

Margolis Advisory Group



Tackling Investment Firm Challenges:

Successful Execution of Strategies and Plans

- A **new and challenging** era is exerting pressure on the operations and profitability of investment managers.
- One key to overcoming challenges in this difficult environment is to **link strategy, planning and execution.**
- The **process is fluid as opposed to linear**, requiring built-in flexibility for ultimate success.
- **Execution must be fully owned by senior management** for firms to survive rapidly changing market conditions.

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INTRODUCTION

Investment markets are experiencing a prolonged period of major upheaval and unprecedented events, which continue to dominate headlines, grip investors and disrupt investment management firms' operations. Against the backdrop of the collapse of several esteemed financial firms, dramatic action by the Federal Reserve and the U.S. Treasury, and a severe credit crisis, the need for investment management firms to operate effectively and efficiently is more critical than ever.

The investment industry generated lucrative profit margins, in the 30% to 40% range, for the last 30 years. During this time, investment managers' profitability was significantly above normal long-term expectations. Times have changed. We have entered a new and challenging era, which is exerting tremendous strain on the investment industry, separating strong from weak performers. Moving forward, expect industry margins to return to more normal and sustainable levels.

At these lower profitability levels, in order to compete successfully, a premium is now placed on productive and efficient operations, the nexus of which is execution. This is challenging for many investment managers, as they tend to exert a notable amount of time on planning and intellectualizing the business, with insufficient focus on implementing such plans. Senior management is often removed from execution, leaving it unaware of and unable to respond to issues that arise during this phase of the process. Management also is often disconnected from its employees, both in terms of each employee's ability to execute effectively and the appropriateness of compensation incentives.

Investment firms positioned to succeed in this more difficult environment are integrated and communicative instead of hierarchical and bureaucratic. Integrated and communicative firms tend to foster an environment in which their investment and business philosophy, and overall strategy and plans are clearly understood throughout the firm. In these firms, senior management and staff interact and communicate frequently and openly, leading to successful execution.

CHALLENGES: UNANTICIPATED AND UNCONTROLLABLE

Challenges—even in stable markets—can cause shortfalls in business results. Unanticipated and uncontrollable hurdles arise in the marketplace trickling into the workplace as employees attempt to execute the business plan. Senior management often assumes its work is done after completing the strategy and planning phases, frequently leaving employees unequipped to overcome these obstacles through lack of guidance and assistance. Employees scramble to follow the business plan, which often veers off course. They may deviate from the plan simply to meet their goals, such as altering the target client list or presenting the investment products differently. When this happens, the investment, marketing and operations departments feel burdened. Organizational weaknesses, which

were previously overlooked, are uncovered with no assistance from senior management to correct them. Budgets often overrun. Management then becomes disenchanted, going back to the drawing board to reexamine the plan trying to pinpoint the cause of the breakdown.

SOLUTION: SENIOR MANAGEMENT IN THE TRENCHES OF EXECUTION

Many investment firms routinely operate in these ineffective ways; however, they are likely to struggle, and perhaps fold given the current investment climate. What's the solution to this recurrent dilemma? Senior management must be involved in the execution of the plan. As stated in *Execution: The Discipline of Getting Things Done*¹, "Execution is the gap between what a company's leaders want to achieve and the ability of their organizations to deliver it." The first—and critical—step toward keeping an investment management firm's business plan from derailing during execution is for management to gain a clear and honest understanding of the reason for the disconnect. Business strategy, planning and execution need to be inextricably linked, with ultimate responsibility for successful execution residing at the most senior levels of the organization.

Investment firms that stand the test of time understand the process is fluid not static so data discovered during execution should inform strategy and planning, which leads to continuous adjustments. Successful execution occurs when management and staff are in the trenches together—working as a cohesive team—allowing them to seamlessly overcome hurdles, while keeping the process on course. Firms operating this way can adjust nimbly during the execution phase, instead of making major alterations to the strategy and plan that are likely to be untimely and inaccurate. Let's more deeply explore the process of linking strategy, planning and execution.

