

**SKYWARD STRATEGIC ANALYSIS**

by

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## **Abstract**

This research project provides a strategic analysis of Skyward Capital Management. Skyward is small and independent investment management firm within the Canadian Managed Money Industry. In particular, this paper aims to determine the best strategic alternative for Skyward to pursue as it seeks to grow its profits while in competition with dominant bank and insurance adversaries. This report finds that keys to success include developing a modern value proposition and collaborating with your toughest competition to gain improved sales distribution.

**Keywords:** strategic analysis; money management business; broken value proposition; differentiation; distribution; value chain; competitive structure; customer segments; sources of advantage.

## **Dedication**

I would like to lovingly dedicate this project to my wonderful wife and son, Tracy and Reid. You both gave me non-stop support and encouragement as I pursued this MBA and I feel very fortunate to be a part of your family.

## **Acknowledgements**

I would like to express much gratitude to the SFU executive MBA faculty and staff for the exceptional program they have delivered. Additionally, the fantastic student cohort certainly deserves a hand of applause for making the experience so much fun. Lastly, I would like to thank my great colleagues at Skyward for recommending I complete this MBA, and for making it all possible.

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## **1: Introduction**

This document provides a strategic analysis of Skyward Capital Management (fictitious name), which is a privately owned investment management firm located in Western Canada. The main objectives of this project are to identify key business strategy alternatives, assess these alternatives in terms of their fit with the firm's strengths, weaknesses, opportunities and threats, and lastly to recommend a specific course of strategic action.

In doing this research I hope to gain a better understanding of the potential for small independent investment management firms like ours to compete effectively within the context of Canadian industry maturity, and oligopolistic Bank and Insurance Company dominance. My personal motivation for choosing this topic is that I am the President and am responsible for growing the company. More broadly, I hope this subject will be of interest to Canadian investors since it will shed light on some of the industry dynamics that influence the nature of the investment products and services they receive.

More specifically, I am eager to find a business strategy that can help turn around our company's financial performance in the face of challenging firm-specific conditions such as poor investment product track-records and limited financial resources. To carry out this strategic analysis I will begin with a brief explanation of the

Money Management business. Following that, I will outline the current position of Skyward then continue with a look at the industry's value chain, competitive structure, customer segments, sources of advantage, as well as external forces and trends. From there I will examine Skyward's relative competitiveness, strategic alternatives, work through option feasibility, and provide a final recommendation.

## 1.1 Money Management and Food

To get the (dough) ball rolling, in this part of the report I will describe a bit about how the money management industry works by making some comparisons to the prepared food business. As I do this, I will also try to clarify the meanings of some of the main investment industry terms you will encounter as you read this paper. From left to right, Figure 1 below covers some of the steps and concepts involved in the food preparation business, and below the diagram I will describe parallel parts of the Money Management industry.



*Figure 1: Money Management and Food*

- **Raw Food = Asset Classes** – As you may know, food is organized into four food groups: Meat & Legumes, Grains, Dairy, and Fruit & Vegetables. In the investment world, securities are grouped into various broad categories as well, and these are called asset classes. The three main Asset Classes are Stocks, Bonds and Money Market.
- **Chef = Portfolio Manager** – In some ways, a Portfolio Manager (PM) is similar to a cook who decides what dish to make, what ingredients to use, and how to prepare it. The industry also has Client Portfolio Managers (CPM) that focus mostly on managing client relationships as opposed to selecting investments.
- **Kitchen = Investment Platform** – Just as chefs have kitchens stocked with the food and equipment they need to cook, Money Managers do their work using something comparable called an investment platform which provides the investment research and trading systems they need in order to buy and sell securities for their clients.
- **Cuisine = Strategy** – As Chefs specialize in certain types of cuisine, Money Managers do something similar by developing and following distinct investment strategies, which are also called disciplines, to select securities in their own particular way. For instance, some Money Managers investing in stocks follow a growth strategy which means they try to identify and buy shares of companies that are growing their earnings faster than other companies. Other Money Managers have a value investment style which involves looking for and owning companies whose shares are cheaper than average relative to their earnings.

- **Dish = Mandate** – Just as a Chef might start with raw beans and follow a recipe to cook a dish called Baked Beans, a Money Manager might likewise start with Canadian stocks and apply a value investment strategy to manage a mandate called Canadian Value Stocks. Although mandates are typically defined by way of the underlying asset class and discipline, they can be further defined through a geographic region such as Europe or Asia. With respect to an additional mandate example, a Long-term High-yield Canadian Bond Mandate might invest in Canadian corporate bonds maturing in over ten years that offer above average interest rates.
- **Table Service = Direct** – Most restaurants serve their dishes directly to their customers, and some kinds of Money Managers, such as Counsel Firms, do this as well. With this direct to client service approach, only minimal packaging is required. For example, at a restaurant, food can simply be put on a plate, and likewise for a Money Manager, direct delivery of their services can be done with little or no legal packaging.
- **Packaging Container = Product Format** – If a restaurant wanted to sell more baked beans, it might choose to distribute their product through additional Third-party Sales Channels, such as other restaurants and grocery stores. To ship their product and enable sales elsewhere, they would need to package their Baked Beans in different containers, like Cans or Tubs, depending on which Sales Channel they were shipping to. Money Managers have to follow a comparable approach if they want to sell their mandates through Third-party Sales Channels.

In the money management business, direct distribution is lower-cost than Third-party Distribution since less legal packaging is needed and no wholesaling is required.

- **Waiter = Salesperson** – A salesperson’s role in the investment management world is similar to a waiter’s or store clerk’s in the prepared food business. There are different types of salespeople depending on which kind of Third-party Sales Channel Company they work for, and these differences determine which product formats the Money Manager must use for distribution. For instance, if a Money Manager wants to sell their mandate through a Planner who works at a Mutual Fund Dealer, then they need to package their mandate in a product format called a Mutual Fund, which is one of several varieties of Investment Fund product formats.
- **Menu = Product Platform** – For the Money Management industry, maximizing Third-party Distributions akin to trying to be included on as many restaurant menus as possible since these both enable and constrain the dish options waiters can recommend. In the investment world, these menus are referred to as distribution or product platforms and they are defined by the product formats and mandates they offer, as well as the technology they make available to salespeople for overall order and client account management.
- **Meal = Portfolio** - At a restaurant you can order a single dish, such as Baked Beans, or you can ask for a few different dishes and combine them into a meal. One can do precisely the same thing within the money management industry by

investing in several different kinds of mandates. This combination of all one's investments across all of the various types of mandates is called a portfolio.

Having just taken a look at some of the Money Management processes and concepts that are universal to the business as a whole, we will now turn our attention to Skyward Capital Management as a specific company. Skyward is a participant in the Canadian Managed Money Industry, and in the next section I will delve into the organization's current position.

## **2: Skyward Today**

### **2.1 Skyward Company Overview**

Skyward Capital Management is a Vancouver-based, employee-owned investment management business caring for \$1.2 billion in assets. The company currently has clients in 8 of the 10 Canadian provinces, and was founded in 1989 when three individuals from another investment firm decided to start their own business.

Skyward is legally registered as a Portfolio Manager, or Money Manager, which means we can act under our own discretion to buy and sell investments for our clients without having to ask our client's permission to do so. By comparison, other kinds of investment professionals and firms offer investment services on a non-discretionary basis. Representatives at these kinds of companies are usually called Advisors, Agents or Planners, and they are required by regulators to confirm client acceptance of every investment trade before it is placed.

As I have touched on above, although money management is essentially a service, Money Management firms can also be thought of as offering products, which are sometimes called mandates. Up to this point, Skyward has offered a traditional product line-up of stock and bond mandates that employ largely undifferentiated investment disciplines and seek to achieve higher returns relative to the markets we are invested in. At Skyward, our stock selection discipline is often referred to as "core". This investment strategy is essentially a combination of value and growth disciplines. In



other words, for our stock mandates, we look for companies that are both cheaper and faster growing than average. Due to the blended nature of this approach, the pattern of returns we generate tends to be more similar over time to the broader market averages than either a growth or value approach alone.

## 2.2 Skyward Strategic Position

- 1) **Where** - With respect to the geographic region in which Skyward operates, we are currently open to accepting clients all across Canada. In terms of the client segments we serve, Skyward is a generalist firm and offers discretionary investment management services to both families and institutions. On the institutional front, examples of organizations include foundations, pensions, mutual fund companies and investment dealers.
- 2) **What** - The company's current value proposition might be best described as "helping Canadian institutions and families better invest their funds by integrating specialist money manager services at a reasonable price". Specialist Money Managers have individuals or teams of Portfolio Managers that focus on executing just one strategy within a single asset class. With regard to pricing, although we are less expensive than our peers, there is an internal reluctance to overtly promote this aspect of our proposition since it's felt it may detract from quality perceptions of our services. In other words, since we're cheap, we must be no good. At the heart of our value proposition is really an offer to outperform the returns of the broader stock and bond markets.

3) **How** – With respect to how we aim to deliver on our value proposition in terms of money management functions, our in-house Investment Group handles all the stock selection responsibilities for mandates investing in developed stock markets, and we've hired outside Portfolio Managers, called Sub-advisors, to execute the security selection functions for all our other mandates. For instance, to manage all of our fixed-income mandates we use a firm called Addenda Capital, who employ teams of bond specialists, and for our emerging markets stock mandate we have hired a company called Berkley Street as Sub-advisors. From a distribution standpoint, we largely employ a direct to client sales and service model through a small team of client-facing Portfolio Managers who are also responsible for adjusting the asset mix between the various mandates in the portfolio.

### **2.3 Skyward Current Performance**

Investors are often attracted to employing specialist Money Managers since they have greater expertise and experience employing their strategy within a particular asset class, and this is thought to create a greater potential to achieve better investment results going forward. Unfortunately for Skyward, our specialist money manager approach that worked well in the past has not recently added additional returns for investors. This underperformance represents an operational problem for the firm since it essentially leaves us with a broken value proposition. Over the past 3 years, our disappointing investment results have led to client departures, few client additions, and a decline of Assets under Management (AuM) of 30%. While aggressive cost-costing

measures helped soften the blow somewhat, this fall in AuM still resulted in profits tumbling by 25%. By comparison, other Canadian Money Managers have fared quite well as market recoveries from the global financial crisis created average cumulative growth in AuM over the same period of 24%.

## **2.4 Skyward Issues and Problems**

Beyond a lacklustre value proposition, Skyward has additional internal challenges. For one, the company is held back by an extremely weak distribution system. As it currently stands, in terms of direct distribution, we have only three Client Portfolio Managers who act as salespeople, and each of these individuals are expected to retire within the next five years. In terms of Third-party Distribution, we are also very limited, although we have begun to make some improvements of late.

