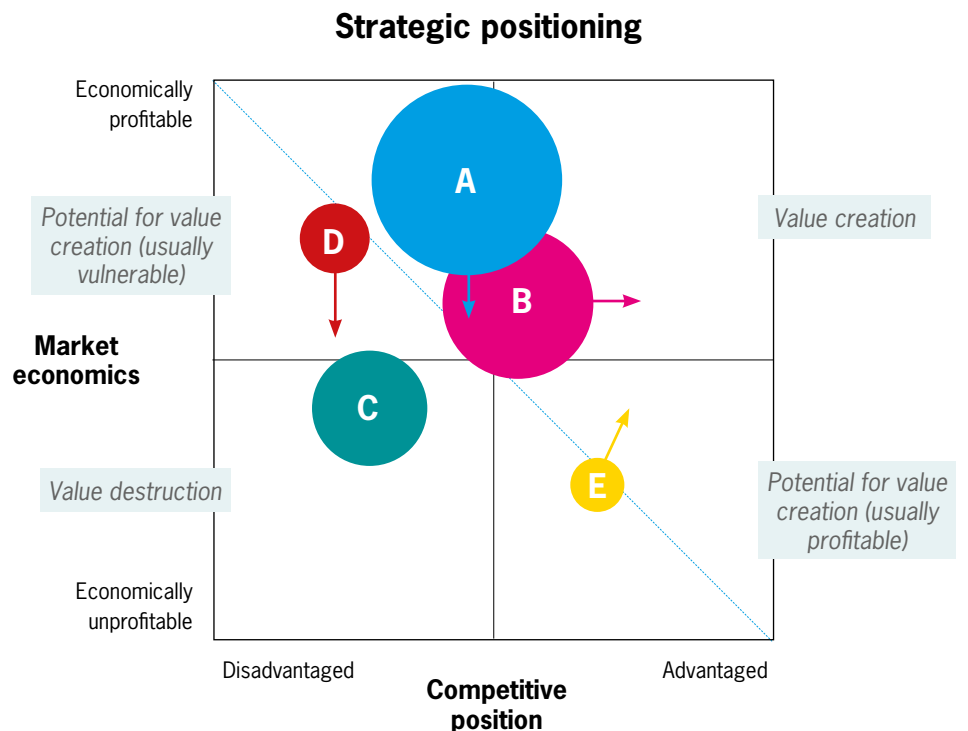


Fig. 2 – Strategic positioning (bubble area proportional to equity invested by the firm)

“Unless your firm can either price in line with competitors and grow market share, or charge a premium price without losing share, its client offering is not advantaged”

market share, or charge a premium price without losing share, its client offering is not advantaged.

Cost advantage

Similarly cost advantage can arise in many ways, e.g. lower unit labour or premises costs, more efficient processes, fewer errors, economies of scale, more cost-effective marketing... Cost advantage can generally be more easily quantified objectively, for example from industry benchmarking data and from reviewing competitor financial data alongside knowledge of their operating model. A difficult area of activity to allow for is risk management, with costs hard to isolate, and benefits to the firm's income, stability and reputation only revealed in stress scenarios.

A firm with an advantaged operating cost position can match competitors' prices and enjoy superior returns, or undercut them to grow market share while remaining profitable.

The impact of strategic positioning

The competitive positions of a firm's activities might be combined with market profitability in another 2x2 chart – see Figure 2 (where the bubble area is now proportional to equity invested by the firm). Again the more detailed the analysis can be, the better.

In this example, the analysis shows that two of the firm's core areas of activity are generating value, but D is a disadvantaged offering in a market which is becoming less attractive and needs close focus or maybe even exit. The firm may well have been unaware that C is destroying value – perhaps because it has not previously segmented or analysed its business in this way, or recognised all related costs.

Constructing similar charts for competitors can help shed light on their likely competitive moves and how they might respond to new strategic initiatives.

Understanding market attractiveness and strategic positioning forms the core of a robust strategy review and all sorts of benefits flow from it, including:

- identifying areas of current and potential future value destruction, for immediate attention;
- revealing/validating the firm's strategic assets and organisational strengths that are already generating value and that could be developed further and/or deployed in new ways;
- providing a baseline against which to evaluate alternative future strategies;
- identifying the unique strategic issues facing the firm. Strategic issues are those that threaten the value of existing strategic positions or open new ones up for occupation and that any viable strategy must recognise and address. Some of these will be common to most industry participants: examples might include European harmonisation, the RDR, technological change (in both back and front offices) and more demanding clients (asset class choice, transparency, market/portfolio access...). Additionally each firm will have its own unique strategic issues, perhaps arising from characteristics of its customer base, gaps in its product range, IT system strengths/deficiencies, staff skill sets or its current competitive positioning.

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In a couple of short articles it has only been possible to give brief overviews of the role and

TEN STEPS TO A WINNING STRATEGY

1. Define your mission, values and objectives
2. Find the best way(s) to segment your business
3. Understand your markets'/segments' characteristics and economics
4. Understand your clients' needs and behaviours
5. Understand your firm's performance and strengths/deficiencies
6. Identify the strategic issues facing the firm
7. Develop strategies that use the firm's strengths to establish advantaged positions in attractive markets
8. Implement single-mindedly across all of the firm's activities
9. Continuously monitor segments, clients and firm
10. Review your strategy regularly!

importance of clear, focused strategy for private client firms, and of a few effective methodologies. It's easy to summarise the key steps (see the sidebar), but harder for firms to follow them through with rigour and objectivity; research and analysis must be detailed and fact-based to give accurate strategic signals and command top management consensus. And it's also hard for most firms to find time to focus on strategy amidst the hurly-burly of business as usual. However, the rewards for those which do are deep and long-lasting.

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