SUCCESSFUL PROCESS: LINKING STRATEGY, PLANNING AND EXECUTION

A successful, repeatable process links strategy, planning and execution, with senior management partnering with its employees during the execution phase. Unfortunately, investment firms frequently operate in ways that are not designed for lasting success.

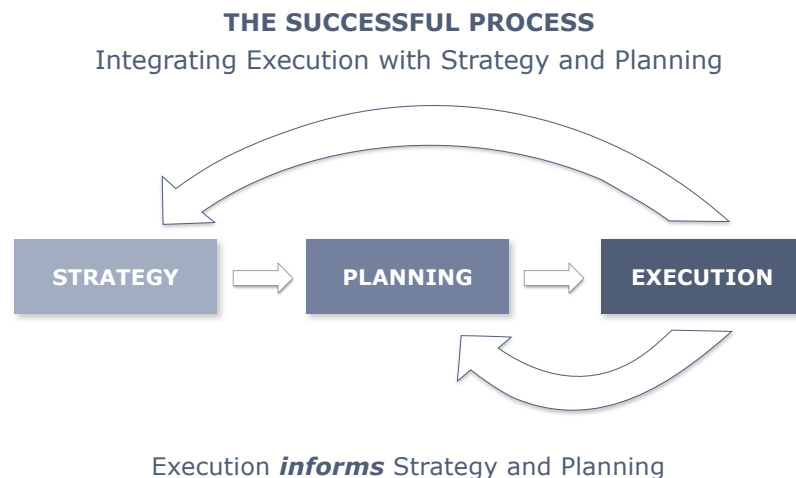
- ▶ A surprising number of investment firms entirely lack a clear process for raising assets, creating loyalty with clients or following a stated investment process. In some cases, a business strategy is casually considered, a general direction is established and goals are loosely set for the firm. This approach is void of necessary thoughtfulness and analysis. Firms can succeed for a period of time using this approach when investment results are strong, which leads to the false belief that management has developed a fine-tuned process, but this is not a recipe for long-term success.

¹Bossidy, Larry and Charan, Ram. *Execution: The Discipline of Getting Things Done* (Crown Business, New York, New York, 2002)

- ▶ Other firms apply a somewhat more sophisticated process with three distinct phases—strategy, planning and execution—designed to be implemented sequentially. In this case, senior management focuses extensively on strategy and planning, arriving at a strategy through careful consideration of its investment and distribution strengths, which are aligned with the current environment, as well as expected marketplace trends. A plan is then created based on this strategy, which includes business goals and budgets that permeate the organization. At this point, management exits the process expecting all departments to execute the plan, meeting or exceeding the goals. In the current environment, most investment firms are operating on both lean budgets and personnel, which can lead to low morale and motivation. This is one reason why management’s involvement in execution is more crucial than ever: employees need to feel supported.
- ▶ Finally, the successful process includes the three distinct phases stated above: strategy, planning and execution. This process is distinguished from the others in that execution informs strategy and planning, and senior management remains involved throughout the process. Integration of these three phases and feedback from execution to strategy and planning is critical to the process. Ultimately, senior management must own the entire process, with less precision and rigidity in its planning, in order to allow for continuous adjustments dictated by information gathered during execution.

It’s second nature for solidly integrated firms to operate with more flexibility. While plans and goals are established for the sales team, management solicits frequent feedback from them on market conditions to ascertain necessary adjustments. Planning should not be static, but designed for modification as the market shifts. Investment firms tend to function best when sales leaders have an equal voice with investment heads so the most current and relevant information is incorporated throughout the process.

The diagram below illustrates the successful process:



STRATEGY: FLUID AND DYNAMIC

An effective strategy is essential for lasting success. An investment management firm can certainly succeed for awhile relying on strong investment skills and solid distribution, but without a thoughtful strategy it will ultimately underachieve—and perhaps fail, particularly in today’s environment. Investment management attracts strong, capable competition. To rise to the top, a firm’s strategy must be both sound and flexible.