Furthermore, given the financial and value proposition challenges, some of the main shareholders and senior leaders lack confidence and long-term commitment concerning the growth of business. Culturally speaking, the effect of this is that there is no appetite amongst the shareholders to risk additional capital investments to expand the company, and this preference obviously constrains the viability of some strategic options that might otherwise be attractive.

Given the circumstances identified above, the main strategic issue I hope to resolve through this analysis is: how can Skyward grow our profitability given recent product underperformance, minimal distribution, constrained resources, and

formidable competition? Perhaps somewhat surprisingly, despite the challenges I've outlined, I do believe we can find ways to jump the hurdles and succeed into the future.

As we search for ways to flourish in this environment, our Executive Team has been considering three strategic alternatives: Performance, Customization or Retirement. Under the first option, we could hire new high-performance PM Sub-advisors who would take over the security selection functions, and improve our distribution through client referral programs. As a second option, we could focus on delivering greater customization to families, and grow our AuM by hiring or acquiring new CPMs who can bring their existing client relationships to Skyward. To execute this second option, we would need to employ a broader investment platform that would enable better customization. Thirdly, we could specialize in meeting specific retirement-related demands for new investment strategies that actively reduce risk and provide more income. To enhance the distribution of our services under this third approach, we could manage money for third-party mutual fund companies and investment dealers. By pursuing this tactic, representatives outside our firm could sell retirement-specific investment mandates managed by Skyward. The diagram below encapsulates the key concerns of this strategic analysis (Please see Figure 2 below).

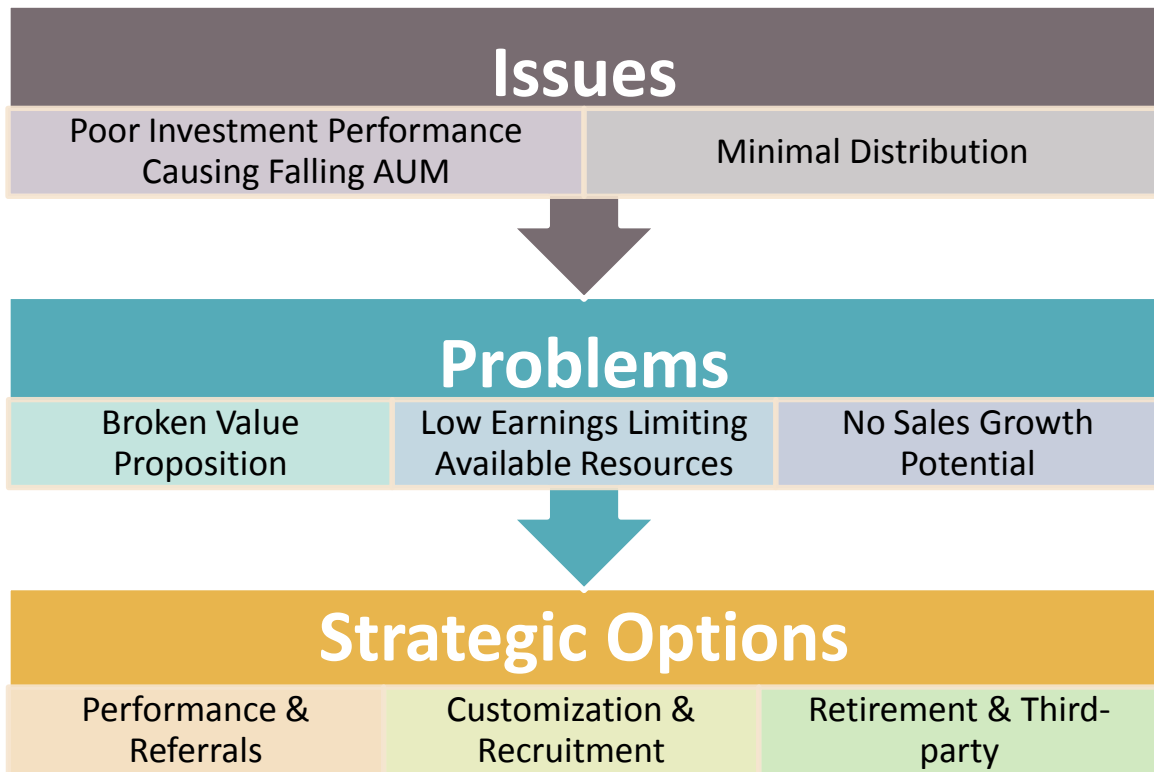


Figure 2: Skyward Strategic Concerns

### **3: Lay of the Land**

I have four main objectives in this third part of the strategic analysis. First, I want to identify the various entities that take part in the Canadian Managed Money Industry as Suppliers, competitors, sales channels and clients. I also wish to understand how these players impact opportunities, threats and the relative competitive positions. Second, I would like to delve into the nature of client preferences and industry trends for a better appreciation of how these elements might shape future threats and opportunities. My third goal will be to discover the industry's main sources of competitive advantage, and explore the relative importance of each. Last, but not least, I wish to assess the competitiveness of the various types of money management firms with respect to the industry's main sources of advantage, and moreover consider where Skyward stands in terms of its strengths and weaknesses by comparison.

#### **3.1 Managed Money Industry Overview**

##### **3.1.1 Industry Definition**

Skyward competes in what I have referred to as the Canadian Managed Money Industry which provides discretionary investment services to both institutional and private clients. In this industry, money management firms get paid to make and execute investment decisions on behalf of their clients, and these companies generate revenues by charging their clients management fees on the assets they hold in their mandates.

It's worth noting here that non-discretionary investing is not included in my definition of the Canadian Managed Money Industry, except for the portion of non-discretionary assets that end up being placed into a managed money products. Non-discretionary investing occurs where an investment professional offers advice, or clients make their own investment decisions without getting advice. For instance, people sometimes purchase money management directly through CPMs at an investment counsel firm, but often they access discretionary money management through Investment Fund products, like mutual funds, that are sold by non-discretionary salespeople such as Advisors, Planners and Agents.

The diagram below maps out the levels of assets managed in each of the various Individual and Institutional client categories (see Figure 3). Institutional investors, such as Pensions, Corporations and Not-for-profits tend to have larger portfolios and generally prefer to hire Money Managers directly to avoid the perceived or real additional costs of fee layering.

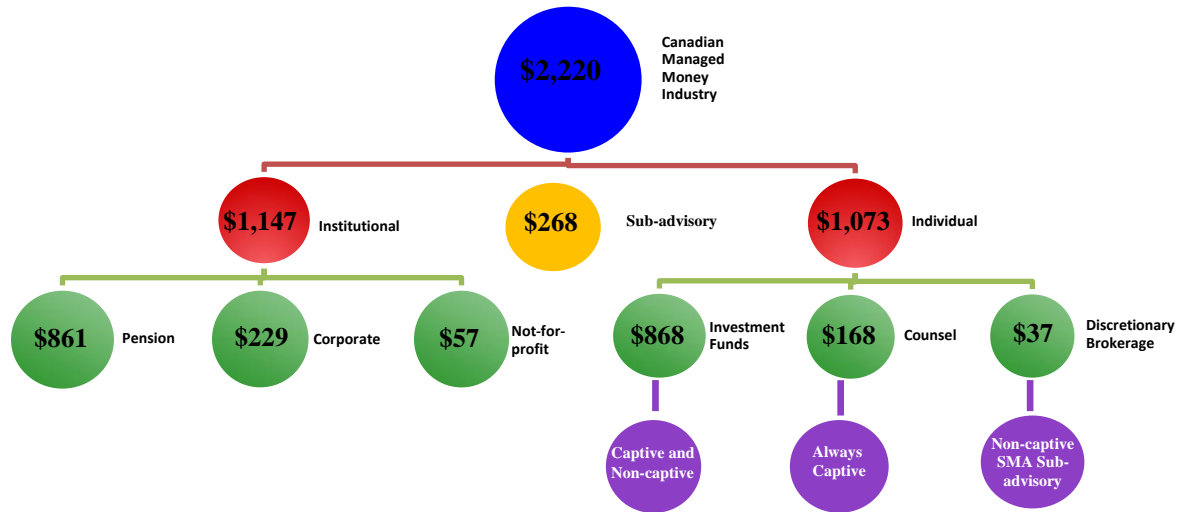


Figure 3: Canadian Managed Money Industry. From Investor Economics, Managed Money Advisory, 2012 (Figures shown in \$billions CAD)

### 3.1.2 Canadian Managed Money Value Chain

In an earlier section, 1.1 Money Management and Food, we looked some of the basic concepts, processes and terms that are used in the managed money industry. In this section, I will describe the various players in the value chain for the Canadian Managed Money Industry. The illustration below (Figure 4) highlights the key participants and includes Suppliers who provide inputs, Money Managers who are the companies responsible for product marketing and/or security selection, direct or third-party Sales Channels that sell and service money management products to clients, and finally, the various kinds of Clients who purchase managed money products.



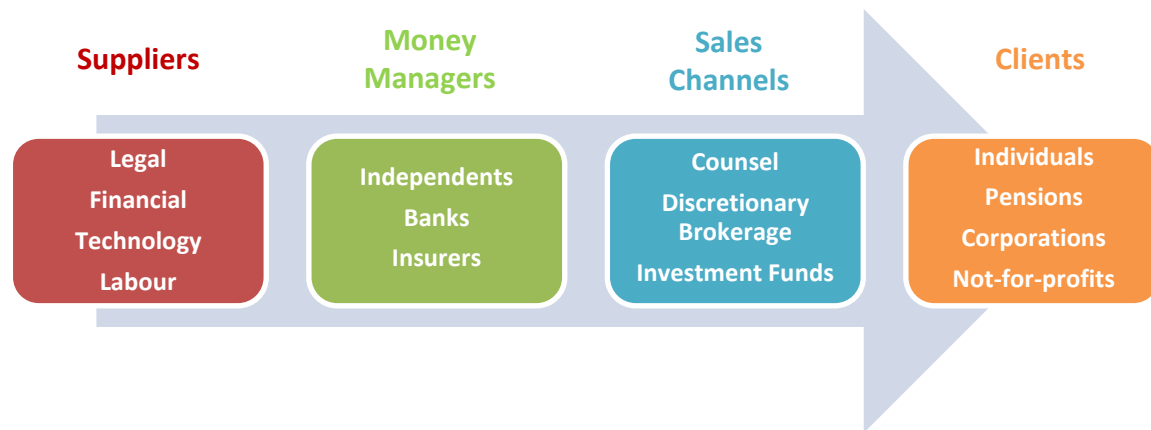


Figure 4: Canadian Managed Money Value Chain Participants

### 3.2 Four Types of Suppliers

- **Legal** - Law Firms assist in maintaining regulatory compliance with security commission requirements such as registrations, product filings and reporting.
- **Financial** - Service providers in this category include Accounting Firms for audits and reporting; Custodians for asset safekeeping, client record-keeping and valuations; Brokers for research and trading; Other Money Managers for mandate sub-advice; as well as Data-providers for security and benchmark information.
- **Technology** – Information management systems are needed to help execute operational functions such as internal accounting, quantitative security selection, portfolio asset allocation, regulatory compliance, payroll, and reporting, as well as enterprise resource and client relationship management.

- **Labour** – People are needed take care of tasks such as investment research, security selection, trade management, legal and accounting, business management, operational system design and maintenance, sales, service and administration. Given the professional service nature of the industry, people are the biggest part of the value chain and represent approximately 70% of the total cost structure.

### 3.3 Three Kinds of Money Managers

Concerning the industry's structure, it is quite concentrated. According to Investor Economics, as of June 2012, there were 179 competitors in all, but the top 20 manage 60% of industry assets (Yeung, 2012). Figure 5 below shows the portion of industry assets managed by various size firms.



Figure 5: Assets by Firm Size

Money Managers come in various forms depending on what functions they choose to execute. For instance, some only offer security selection, while others only execute marketing functions, and some are forward integrated to execute sales as well. While Money Managers typically execute the security selection function within the value chain, they may also buy these security selection services from external PMs, which is called a “Sub-advisory” relationship. In fact, oddly enough, some money management companies don’t manage any of their own money, or even deal directly with any of their end clients. For instance, North West Ethical Funds is registered as a Portfolio Manager but essentially has a product marketing focused business model whereby they outsource all the security selection functions to Other Money Managers through Sub-advisory relationships. North West Ethical Funds then concentrates on being good at gaining and growing distribution through non-captive Investment Funds Sales Channels. Alternatively, as touched on earlier, some other money management companies may do their own security selection and also be forward integrated to carry out a direct to investor sales and service function. These same companies may also sell through Third-party Sales Channels such as Investment Funds, which adds distribution by enabling external Advisors, Planners and Agents to sell the Money Manager’s services.

- **Independents** – This group would include companies like Skyward, and other investment counsel operations or mutual fund manufacturers not owned by Banks or Insurers. Our company is an example of a firm that is forward integrated to perform both the money management and sales functions.

Traditionally, firms like ours have competed on price by targeting institutional and wealthy private investors who are too price-sensitive to find mass-market Investment Fund product formats appealing. Skyward employs both PMs for security selection and CPM for sales and service.

- **Banks** – This competitive bucket is comprised of 76 domestic and foreign banks as well as Canadian Credit Unions. These Money Managers are forward integrated and are industry leaders regarding the size and breadth of their distribution channels. According to Deloitte, from 1989 to 2009, Banks were able to leverage their brands and branch distribution networks to expand their mutual fund market share from 32% to over 44%. Without a doubt, Banks are Canada’s most formidable competitors, and as discovered by Investor Economics, over the past three years they grew AuM at rate 47% faster than the industry as whole. As one competitor example, TD Asset Management, which is the investment management arm of the Toronto Dominion Bank, just passed upwards through \$200 billion of AuM. Almost all these assets are concentrated in the Mutual Fund product format and have been gathered through their own Mutual Fund Dealer (TD Waterhouse Financial Planning) and their own Counsel arm (TD Waterhouse Private Investment Counsel). As with all of the Canadian banks, TD pursues a supermarket strategic position and offers to comfortably and conveniently integrate all of the financial services you require.
- **Insurers** – These players are defined as insurers who manufacture money management products such as Pooled Investment Trusts and Segregated Funds.

As a group, they typically have captive sales forces to sell to Individuals and Institutions, and they are particularly strong in the Pension space. One example of a company fitting the bill is Sun Life Financial. Due to their suite of insurance employee benefit offerings, they've been able to build strong relationships with corporate HR departments, and this has helped them effectively sell Pooled Investment Trusts to the Pensions of those same clients.

Of late, Insurers have generally performed weaker with respect to serving the Individual client segment. This is mostly due to the fact that the product format sold by Insurance Agents to Individuals, called a Segregated Fund, is the industry's most expensive type, and this has dampened both its performance and price appeal. For a quick snap-shot of recent operating and financial performance, in 2012, Sun life's Pension business, which represents 2/3rds of its AuM, grew its earnings by 5%, while its Investment Funds assets, which are 1/3rd of the business mix, saw considerable redemptions and an earnings drop of 10% (MacKinnon, February, 2013).

### **3.4 Three Sales Channel Types**

Sales Channels are the part of the value chain that interacts with the various types of Clients by performing the money management industry's sales and service functions. Here are brief explanations of the three kinds of Sales Channels.

- **Counsel** – These channel members include Skyward and other independent investment counsel firms, as well as the counsel arms of Canadian Banks. Money

is usually managed through the most basic of mandate formats; either Pooled Investment Trusts (where client assets are co-mingled with other investors without a legal prospectus) or through in-house managed Separately Managed Accounts (or SMAs which are sometimes referred to as segregated).

- **Discretionary Brokerage** - This group is made up of SMAs, which are offered by full-service Investment Dealers, where the mandates are managed on a Sub-advisory basis by an external PM. This category also includes assets held in product formats called Wraps, which are portfolios that are managed by combining and adjusting an asset mix of several different SMA mandates.
- **Investment Funds** – This Sales Channel is a catch-all distribution category that includes all other distribution platforms and representatives that offer unitized money management. The distinction here is that these assets are not separated or segregated from the assets of other clients, but rather the assets are combined and held in an Investment Fund of some kind. Product formats fitting the bill include traditional Mutual Funds, Segregated Funds (confusing name for a unitized insurance company product) and Exchange Traded Funds (ETFs). In terms of participating sales and service operations, this channel is comprised of Mutual Fund Dealers, Full-service and Discount Investment Dealers, as well as Life Insurance Agencies.

Some Sales Channels mentioned above are described as captive and only offer products manufactured by their affiliated Money Managers. For instance, BMO Asset Management, the Money Manager, is forward integrated with BMO Financial Planning

and BMO Investment Counsel, which are both captive versions of Investment Funds Sales Channels. This means that planning and counsel distribution operations are owned by the Bank of Montreal and exclusively sell BMO Pooled Investment Trusts and BMO Mutual Funds. An Investment Dealer such as BMO Nesbitt Burns, on the other hand, is described as a non-captive or open-architecture operation, since its distribution platform includes both proprietary money management products such as BMO Mutual Funds and independent money management products like Mackenzie Mutual Funds.

### **3.5 Money Management Clients**

#### **3.5.1 Market Size and Growth**

As of June, 2012, the Canadian Managed Money Industry had total AuM of \$2.2 trillion across all client categories, and according to the Investment Funds Institute of Canada, our country's mutual fund format AuM has grown by 9% per annum since 2002. With respect to earnings, according to a recent McKinsey study, North American asset managers currently have operating profit margins of 28%, and while these profit levels are 20% lower than their peak in 2007, they are still in-line with the industry's 10 year average (McKinsey and Company, 2012).

#### **3.5.2 Five Client Segments**

In terms of understanding some of the characteristics of the various segments, here are client descriptions of Individuals, Pensions, Corporations, Not-for-profits and Sub-advisory.

- **Individuals** – Also described as retail, this client group represents financial assets that are privately held, as opposed to financial assets held within various organizational structures such as Pensions, Corporations and Not-for-profits. Typically, private individuals sticking with managed money investment approaches tend to progress through different Sales Channels as they age. For example, people might start by buying Investment Funds through a Mutual Fund Dealer, and later move to a Discretionary Brokerage or Counsel offering.
- **Pensions** – This set of clients is made up of corporate and government defined-contribution and defined-benefit pension plans. This group prefers a Pooled Investment Trust product format since it allows assets to be grouped together with other client assets to reduce average fixed costs and lower overall expenses.
- **Corporations** – These are institutions that have balance sheet surplus assets that require management for regulatory reasons, exist as security against potential obligations, are awaiting other business opportunities, or are just in place in order to maintain cash-on-hand liquidity.
- **Not-for-profits** – This client segment includes charitable foundations and endowments, examples of which would include the Vancouver Art Gallery Foundation and the Metis Settlement Trust. As with Pensions, these clients generally have more conservative investment objectives since the trustee decision-makers have fiduciary responsibilities to act in a prudent manner.



- **Other Money Managers** – As touched on earlier (see p. 27), this kind of client relationship comes about when Money Managers manage money for each other. This usually occurs for a mandate where the client firm lacks the necessary in-house expertise or is seeking to add an outperforming track-record. From the standpoint of the Money Manager purchasing Sub-advisory security selection, this would be viewed as a supplier relationship. Sub-advisory contracts can exist for every kind of mandate and product format. Seeking to manage money through Sub-advisory agreements is an attractive tactic for gaining Third-party Distribution since these product format structures typically already have a spot on an existing external distribution platform.

### **3.5.3 Relative Size and Growth of Client Segments**

With respect to the key client groups that the industry serves, some will recede and some will gain prominence. For instance, companies have strongly shifted away from accepting responsibility for obligations relating to the retirement income needs of their employees. Consequently, Pensions may stagnate, and this sector accounts for 75% of the AuM of the Institutional client segment. Demographic effects should also help shift assets from the Pension to Individual clients segments since some people opt to transfer assets out their pensions at retirement and rollover the monies to a Locked-in Income Fund, which would bolster AuM in the Investment Funds Sales Channel.

Individuals, whose investments represent roughly half the industry's assets, are increasingly being forced to take investment matters into their own hands as they seek

to gain financial security for retirement, and this is likely the industry's leading growth opportunity. In particular, this trend will help create attractive openings for certain retail product strategies. For instance, McKinsey found that between 2008 and 2012, retail managed solutions aimed at meeting specific outcomes such as risk reduction, instead of market relative outperformance, grew their AuM by a whopping 25% per year (McKinsey and Company, 2012).

Another client segment poised for growth is the Not-for-profit group. If the historical relationship between age and giving remains intact, then as Canadians grow older, charitable contributions should continue to expand. According to Leave a Legacy, 83% of Canadians made a donation in 2007, for a total of \$10 billion, and this figure represented a healthy increase over total 2004 contribution levels of \$8.9 billion. Furthermore, 7% of Canadians plan to gift money to charities through their estates, which should fuel further growth as wealth transfers continue to accelerate.

#### **3.5.4 Seven Client Preferences**

In this section, I will outline the leading purchase drivers which are common across all of the customer segments. Although the importance rankings vary amongst client groups, generally speaking, money management attractiveness is based on the following universal factors. Overall, they are ranked as follows:

- 1) **Lower Fees** – Investors are increasingly opting for lower-priced investment solutions. This is due to four factors in particular. First, the low recent and expected return environment in causing people to question the value being

received for the fees being charged as a percentage of returns being generated. Second, growing investor experience is increasing price-sensitivity as investors better understand the negative impacts of costs on investment results. Third, regulations are imposing greater cost-transparency rules which are adding to consumer awareness and concern. Fourth, increasing price competition through the expansion of passive low-cost products, such as ETFs, are making fee-savings much easier to access. It's also worth noting that Third-party institutional clients, such as mutual fund companies that outsource money management through sub-advisor agreements, like to hire lower-cost Money Managers because it increases their profits.