Executives arrive at the necessary strategy by assessing the investment firm, analyzing the current and anticipated business environment, and coming to a thorough and distinct direction for the firm. The “SWOT” Analysis, designed by Albert Humphrey², is a useful construct for thinking about strategy. “SWOT” outlines Strengths (S), Weaknesses (W), Opportunities (O), and Threats (T).

- ▶ **Strengths and weaknesses** are inward looking features, which examine the firm’s best and weakest characteristics. These characteristics must include all key firm elements starting with investment capabilities, followed by sales and client service, and ultimately, include back-office and administrative functions.
- ▶ **Opportunities and threats** are outward looking features, which analyze the environment to determine forces that will or could potentially impact the firm. These forces encompass elements such as the competitive environment, market dynamics and pricing pressures.

Strategic analysis should lead an organization in a specific direction leveraging its strengths, minimizing its weaknesses, taking advantage of opportunities and guarding against threats. Identifying weaknesses allows the firm to take appropriate corrective action.

When applied to investment management firms, the SWOT analysis needs to be dynamic in response to the rapidly changing industry environment. Both the quality of the personnel and the strength of the firm culture are particularly important to a firm’s success. As such, the analysis should emphasize the competence of its personnel to deliver and execute the plan’s goals. Firm culture, integrated versus hierarchical, should also be assessed during the analysis to determine the firm’s ability to freely communicate and collaborate.

Business strategy should be intermediate-term. A long-term approach, other than the firm’s core approach to investing client assets and fundamental business philosophy, is unrealistic given the dynamic nature of the investment industry. On the other hand, a short-term strategy becomes a tactical exercise as opposed to a smart strategy.

²Humphrey, Albert. Stanford University; 1960s – 1970s

“Planning is critical to success, as it’s managements’ vehicle to turn an articulated strategy into blueprints that guide action.”

An intermediate-term strategy isn’t defined by a specific time period, although it should be long enough to be effectively planned and executed over a reasonable cycle, typically three to five years. Strategy is intended to be multi-year in scope, however, given the ever-changing marketplace, it requires a level of fluidity rather than being etched in stone. While the overall strategy may remain intact, modifications often occur and should be shaped by information gained by continuously examining the changing marketplace. All too often, strategy is divorced from the actuality of the market causing it to become stale and invalid.

PLANNING: GOALS AND TACTICS

Planning is a critical element of investment management firms’ success, as it’s managements’ vehicle to turn an articulated strategy into blueprints that guide the firms’ actions. Plans come in multiple time-frames—annual, five-year, long-term, and contingency—so management must determine the most appropriate period of time to execute the plan. Strategy defines the overall direction of the firm, while planning sets specific goals and actions for a certain time period based on that strategy.

Most executives are intensely focused on planning, which is often driven by the fact that plans are typically concrete and easily defined by quantifiable parameters. A plan can be examined to conclude exactly what’s expected of the firm, whereas strategy is more amorphous. Planning is the point at which management must decide on specific steps to achieve the strategy, but there will almost always be a level of uncertainty based on the natural fluidity of the markets. Any ambiguity in the strategy is usually disregarded—for the moment—because management must assume that it’s correct due to pressure and desire to develop a plan.

A misleading sense of precision about the plan results from this process, as it’s commonly too static for the veracity of the marketplace. Effective plans must be adaptable to changing conditions, such as those currently plaguing the economy, a persistent credit market crisis, skyrocketing unemployment and an increasing lack of consumer confidence. Management needs to force itself out of its comfort zone of creating a quantifiable plan and into the more realistic world.

Budgets are also determined during the planning phase, which are cascaded throughout the organization to align and inform all departments. Meanwhile, annual budgets are typically linked to annual plans. Quite often management doesn’t finalize budgets—and even plans—until well into the year on which they’re based, leading firms to work on a fixed budget and plan that lack necessary elasticity. It’s far too common for

one planning cycle to be completed just as it's time to start the next one, which is highly ineffective.