- 2) **Investment Performance** – Human beings tend to be backward looking and have a propensity to buy investments with the best past results and liquidate investments with the worst past results. Because of this, one of the main drivers of asset in-flows and out-flows amongst competitors is past investment performance.
- 3) **Specialized Mandates** – As with most professional services, investors have a preference for receiving investment management services from those they believe are most capable of providing the specific kind of money management skills they want. Money Managers can achieve attractiveness on this dimension by acting as a specialist for a particular unique asset class and strategy, or by focusing on satisfying a particular client need such as risk reduction and delivering that through outcome-based “solution” strategies.

- 4) **Advice Confidence** –Retail investors are often looking for guidance they can trust and feel confident in. This frequently stems from perceptions of advisor competence in money management, communication skills, as well as characteristics like credentials and experience. Due to lower levels of sophistication which make personal assessment more difficult, private investors typically also find greater value in unbiased recommendations that are seen as unaffected by either financial incentives or a limited selection of investment options.
- 5) **Portfolio Customization** – This feature relates to the fact that money management clients may want a solution that is a perfect fit with their unique needs. Although this may be of lesser importance to some segments, amongst retail customers, a TD Bank investment survey found that portfolio customization was the leading preference (TD Bank, 2010).
- 6) **Client Experience** – A valuable client experience can include getting products that are simple to understand, one-stop-shop integration of services from their current financial institution, receiving frequent service contact, having easy service access through phone, web or convenient locations, quick inquiry response times, minimized paper-work, an enjoyable personal relationship with the firm representative, and getting free service add-ons such as retirement planning and invitations to educational events.
- 7) **Safe Brand** – This element can add attractiveness by lessening client concerns such as risk of fraud or insolvency, and this brand dimension becomes of higher

importance during difficult market conditions, which can sometimes result in a “flight to safety” where AuM shifts to firms with stronger safety image.

### 3.5.5 Client Preferences by Segment

Below is a table which lists each of the client preferences identified above and rates their relative importance to each of the client segments mentioned earlier (please see Table 1).

*Table 1: Client Segment Preference Importance*

Client Preference	Preference Importance to Individuals	Preference Importance to Pensions	Preference Importance to Corporations	Preference Importance to Not-for-profits	Preference Importance to Other Money Managers
Lower Fees	10%	30%	25%	25%	30%
Investment Performance	15%	30%	25%	25%	15%
Specialized Mandates	20%	15%	20%	20%	30%
Advice Confidence	10%	0%	5%	5%	0%
Portfolio Customization	25%	20%	25%	5%	20%
Client Experience	10%	0%	5%	5%	0%
Safe Brand	10%	5%	5%	15%	5%

In this part of the report, I will outline some of the reasons for the preference variations across the various client segments (as shown in Table 1 above).

- **Lower Fees** – I have found through experience that there seems to be a relationship between a client’s investment expertise and their price-sensitivity. That is to say, as knowledge grows, so does the reluctance to fork over management fees. For this reason, in the Pension and Sub-advisory client categories, where money manager selection is often decided upon by experienced consultants, the fees tend to be lower. Whereas, for the more retail oriented folks, such as Individuals or the trustees on Not-for-profit boards, fee-sensitivity is not as great.
- **Investment Performance** – As you will notice above, I’ve ranked this dimension as most important to Pension clients. The main reason for this is that pension consultants who provide Money Manager selection and monitoring services to Pensions typically only get paid when they do a search, and accordingly they are very eager to fire and replace any underperforming Money Managers. Broadly speaking, however, there is currently a strong demand shift away from an active relative-return performance focus in favour of market returns with less cost, exposure to alternative asset classes or specific outcomes such as higher income.
- **Specialized Mandates** – This factor holds the greatest appeal to the Individuals and Sub-advisory client segments. Increasingly, families are choosing Money Managers they feel are best positioned to serve them in retirement, and Sub-

advisory mandates are always selected with very specific criteria around investment objectives, asset classes and strategy type. It is also anticipated that due to growing Baby Boomer risk-aversion, portfolio asset-mixes will shift from higher risk to lower risk asset classes thereby reducing industry profit margins. For example, at the end of 2011, typical stock management fees were 72% higher than those on fixed income assets (McKinsey and Company, 2012).

- **Advice Confidence** – This factor holds the most interest to Individual investors primarily due to their lower levels of sophistication which makes them more reliant on advice through the money management process.
- **Customization** – This client preference tends to be popular across the various segments largely due to the perception that the likelihood of goal achievement increases when solutions are specifically designed to meet one’s unique needs. I’ve also noticed that interest in customization goes up considerably in situations where clients perceive their needs to be very different than those of others.
- **Client Experience** – For some reason this preference seems to be more important or valued by Individuals as compared to Institutions. Perhaps it’s that a comfortable and enjoyable client experience adds to the sense of trust that Individuals have a greater need for.
- **Safe Brand** – Here too, brand seems to matter more to Individuals as well as Not-for-profits. Professionals, who are the decision-makers for Institutional clients, seem quite happy to work with lesser known money management firms. It may also be that Institutions understand that the investment assets are actually held

at a relatively safe custodian such as RBC, which makes the Money manager's brand less important.

### **3.5.6 Summary of Client Opportunities and Threats**

In this section of the report I will briefly review the leading threats and opportunities that are likely to arise from expected changes in client behavior and preferences.

- In terms of customer threats, the demographic trends around Baby Boomers approaching and moving into retirement will cause a major behavioural shift from saving to spending, and this will reduce inflows to portfolios and magnify out-flows from the same portfolios. However, this negative influence on AuM will be somewhat offset as Baby Boomers downsize residences, receive inheritances, and sell the private businesses they own. As mentioned, an additional threat exists in the form of growing customer price-sensitivity which is contributing to increased price-competition and downward pressure on revenues in general. Lastly, there is a strong demand shift away from active relative-return stock mandates which is a particular threat to Skyward since all of our in-house managed AuM is of this type.
- With respect to client related opportunities, Baby Boomers are increasing demand for certain specialized investment mandates with new objectives. Instead of seeking good relative returns from benchmark-hugging products, they are now much more interested in retirement outcome-based solutions such as



proactively risk-managed and yield enhancing strategies that are designed to help them better meet their retirement goals. From 2008 to 2012 solution mandate assets have grown cumulatively by over 50%. Fortunately, these kinds of low risk, high yield outcome-oriented mandates continue to see growing interest across all Institutional and Individual client segments. In particular, the expanding desire for low-priced vehicles, in combination with aging demographics, is creating an excellent opportunity to launch retirement-themed investment solutions that are inexpensive for consumers and cheaper for Money Managers to manufacture.

### **3.6 Canadian Managed Money Industry Five Forces**

In this part of the analysis, I will apply Michael Porter's five forces framework to the Canadian Managed Money Industry. According to Porter, understanding the competitive powers at play is essential in order to develop business strategies to improve profits (Porter M. E., January 2008). These industry forces come not only from direct adversaries but also from Suppliers, new entrants, substitute products, and even consumers who each use their power to fight for the profits and utility the industry has to offer.

While the degree to which the various forces are strong or weak is of interest, the best place to look for strategic insights is in how the landscape is changing and what new opportunities and threats are being created. The diagram below identifies the current levels for each of the forces, and it also shows whether each of the forces are

rising, stable or falling. In the section after the chart I will offer an explanation for my views relating to each of the five forces.

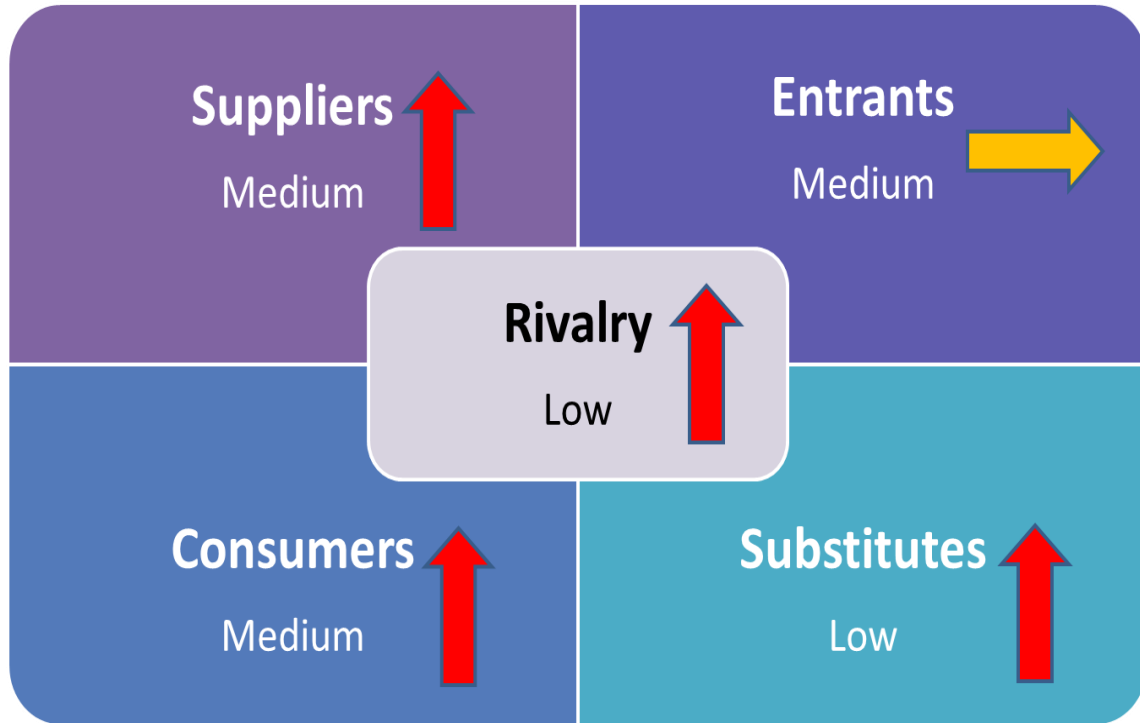


Figure 6: Canadian Managed Money Five Forces

### 3.6.1 Rivalry – Low and Rising

One good place to start when assessing intensity of rivalry is to look at the degree of price competition, and for the Canadian Money Management industry a good way to gauge this is to look at the Management Expense Ratios (MERs) on our country's Investment Funds. These MERs are essentially the prices retail customers pay for money management products. In Canada, MERs are expressed as a percentage of the assets invested, and these prices build-in most of the overall value chain costs for money management, but not all of them. For instance, MERs include money manager fees,

operating items such as legal and administrative expenses, and the ongoing service fees (if any) that are paid to salespeople.

However, one type of cost that is borne by investors, but not reported in MERs, is the commission charged by brokers to the Investment Fund assets when the Money Managers buy and sell securities on behalf of the Investment Fund. These commissions as percentage of Investment Fund assets are called a Transaction Expense Ratio (TER), and this cost to consumers is buried and largely hidden from consumers. Also excluded from MERs are any additional commissions or advisory fees that Advisors, Planners and Agents may charge to clients to buy, sell or monitor Investment Funds.

In terms of MERs, Canada has been bucking the global trend, and maintaining high and relatively stable prices over the past twenty years. In fact, a 2011 Morningstar report found that Canada had the highest stock fund fees of the twenty-two countries studied. (Benjamin, March 2011) Compared to Canada, the rest of the world appears to have been competing more on price, or alternatively, it could be that investors and substitutes have been exerting more price pressure elsewhere in the world. As we can see from the chart below, over the past twenty years, global MERs have been generally in decline with stock fund fees falling by 20%, and bond fund expenses dropping by 30%. (Gallagher, 2011)

The apparent lower levels of Canadian Money Manager competitive intensity may also be partially explained by our Financial Service Industry's broad horizontal scope as compared to other countries. As Ghemawat suggests in his book, "Strategy and the Business Landscape", "Rivalry may be muted among broad-scope firms that meet

one another in multiple markets. Fearing that aggressive behavior in any one market will provoke fierce competition everywhere, they may refrain from aggression anywhere” (Ghemawat, 2010). This makes particular sense in the Canadian context when we consider that our country’s banks are the nation’s largest money management competitors, and they are also more concentrated here (by market share) than in many other locales.

Historically, other factors have moderated rivalry as well. Firstly, as seen earlier, AuM has been growing at a fairly vigorous long-term clip, and this healthy expansion tends to make opponents less hungry for market share which lowers competitive intensity. Secondly, switching Money Managers isn’t always quick and easy. One cause is that investment structures and strategies are, by their nature, difficult to understand, and this complexity makes it tough for consumers to research and easily compare the merits of one Money Manager to another. Moreover, changing Money Managers can be time-consuming simply due to the mounds of legal paperwork involved. Overall, these obstacles create Client Switching Costs that afford competitors more pricing power and help subdue rivalrous intensity.

On the topic of change, the biggest upward shift in rivalrous intensity is occurring in the traditional actively-managed, benchmark-focused stock sector of the industry. These are essentially mandates where the Portfolio Managers try to get better investment results than the relevant asset classes they are investing in. In this market space, clients in droves are opting for cheaper options that passively track market indices. For instance, Mckinsey found that from 2008 to 2012 in North America, active

relative-return stock mandates lost \$673 billion, while low-cost passive index-tracking stock mandates gained \$858 billion in assets. (McKinsey and Company, 2012)

Conversely, in areas where growth is high, such as mandates for “alternative assets” like real-estate, or “solutions”, which chase specific outcomes other than trying to beat benchmarks, competitive intensity will remain more muted and profits will be more attractive. In terms of growth in these areas, from 2008 to 2012, AuM in the solutions and alternatives market spaces have expanded cumulatively by 50% and 54% respectively (McKinsey and Company, 2012).

### **3.6.2 Threat of Entry – Medium and Stable**

At first blush it would appear the Canadian Managed Money Industry faces a considerable threat of entry since very little capital is needed to start a firm and launch products. However, the toughest entry barrier to overcome relates to the control of scarce resources in terms of Sales Channels. Michael Porter refers to this as “unequal access to distribution channels” (Porter M. E., January 2008). As we have seen, CPMs, Advisors and Planners can only sell what is on their firm’s shelf, and getting shelf-space as a new company is very challenging. This is due to the fact that incumbent Money Managers were first to take up existing shelf space and obtaining new distributor agreements typically requires a three-year operating and performance track-record. The distribution entry barrier is gaining strength as well because most Sales Channels are now actively reducing non-proprietary mandates to encourage salespeople to increasingly sell proprietary mandates that add profits in other parts of the value chain.

In spite of the distribution challenges, the threat of new entrants remains. For instance according to Investor Economics, the number of Canadian money management firms has risen from 144 in 2009, to 170 companies in 2012 (Yeung, 2012). The most successful of these new entrants have been using the ETF product format to bypass the distribution barrier. ETFs are different from regular mutual funds in a crucially important way since their listing on stock exchanges makes them available for purchase by a wide range of Other Money Managers and Sales Channel participants.

As a result, I believe the most likely new entrants to the Canadian Funds industry are Global Competitor Incumbents who would use the ETF format to side-step the distribution constraints associated with Captive retail dealers, and instead focus on accessing capital through open platform brokerage channels. This business strategy can be readily executed, as well, since the typical low-price value proposition for ETFs allows for good asset growth traction without needing any wholesale distribution infrastructure. Since these foreign new entrants are geographically diversifying from other regions, they can rely on existing revenues and capabilities that allow them to compete more intensely on price to gain market share in Canada.

Canada is an attractive market to enter as well due to the fact that our fee levels are higher than in other parts of the world. One recent new entrant example can be seen in Vanguard, a powerful U.S. Money Manager with a whopping \$2.2 trillion in AuM. Coincidentally, this firm has the same global AuM as the entire Canadian Money Management Industry. Vanguard arrived in Canada last year and has launched 11 Canadian stock exchange-listed ETFs. In terms of who these foreign-based start-ups

threaten, Canada's existing ETFs and Investment Funds manufacturers will likely feel the greatest impact.

### **3.6.3 Substitutes – Low and Rising**

Substitution threats to Canadian money management services are largely made up of approaches that involve parties managing money themselves instead of hiring some external party to do it for them. Since 2007, while global financial assets have expanded by 10%, the managed money share of those assets has fallen (Pierre-Ignace, 2012). Sources for this threat can be found in three main areas. The first example can be seen in the Individual client segment, and essentially a person's propensity to manage their money themselves depends on four variables: ability, time, interest and price-sensitivity. As people gain investment experience and knowledge, and as technology enhances and simplifies do-it-yourself tools at discount investment dealers, people's ability to manage their own portfolios increases. The demographics around retirement also increases the time people have on their hands to be able to manage their own money. With respect to interest in managing money, this variable may not change much or may grow as investment knowledge expands comfort with the subject. Lastly, price-sensitivity is on the rise, and this adds to the substitution threat since it motivates people to consider managing their own money as a way to cut costs.

A second area where we have seen an impact from the do-it-yourself movement is in the Pension segment. Mostly as a cost reduction tactic, large Pensions in particular have been firing external Money Managers and taking the function in-house. Also

contributing to this tendency is the fact that Pensions, as with other investors, are becoming more interested in passive investment approaches which are easily executed by buying all the companies in a stock market index, in the same weight as that stock market index. According to Investor Economics, between 2009 and 2012, the portion of externally managed AuM fell from 60% to 57%, as compared to the assets that Pensions managed for themselves internally (Yeung, 2012).

The last factor that is increasing the threat of substitution is that of Advisors upgrading their own registrations to become Portfolio Managers. Advisors who work at Full-service Investment Dealers have traditionally offered advice on a non-discretionary basis, and have historically had half their practice assets invested in other people's managed money products. What these Advisors have realized is that by becoming Portfolio Managers themselves they can manage their own client's money, and cut incumbent Money Managers out of the revenue equation. Since removing high-embedded money management costs will add significantly to employee compensation, there is a strong propensity for Advisors to become Portfolio managers and make this happen. This backward integration tactic is quite easy to execute as well since once an investment advice relationship is established, from there on in, investment products and services are mostly sold not bought, in that the Advisor largely controls what happens with the assets. In other words, it's quite easy for the new Portfolio Manager to make the sale and impose some minimal switching costs on the end investor.

I think it's also worth noting that as Advisors continue to become Portfolio Managers themselves, the best way for incumbent Money Managers to counter this



substitution force is to launch ETFs that will be used as money management inputs by these new Portfolio Managers. This tactic can be effective since it helps simplify portfolio management, and thus is appealing given the new Portfolio Managers still need to service clients as well, and hence face mounting time pressures from their dual roles.

#### **3.6.4 Clients – Medium and Rising**

With respect to this force, there are a few issues impacting client bargaining power. The first is buyer profits in the form of investment returns. For instance, a 2.4% MER used to eat a third of a typical balanced fund's gains and income, but given the current low return environment, the MER is now expected to gobble-up half the returns. In other words, profitability in the form of investor returns is shrinking and this increasing motivation to look at lower-priced competitor offerings or substitutes such as managing money one's self.

Another factor that is strengthening customer bargaining power is greater buyer information. This change is being driven both by growing investor knowledge through experience as well as the massive expansion in information access offered by the internet. This is creating an understanding of the true nature of costs as well as the direct negative impact of those costs on performance.

The increase in buyer access to information combined with diminished investor profits in the form of returns is leading to higher price-sensitivity and greater customer bargaining power. In terms of counter-balancing pressures that partially offset this

growing investor force, money management consumers are, and will remain, broadly fragmented. For instance, a successful money management mandate will usually have between 50,000 to 200,000 investors, and this helps to constrain consumer bargaining power.

### **3.6.5 Suppliers – Medium and Rising**

Switching costs are one of the factors that can increase Supplier bargaining power. One example of this can be found with Custodians who provide financial services such as client-record keeping, fund accounting and asset safe-keeping. Switching Custodians involves time-consuming and costly new systems integration work, making it a daunting proposition. Custodians also have oligopolistic concentration levels with the top four players accounting for roughly 90% of the market. And since Custodians are typically owned by Banks, who are also competitive players, I suspect pricing may be kept at levels above what is profit maximizing, simply to bolster strategic competitive barriers. Custodian prices can also be kept high since their cost relative to total Money Manager expenses is small, especially in comparison to other larger items like Labour.

When looking at the other external professional services that are needed to offer money management services, most are quite generic with almost no impact on product differentiation. As a result, many other Suppliers have limited negotiating power. However, one Supplier, that of Labour, has considerable bargaining power. Of particular concern are the labour inputs of PMs who perform security selection as well as the CPMs, Advisors, Planners and Agents who manage relationships in the various Sales

Channels. The power held by these individuals depends solely on the extent to which their differentiation as inputs enables them to attract or move AuM. As for the Portfolio Managers, if they have strong performance track-records, they also have more power to get mandate assets to follow them if they change firms. Star PMs, for example, would hold considerable bargaining power. With respect to the individual salespeople, their differentiation power flows from the strength of their personal client relationships. If these representatives change firms, many of their clients will follow them, and usually the product mix will change as a result, putting legacy mandate assets at risk.