At most firms, employees' performance guidelines and incentive awards are an element of the plan. Management should communicate regularly with all employees about their performance, as well as progress toward achieving established goals.

While planning is important, investment firms regularly invest more time in planning than strategy. A domino effect then occurs, causing management to redirect its focus to competing priorities or to dedicate too little thought and attention to the key element of the process: execution.

EXECUTION: MOST CRITICAL STEP IN THE SUCCESSFUL PROCESS

More investment firms fail due to improper execution than from weak strategy or inadequate planning. Senior management often assumes that execution will flow naturally from the strategy and plan, which were so carefully and precisely designed. A common problem at investment firms is that existing staff is either incapable of executing well or does not have proper incentives. However, even if management has placed the right people in the right jobs, with appropriate incentives, it makes the mistake of assuming that staff should execute the plan properly with little or no guidance.

While effective execution at investment management firms is complex, it's achievable when senior management is committed to ensuring that the staff is capable of executing successfully and is compensated fairly, and management maintains a high degree of involvement in execution. The fundamental elements necessary for proper execution are:

- Investing assets in a style consistent with established guidelines
- Generating strong results over the long-term
- Cultivating and managing client relationships
- Attracting new clients in a way that engenders client loyalty
- Focusing on the intricate investment and operational needs of clients

Importantly, each of these activities must be in sync with the established strategy and business plan.

Strategy, planning and execution form a continuous loop as opposed to a linear process. Strategy informs planning, which informs execution; in turn, execution informs strategy and planning. Execution occurs in real-time, providing the most current, relevant information about the marketplace and specific challenges in the workplace, which should lead to necessary modifications to the process.

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SUCCESSFUL EXECUTION: MANAGEMENT’S INVOLVEMENT AND OPEN COMMUNICATION

One element to successful execution requires management to be less precise and rigid in its goal setting, given that we operate in a constantly changing environment, which is currently characterized by extreme difficulties. Directional goals are necessary; however, the fluidity of the business must be incorporated into these goals.

Operating without unyielding goals is easier in small organizations than in larger firms, although larger firms can do so if they make a conscience effort. Large firms must place heavy emphasis on constant communication in all directions—up, down and across—in order to succeed in this effort. While formal updates are important, most of this communication must occur informally, which happens in an open and communicative culture.

The more consistently and deeply involved management is in execution, the better it can regularly and effectively communicate requirements of its employees throughout the year. Employees, in turn, are likely to respond positively, as they feel management has a greater appreciation and respect for their daily experiences and challenges.

Importantly, management will gain a better understanding of the ability of the front-line employees to deliver the desired results. The investment industry is inundated with a pool of candidates seeking employment, although the quality of potential employees is mixed. After employees are hired, it’s important for management to monitor and assess the realistic capability of each employee to achieve established goals, which requires that management both closely observe its employees, and carefully craft incentives that encourage and reward superior performance.

Senior management involved in execution typically leads firms highly focused on delivering excellent results for its clients. The marketplace has an understandable and positive impression of these firms’ values, and the services and products they can deliver their clients. These firms follow a deliberate and consistent investment style, which resonates throughout the firm creating a collegial and aligned culture. Management tends to apply an integrated and successful process, which includes commitment to and involvement in execution. In this environment, executives consistently communicate its philosophy to the firm’s clients, the public, and its personnel, regardless of their roles in the firm.

Firms operating this way tend to be collegial instead of hierarchical, with senior management involved in all steps of the process. In this environment, employees understand that plans are designed to serve as a guide, while working with the knowledge that the marketplace is fluid and in order to survive firms must be nimble when direction needs to shift. Employees in a highly collegial and communicative firm feel more united, resulting in a higher level of performance and success.

EXAMPLE: EXECUTION IN PRACTICE

Let's examine two scenarios to understand how the approaches might differ and the importance of management's involvement in execution. After careful planning and research, executives determine that the firm should expand business in a new, fast-growing distribution channel. The firm has a good breadth of product that could be expanded through team lift-outs or acquisition. Research estimates that the firm could potentially gain 5% market share over five years.