In essence, this force relates to a battle for influence over client loyalty and control over their investment assets. Money Managers and their labour inputs are effectively fighting to sway client perceptions of corporate derived value versus employee derived value in terms of who or what is contributing most to the client's willingness to pay. By and large, Labour has been increasingly winning these fights. This is in part due to the fact that, on average, salespeople have become more experienced, and this has allowed for the building of stronger client relationships over time. As a result, salespeople leaving captive Sales Channels usually export half their clients and turn over almost all the products within one year. Overall, the performance-based differentiation of Portfolio Managers and the relationship-based differentiation of salespeople are both leading to growing bargaining power for these labour inputs. As a result, Labour has been able to demand more pay and increasingly squeeze Money Manager profits. For instance, McKinsey states that from 2010 to 2011, Portfolio

Manager compensation grew by 7% and Salespeople got raises of 12% (McKinsey and Company, 2012).

### **3.6.6 Summary of Five Forces Threats and Opportunities**

The upshot from this five forces investigation is that the Canadian Managed Money Industry is still very attractive but is experiencing growth in rivalrous intensity, bargaining power of Clients and Suppliers, and threat of substitution. As these forces continue to mount, it will be important for Money Managers to be increasingly selective around the business strategies they pursue and the tactics they employ. Here are what I believe to be the top five insights from this part of the analysis.

- 1) Rivalrous intensity is expanding at a frightening pace in the more generic areas of the industry such as traditional relative return mandates across the primary asset classes of stocks bonds and cash. This is happening because the client benefits in these categories can be easily replicated through low-cost passive investment approaches. Since many cost advantages favour larger players, it will be increasingly important for smaller firms to focus on the differentiation part of the profit wedge.

Tactically speaking, “willingness to pay” strategic positions will need to centre on managing either alternative asset classes through unique Niche Strategies or specializing in the solutions space. Since investment “solutions” seek to satisfy very particular problems, companies can offer solutions either by

- creating a single specialized mandate that solves one widely held client problem, or take a customized approach that solves clients unique problems one by one.
- 2) The most dangerous new entrant threats are large foreign firms who have pre-existing capabilities to compete on cost and are using the ETF Investment Funds format to overcome distribution challenges. The greatest threat of these new entrants will be to incumbent Money Managers competing in non-captive Investment Funds Sales Channels where ETFs are prominent. To overcome this new entrant threat, incumbent firms may want to focus on gaining Third-party Distribution on traditional product platforms, from which new Money Managers are barred due to lack of operational and performance history. The best example of this is the Discretionary Brokerage Sales Channel which enables mandates to be sold on a Sub-advisory basis.
  - 3) As we have seen, there are growing competitive pressures arising from substitution amongst the do-it-yourself crowd. In terms of mitigating this threat, Money Managers will want to follow strategies in asset classes that are in demand but difficult to do your-self without higher resource and expertise levels. The do-it-yourself movement is really quite similar to low-cost passive trend in that traditional asset classes and strategies are getting fished-out first. As a result, the key to countering the substitution threat is to focus on creating and executing more innovative and complex disciplines, ideally within alternative asset classes.

- 4) With respect to managed money buyers, the growing bargaining power relates to the low return environment and increased access to information through the Internet, which are both adding to price-sensitivity. The best defense in this instance is to focus on driving up value through tough-to-replicate differentiation. The key for Money Managers here will be to shift away from generic market-centric business models, and to embrace more client-centric approaches that improve “willingness to pay” by more precisely addressing specific client needs, ideally delivered through unique and tough-to-replicate Niche Strategies.
- 5) Growing bargaining power on the supplier front is thanks to key parts of the labour-force which are increasingly using their differentiation power with clients to demand higher compensation. Money Managers are also becoming more prone to giving in since traditional organic growth has flattened out and protecting market share has gained importance. In terms of defensive tactics to guard against this, Money Managers need to increasingly market the “Discipline” as opposed to the “Portfolio Manager”. Firms should also look for ways to corporately play a bigger part in the client experience so as to reduce sales representative prominence. Money Managers may even want to consider extreme moves such as rotating salespeople amongst their clients to inhibit relationship building and tilt power away from Labour.

### **3.7 Further Industry Trends**

In this section, I will seek to identify and shed light on some additional big picture political, economic, social and technological shifts that may impact the attractiveness of different business opportunities within the Canadian Managed Money Industry.

#### **3.7.1 Government Trends**

On the governmental front, the main concerns relate to upcoming changes in monetary and regulatory policy. First, due to explosive debt levels, leaders are likely to want to keep interest rates artificially low. This is because, as Scott Mather of PIMCO points out, it “transfers value from savers, investors and creditors to government debtors”. (Mathers, 2011) These prolonged low rates will continue to discourage savings and the resulting contributions into bond funds in particular. Second, in an effort to shift liability and be seen as protecting voter’s interests, governments are expected to further add to the industry’s regulatory cost burden. This governmental move will shift competitive advantage to the larger incumbent competitors who have the scale to lessen the effect.

#### **3.7.2 Economic Trends**

Business conditions will likely be the biggest single factor shaping near-term mandate inflow and outflow dynamics. According to the ICI’s 2012 Investment Company Fact Book review of current trends, recent muted demand for funds has been “driven in large part by the low interest rate environment, volatility in the equity market, and the

slow pace of the economic growth” (Brian Reid, 2012). In other words, investors place less money in managed stock portfolios when perceived risks are higher, and they invest less money in managed bond portfolios when the after-fee interest levels are lower. In times like these, investors tend to hold more money in non-managed cash instruments, such as government T-bills, until economic conditions improve. It is also worth noting that behaviourally, retail fund investors tend to be laggards that pour money into products long after economic and market recoveries have already happened. As a result, this combination of economics and behavioural finance leads to missed returns and delayed asset inflows following business recoveries. On the positive side, the expected low interest rates should keep cost of capital very reasonable, and this will make financing easier for Money Managers to expand where opportunities do present themselves.

Another interesting impact of low interest rates is that they reduce the spread profits Banks can generate from lending activities, and increase the liability coverage costs of Insurers. McKinsey and Company found that in 2011, North American asset management was the most profitable financial service sector with Returns on Equity (RoE) of 13.5% versus 8.1% for insurance and 5.1% for banking (Pierre-Ignace, 2012). We can also see this situation in TD’s 2012 financial performance where the Wealth and Insurance division grew cash flows by 12% while overall lending operations were flat for the year (Reucassel, TD Bank Research Comment, March 2013). Due to the low interest rate landscape, both Banks and Insurers will continue to increase their strategic focus on



investment management, and this trend should further add the industry's rivalrous intensity.

Economic conditions are also re-shaping the Pension client segment in ways that will favour Insurers over other Money Managers. The combination of low past stock market returns with low current interest rates has left the vast majority of Canadian defined-benefit pension in an under-funded position with unmanageable contribution requirements. Accordingly, many organizations have to re-negotiate their benefit agreements with their members. Through this process a new class of hybrid, or target plan, has emerged which aims to deliver certain retirement benefits but stops short of making full legal guarantees. Under these new plans, members and plan sponsors share the future funding risks together. One outcome of this change is that these plans, given the risk sharing, tend to offer members more choice and control over a portion of the investment decisions, as compared to defined-benefit plans, and this will have the effect of increasing the administration and individual member services that are needed. Since Insurers are already better positioned to provide this, I believe they will have the competitive upper hand in the Pension space as this trend continues. So far, according to KPMG, from 2006 to 2010, levels of defined-benefit assets have fallen by 15% while target plan pension assets have doubled over the same time frame (KPMG, December 2012).

### **3.7.3 Social Trends**

As introduced earlier, I believe the greatest change along the social dimension relates to the demographic implications of Canada's aging population. As Baby Boomers approach and move into retirement, money management firms will experience both headaches and pain relief. First, as people age, they become more risk-averse and therefore more conservative when it comes to their investment objectives. In 2000, only 44% of affluent U.S. investors considered preservation of capital to be a priority, but by 2010 this number had risen to 56% (Franklin Templeton, 2012). This growing focus on security will tend drive money management assets out of risky stocks and into safer mandates such as bonds. This shift will be troublesome for money management firms since conservative assets classes, like bonds, generate roughly half the profit margin that stock mandates do. One counterbalancing factor however may come in the form of inter-generational wealth transfers. Franklin Templeton Investments projects that, between 2010 and 2020, Canadians will inherit \$738 billion as older generations pass away (Franklin Templeton, 2012). Furthermore, as portions of these monies land in the portfolios of younger Canadians, levels of assets allocated to stocks will likely grow, and this may help to protect profit margins.

As Canadians retire, the Money Management industry will also be impacted by changes in saving and spending behaviours. After work, people stop saving and adding money to their investment portfolios, and instead start spending and withdrawing money from their accumulated savings. All other things being equal, this change will reduce the level of financial assets that are available to be managed. For instance, from

2012 to 2031, the percentage of Canadians adding money to their portfolios is expected to decline by 14%, while the portion of us pulling money from our portfolios is predicted to grow by 53% (KPMG, December 2012). One additional offsetting dynamic, however, may be found in that Canadians through retirement are also expected to sell private businesses and down-size real-estate, which will help top-up their financial asset retirement portfolios.

Perhaps the most important effect of Canada's retirement demographics is that a large and increasing number of investors, who control the lion's share of the assets, are now looking for retirement investment solutions that aim to achieve specific outcomes such as higher monthly income and increased capital protection. This circumstance is creating the industry's single best business opportunity in terms of under-served and growing client demand for Specialized Mandates of this nature. According to Mckinsey, retail assets in these kinds of outcome-oriented solutions have grown in North America by 25% over the past five year, and they are forecasted to double over the next five years to \$2 trillion (McKinsey and Company, 2012).

#### **3.7.4 Technology Trends**

The key drivers in this area are effects from advancements in both financial engineering and information technology. With respect to financial engineering, the creation of index funds such ETFs have enabled investors to gain easy access to diversified passive pools of securities at a very low price. From a product strategy point of view, further innovations are now making it possible to use the low-cost ETF product

format to offer active investment strategies that pursue specific investor outcomes or goals. On the other hand, some financial engineering experiments haven't fared so well and have led to increased investor caution. For example, over the past ten years, the use of derivatives to create opaque investment products such as Mortgage Collateralized Debt Obligations helped create a global financial meltdown. As with most things new, the potential problems often aren't clear at the outset. For these derivative-based products, the big hidden danger in the past was related to unknown counterparty and liquidity risks. The consequence into the future is that investors will be more leery of financially engineered products with unclear derivative risks, and managed money salespeople will steer clear of them due to complexity-based legal liability they may face if clients lose money.

With respect to advancements in information technology, the Internet going forward will continue to increase transparency around managed money products and services. More than ever, investors are easily able to peer through the forest and find just the tree they're looking for. In particular this is creating better-educated clients with a greater understanding of managed money costs. For instance, not only are people becoming more aware of MERs and how they have a direct negative impact on investment performance, there is another whole level of fees that has been buried, which the Internet is bringing out into the open. These costs are called Transaction Expense Ratios (TERs), and they are the commissions paid on securities bought for portfolios and ultimately paid by clients. These hidden expenses, which run from .1% to

1.2%, are on top of MERs. As TER awareness grows, consumers will increase the importance they place on their preference for Lower Fees.

#### **3.7.4 Summary of Industry Trends**

This section will recap the main government, economic, social and technological developments that are expected impact the industry longer-term. First, low interest rate monetary policy, aimed at stimulating growth and reducing debt servicing costs, will also likely constrain developed market investment returns and industry AuM expansion going forward. Second, these same low interest rates will likely drive Banks and Insurers to pursue greater RoE by placing more strategic focus on the money management parts of their businesses, and this will further ramp up rivalrous intensity. Third, Canada's aging demographics will put massive money in motion as investors shift assets into Specialized Mandates offering retirement solutions. These new products will best be managed using innovative Niche Strategies that offer greater capital safety and income. Fourth, the Internet will continue to expand investor access to information about costs and their adverse effect on returns, and this will continue to drive up price-sensitivity and the Client preference for Lower Fees.

## **4: Skyward in Competition**

This chapter will delve into sources of competitive advantage and determine how Skyward stacks up against the key competitive groups of Insurers and Banks. Before we look at specific advantages, it's worth noting that earlier in the development of strategic theory, individuals like Michael Porter suggested that companies should pursue what he termed as generic strategies that sought to excel either on a cost or differentiation basis (Porter M. , *Competitive Strategy*, 1980). The reasoning for this was that it would be difficult to maintain the internal consistency of leveraging strengths and avoiding weakness unless one chose between the two positions. More recently however, theorists such as Pankaj Ghemawat have successfully argued against the need for mutually exclusive strategic approaches. Ghemawat instead suggests that the building of dual competitive advantages is possible and should be employed in an attempt to create the biggest possible profit wedge between willingness to pay and cost (Ghemawat, 2010). The following part of this analysis will set out some of the means by which Money Managers are able to build both cost and differentiation advantages to maximize their profit wedges.

### **4.1 Sources of Cost Advantage**

This section of the study will investigate the key success factors the industry uses to better manage expenses. Table 2 below identifies some of the specific competitive

advantages in their order of importance that enable Money Managers to add profits by reducing costs.

*Table 2: Industry Sources of Cost Advantage*

Industry Key Success Factors	Importance of Advantages (as a percentage)
Captive Sales Channels	40%
Economies of Scope	20%
Economies of Scale	15%
Bargaining Power	10%
Operational Efficiency	10%
Omitted Activities	5%

This segment of the paper explains how each of the key cost drivers shown in the table above can be used by Money Managers to increase margins or better meet the investor preference for Lower Fees.

- Captive Sales Channel** – This can be seen in situations where money management firms are forward integrated to execute the client sales and service function. In these cases, firms often choose a captive distribution approach which limits investment options to only proprietary products (which are

manufactured by the Money Manager that owns that distribution operation). By doing this, firms can reduce their per person Labour expenses in two ways. First, when no competitor products are available, sales compensation can be set lower without hurting sales productivity. Second, under this scenario, there is also pressure to offer higher quality products, and this enables Money Managers to further cut costs by employing less expensive non-star Portfolio Managers.

- **Economies of Scope** – These cost savings occur when companies can use the same resource in a non-rivalrous way to produce multiple products. For instance, a large firm might manage several bond mandates where the various portfolio management teams can share much of the same investment research resource.
- **Economies of Scale** – The main scale advantage can be seen when more assets are held in each investment mandate. This causes the average fixed costs per dollar of AuM to decrease, and hence improves margins by reducing operating costs as a percentage of revenue. For example, if we assume that a portfolio management team expense are \$1 million, and the management fees charged to Clients are 1% on a mandate with \$300 million in AuM, then the portfolio management cost as a percentage of revenue is .33%. However, if the assets in the mandate were to grow to \$600 million with security selection labour costs fixed, then the expenses as a portion of sales would fall to only .17%.
- **Bargaining Power** – This cost advantage occurs due to the fact that when companies can offer Suppliers bigger contracts, they can use this financial might to negotiate better pricing per unit of usage.



- **Operational Efficiency** – This cost reduction approach involves managing money while using fewer inputs. We can see this advantage in action when we look at passively managed investment approaches that simplify the stock selection function. For instance, some mandates simply hold all the stocks included in the U.S. S&P 500 Index and require only occasional rebalancing. This passive money management style needs a smaller Portfolio Manager team, and hence this reduction of inputs lowers fixed costs.
- **Omitted Activities** – This cost reduction tactic involves not doing something your competitors spend money on. One example of this can be seen at PH&N, a local firm which recently purchased by the Royal bank of Canada. Traditionally, PH&N executed no marketing, and this allowed them to price lower at the same profit level and gain sales through word of mouth instead.

## 4.2 Sources of Customer Utility Advantage

Having reviewed the industry's key cost drivers in the section above, this part of the paper will now look at some of the main differentiation factors that Money Managers employ to expand their profit wedge through higher pricing. Previously, table 1 set out the relative importance of various preferences across five client segments. Table 3 below will now illustrate the relative significance of client preferences for the industry as a whole, and map which sources of differentiation are used by firms to fulfil those preferences.

Table 3: Money Management Differentiation Factors

<i>Client Preferences</i>	<b>Importance of Client Preferences (as a percentage)</b>		<b>Industry Key Success Factors</b>	<b>Importance of Advantages (as a percentage)</b>
Investment Performance	30%		Star Portfolio Managers	12%
			Large Line-up	6%
			Lower Costs Enabling Profitable Lower Fees	6%
			Compelling Research	6%
Specialized Mandates	20%		Niche Strategy	20%
Advice Confidence	20%		High-calibre Representatives	20%
Portfolio Customization	10%		Custom Capabilities	10%
Client Experience	10%		Exceptional Service	5%
			Distribution Breadth	5%
Safe Brand	10%		Safety Image	10%

This section below will describe the Money Manager differentiation factors shown in Table 3 above. It will also clarify how firms can use these advantages to better meet certain client preferences and thereby strengthen pricing power.

- **Star Portfolio Managers** – As the investor common warning goes: “past performance doesn’t guarantee future performance”. Nonetheless, investors love to chase performance and, as a rule of thumb, typically 2/3<sup>rd</sup> of industry AuM is held with Money Managers who have demonstrated better than average past results. As we will see in the next two points, other factors can contribute to Investment Performances, but all other things being equal, it’s still advantageous to have strong track-record Star Portfolio Managers running your mandates.
- **Large Line-up** – Money Managers that have expansive product line-ups, with many mandates, often have better-looking past investment performance, but the numbers can be deceiving. This is because it is common industry practice to wind up mandates with poor past performance and roll the assets into similar mandates with better past performance. This tactic results in a phenomenon called survivor bias which makes the company’s mandates look more attractive than they ought to. This effect is similar to seeing active people around your neighborhood and concluding your community is healthy, without taking into account all the sick people who are out of sight in hospitals.
- **Lower Costs Enabling Profitable Lower Fees** – In the money management world, when lower-cost manufacturing allows firms to profitably price products at lower levels, it results in a double benefit. First it improves demand with price-

conscious investors, but it also directly improves the product's net-of-fee track-record, which in turn ramps up demand amongst performance seeking investors.

- **Compelling Research** – This source of advantage stems from an ability to make a strong argument that the brand new investment strategy you are offering would have been effectively historically. Typically this capacity is made possible by certain kinds of quantitative investment research resources and skills which enable empirical discipline back-testing.
- **Niche Strategy** – Investors who value Specialized Mandates tend to be drawn to Money Managers with a niche focus that matches their needs. Examples can include innovative strategies in alternative asset classes like private equity, real estate, or commodities for those investors pursuing advanced diversification, or outcome-based solution disciplines that target specific levels of risk and income to better match Pension liabilities.
- **High-Calibre Representatives** – The best way for Money Managers to better meet client preferences around Advice Confidence is to attract and retain higher quality sales and service employees, particularly along the dimensions of interpersonal skills, credentials, investment expertise and experience.
- **Custom Capabilities** – To be able to deliver smartly customized portfolios to Individual clients, CPMs need access to investment and product platforms with the widest range of options which enables the broadest variety of investment combinations. Banks lead in this capacity with their open architecture investment dealer platforms that provide access to everything under the sun.

- **Exceptional Service** – With clients for whom an enjoyable client experience is important, firms need to be adept at designing and delivering consistently exceptional service. Top firms in this department do a better job of designing experiences around the client feelings they want to elicit, and then carefully delivering on the details. A strong service culture is also needed since employees who deliver the best client experience tend to highly value client service themselves.
- **Distribution Breadth** – This advantage relates to having many salespeople in prime locations, with direct access to investors, and incentives to sell the firm’s products. This key corporate capability likely helps meet the preference for a client experience that includes convenient locations and reduced product research costs.
- **Safety Image** – As mentioned earlier, within the industry, the most important brand dimension is that of safety and security. To have more appeal along this client preference, it is essential for companies to possess an appearance of financial strength. Additionally, it’s worth noting that the importance of this preference increases as people age due to the typical psychological shifts that occur.

### **4.3 Relative Competitive Analysis**

This section will offer a comparative evaluation to establish where Skyward stands versus our main competitors from the standpoint of how our strengths in the industry's key sources of advantage stack-up relative to theirs. For this analysis, I have assumed that typically, 30% of the client's selection of Money Managers would be based on their preference for Lower Fees, and 70% of the purchase decision would be driven by differentiation factors that make the service the best fit. The following assessment will compare Skyward against TD and Sunlife, who are prime examples of tough opponents in the Bank and Insurer competitive groups (please see Table 4 below).