Firm 1: Hierarchical

In a hierarchical firm, management develops a plan without heavy involvement of the employees expected to execute in the market. A number of factors may not be considered using this approach, including:

- Current trends in product demand
- Acceptance of existing products in the marketplace
- Keys to new products being positively received in different distribution channels
- Willingness of the market to accept lift-outs

In this common scenario, senior management exits the picture after delivering the plan, leaving middle management to execute.

Even if appropriate input had been gathered from the execution team, unanticipated issues can still arise, which is even more likely in today's environment. Time and again, management is surprised when the market takes a turn causing the need for adjustments to the distribution approach. Commonly, products that were once attractive in existing markets may have subtle characteristics that now make them less desirable in certain new markets. Further, additional support infrastructure may be required and sales personnel may not be as effective as necessary in new channels.

Firm 2: Collegial

Highly collegial and communicative firms may not completely avoid these pitfalls. However, senior management is more likely to adjust quickly to these issues and to build more flexibility into planning because of its involvement in every step of the process. A strong firm culture creates a shared way of thinking and reacting, accepting the likelihood of unexpected hurdles and possessing the ability to respond effectively to common issues, as described above, such as once attractive products turning out to be less desirable than expected.

The current market environment presents challenges so serious that firms slow to react may fail. Collegial firms are better equipped to respond quickly to market challenges, make adjustments and introduce changes throughout the organization.

“An increased focus on execution can be dramatic, transforming mediocre firms into top-tier performers.”

Results

Ultimately, the results of hierarchical firms, in which management is not involved in execution, are likely to be unsatisfactory at best. In this situation, there is no mechanism in place to react quickly to execution obstacles and to make mid-course corrections. Middle management is again left to its own devices to improvise, senior management becomes disillusioned and a general level of dissatisfaction sets in.

Highly collegial, communicative and integrated firms, in which senior management is connected to the execution process, have the ability to address marketplace hurdles through open communication with middle management. In this case, chances of successfully executing the plan, even in the face of extreme challenges, are much greater.

CONCLUSION

Investment management firms that survive the turbulence of the existing market environment, as opposed to those that fold under the pressure, will possess a key distinguishing characteristic: senior management will embrace and engage in execution.

A successful process—strategy, planning and execution—is fluid instead of static and incorporates the freshest information from the marketplace, allowing real-time adjustments. Most senior management teams spend far too much time on strategy and planning, while paying insufficient attention to execution. This creates a gap between management’s ideal execution and the reality of middle management’s ability to execute properly, due largely to management’s lack of involvement and unexpected obstacles.

An increased focus on execution can be dramatic, transforming mediocre firms into top-tier performers. When management is in the trenches with its employees, it can make informed judgments of the validity of the plan, the employees’ capabilities and the reality of successful execution. Management’s involvement in the entire process tends to promote firms with strong investment cultures, which leads to a collegial as opposed to a hierarchical culture. In this environment, all employees understand and accept the strong likelihood of unanticipated hurdles occurring during execution, and they are prepared and willing to work as a unified team to make quick and appropriate adjustments.

For the past generation, the investment management industry has both enjoyed and prospered from extremely favorable conditions. This era has recently come to an abrupt end, threatening the viability of many firms in the investment industry. In order to succeed in this intensely competitive environment, investment firms must be able to perform effectively, with senior management taking full responsibility for execution. ■

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About Margolis Advisory Group

We work exclusively with the investment management industry to enhance sales growth and retention through people, product and process improvements and practical solutions.

With extensive industry experience raising billions of dollars for investment firms, from start-ups to large organizations, we work with executive management teams, and sales and marketing staff to achieve desired results.

While our expertise assists investment managers in thinking through problems and analyzing the marketplace, our clients benefit most when we help them in translating that thinking and analysis into execution.

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