Table 4: Relative Competitive Analysis

Customer Selection Criteria	Selection Criteria Importance	Sources of Competitive Advantage	Selection Criteria Importance	Skyward	Sunlife	TD
Lower Fees	30%	Captive Sales Channels	12%	Strong	Strong	Strong
		Economies of Scope	6%	Weak	Strong	Strong
		Economies of Scale	5%	Weak	Average	Strong
		Bargaining Power	3%	Weak	Average	Strong
		Operational Efficiency	3%	Strong	Average	Average
		Omitted Activities	1%	Strong	Weak	Weak
Investment Performance	21%	Star Portfolio Managers	7%	Weak	Strong	Average
		Large Line-up	5%	Weak	Average	Strong
		Lower Costs Enabling Profitable Lower Fees	5%	Average	Average	Strong
		Compelling Research	4%	Strong	Weak	Strong
Specialized Mandates	14%	Niche Strategy	14%	Weak	Weak	Strong

Advice Confidence	14%	High-calibre Representatives	14%	Strong	Weak	Average
Portfolio Customization	7%	Custom Capabilities	7%	Strong	Weak	Strong
Client Experience	7%	Exceptional Service	4%	Strong	Weak	Average
		Distribution Breadth	3%	Weak	Strong	Strong
Firm Brand	7%	Safety Image	7%	Weak	Strong	Strong

As can be seen above, Skyward has some well-equipped adversaries, and as a smaller firm, we also face greater challenges on the size-related components of our cost structure. Historically, Skyward has also tended to price lower than the competition and taken together, these factors have squeezed our profits. For instance, the average money manager in North America has operating margins of 28%, and Skyward is currently running at 20% (McKinsey and Company, 2012). By comparing our fee schedules to six of our strongest competitors, I also found that our pricing was 20% lower for accounts under \$10 million and a whopping 50% lower for accounts over \$10 million. So, although our lower pricing has allowed us to have more Lower Fees appeal, our inability to outperform the competition on cost management means we have paid a price in terms of relative profit.



The section below will expand upon the points in the Relative Competitive Analysis table above, and seek to explain how the various rankings were determined for each of the sources of advantage noted. Cost advantages will be examined first and will be followed by insights on differentiation advantages.

- **Captive Sales Channels** – I have scored all three competitors as Strong on this factor since each of the companies do well to leverage business models that employ direct captive sales force to lower per person labour costs.
- **Economies of Scope** – Both TD and Sunlife scored Strong here while Skyward rated Weak. Both TD and Sunlife have many more employees using the same research resources and systems in ways such that increased usage of the same resource doesn't increase cost. One example can be seen in the multiple use of proprietary software which properly allocates shares of companies to all the clients who own a particular mandate. Additionally, TD and Sunlife are able to use their strong brands to sell a much wider variety of financial services with no variable brand cost.
- **Economies of Scale** – On this dimension, TD came first, Sunlife second and Skyward third. In terms of product-specific economies, there is often little change in manufacturing costs as AuM per mandate grows. So in this way TD wins with \$3.3 billion per mandate, Sunlife earns second at \$514 million per mandate, and Skyward brings up the rear with \$80 million per mandate. Another source of average cost reduction comes from plant-specific economies of scale that are achieved through disproportionate fixed cost growth relative to

increases in the number of related products produced. For a better sense of the overall power of scale, according to BMO Capital markets, TD increased its AuM by 10% in 2012 which resulted in a 28% leap in profit (Reucassel, TD Bank Research Comment, March 2013).

- **Bargaining Power** – To determine scores on this cost advantage, firm revenues have been used as a proxy, with the result that TD rated Strong, Sunlife Average and Skyward showed-up Weak.
- **Operational Efficiency** – All three companies did reasonably well here. Skyward scored Strong and TD and Sunlife average. With respect to reasoning, each firm is forward integrated with direct distribution models, and this helps to reduce wholesaling effort and expense. Skyward ranked first because we exclusively offer the Pooled Investment Trust product format which is cheapest from an operational point of view since it lowers legal and product management inputs.
- **Omitted Activities** – Skyward scored best on this advantage by doing no marketing, whereas TD and Sunlife pursue this function vigorously.
- **Star Portfolio Managers** – According to the Globefund, Sunlife has 8 five-star-rated mandates through hot-shot Sub-advisors, TD has 3 in-house managed, and Skyward has the equivalent of 1 (were our Sub-advised Emerging Markets mandate in a format that would enable a rating). As a result, Sunlife came first, TD second and Skyward last.
- **Large Line-up** – TD is best with 60 mandates, Sunlife is in the middle with 35, and Skyward gets a bronze medal with 15.

- **Lower Costs Enabling Profitable Lower Fees** – A quick glance at the cost advantage scores shows that TD looks best, and, hence, is in a great position to improve its Investment Performance, as well as meet the client Lower Fees preference, all while maintaining competitive profitability.
- **Compelling Research** – Both Skyward and TD have robust quantitative research and money management systems that enable the production of proven back-tested performance results for new Niche Strategies. The Skyward resource that enables this capability is called Ramkit. As such, TD and Skyward were rated Strong while Sunlife that lacks this resource was scored Weak.
- **Niche Strategies** - Both Skyward and Sunlife were unimpressive and received a Weak rating given their current state generic product line-ups. TD, on the other hand, earned a best-in-class as Canada’s first-mover into the outcome-oriented low-volatility, high-yield solutions space.
- **High-calibre Representatives** – Skyward earned a gold medal on this measure with well-credentialed representatives who also have lots of experience. TD was in the middle, and Sunlife scored lowest due to their greater emphasis on insurance knowledge versus investment expertise.
- **Custom Capabilities** – The ability to tailor portfolios is determined by the number and variety of investment inputs you have available to mix together. Skyward is currently strong, as is TD is strong, since Skyward has a supplier relationship which allows access to TD’s product platform. As for Sunlife, it has limited custom strength and places last.

- **Exceptional Service** – In terms of this advantage I gave Skyward the lead with the delivery of 12 free educational seminars a year. I have placed TD in the middle, with standard service fare. I have put Sunlife last since Insurance Agents tend to sell Investment Funds on a Deferred Sales Charge basis. This means clients pay no up-front commission to buy products, but instead get hit with a heavy fee if they cash out over the first 5 years. As a result, there is less incentive under this monetization model to provide great service and keep clients happy.
- **Distribution Breadth** – Although this advantage may have somewhat weak links to satisfying client preferences, I would argue that distribution is absolutely critical given its tightly controlled and scarce nature as a resource. I say this because the ability to gain money management business, in many cases, is determined by the availability of cross-selling opportunities with a firm’s pre-existing financial service clients. As a result, Sunlife is Strong with excellent corporate group insurance benefit relationships, which facilitates selling money management to Pensions. Similarly, Banks like TD have an informational advantage over the competition as they are the first ones to see money in motion. For instance, when someone sells a business, money is deposited in their bank account. When bankers see this has happened, they can call the client to recommend they meet with the bank’s Money Manager. Pre-existing brand affinity may also help seal the deal. On this strength, Skyward scores last.

- **Safety Image** – This brand strength is mostly determined by size which puts TD and Sunlife squarely ahead of Skyward. Interestingly, TD aims to alleviate nervousness with their slogan “Who knew banking could be this comfortable”.

This next section will recap how Skyward fared overall versus the two competitors in terms of our weighted relative strengths in sources of cost and differentiation advantage (Please see Figure 7 below). First off, Skyward did reasonably well, given our size, on the cost front, with 53% Strong, thanks primarily to our Captive Sales Channel. With respect to our firm’s differentiation strengths, we were somewhat out-matched by our tough Bank and Insurer competition. However, where we did show some solid capabilities were in the areas of High-calibre Representatives and Exceptional Service, which both help with a direct sales distribution model. Skyward also demonstrated differentiation advantages through our strengths in Compelling Research. This key success factor could be used to effectively build new strengths in both Niche Strategies and Distribution Breadth. Skyward could make this happen by using our Compelling Research to effectively develop and market innovative disciplines to gain access to Third-party Distribution. This approach, however, would come with a trade-off since a move away from our own Captive Sales Channel would necessitate more expansive talent and a loss of our lower-cost inputs. In summary, it looks like Skyward has average cost competitiveness, and is somewhat behind our adversaries with regard to the number of differentiation advantages we currently have at our disposal.

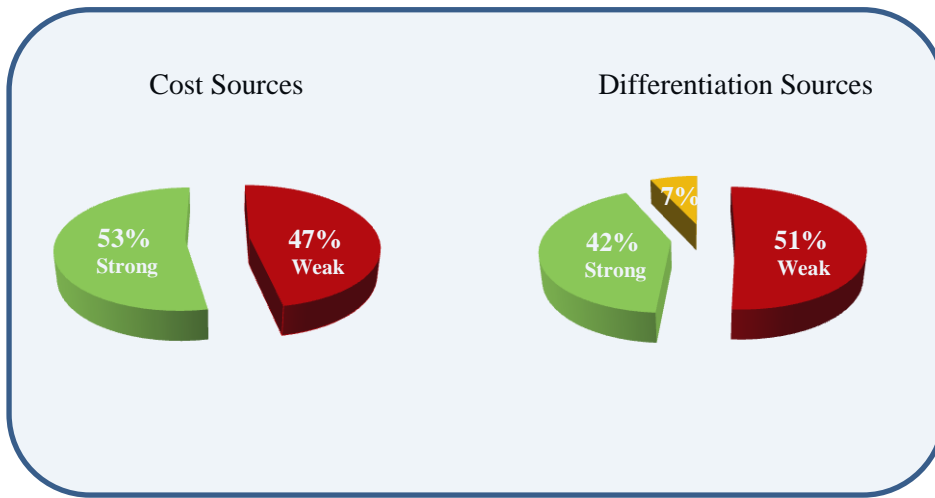


Figure 7: Skyward Relative Advantages

## 5: Key Skyward and Industry Insights

To prepare for the assessment of the firm's strategic alternatives, which will be outlined in upcoming sections, this chapter highlights the key points uncovered through analysis thus far. In particular, this part of the paper will recap the main themes and dynamics in the area's client preferences, our firm's sources of advantage, and the Canadian Managed Money Industry forces and trends.

The central positive and negative considerations will be organized and reviewed using a SWOT framework. This approach will help synthesize Skyward's foremost Strengths and Weaknesses, as well as the industry's major Opportunities and Threats. The primary value of Kenneth Andrew's SWOT structure is the notion that skills and resources need to be assessed primarily in terms of how well they will help address the main competitive environmental issues (Edmond P. Learned, 1969). Figure 8 below displays the core business context elements that need to be considered. Following the SWOT table, a brief recap of each point will be given, as well as some insights regarding their impact on our firm's potential strategic direction.



Figure 8: Skyward SWOT Analysis

- Captive Sales Channel** – Going forward, intensifying price competition will make it essential for Money Managers like Skyward to remain cost-conscious in order to protect profits. This means that, regardless of the strategic option we pursue, we will either need to maintain and leverage existing cost advantages such as the lower-cost inputs stemming from our Captive Sales Channel, or replace them with more suitable cost advantages.
- Compelling Research** – The main benefit of this strength is that it allows us to prove the past effectiveness of innovative new investment strategies. Our proprietary quantitative investment research system, Ramkit, will be particularly



useful in giving us a sales and marketing leg-up over adversaries if we choose to launch new Specialized Mandates.

- **Custom Capabilities** – As discussed earlier, this aptitude comes from having a wide range of investment options that enables the creation of unique client portfolios, as opposed to cookie-cutter products. Our existing supplier relationship with TD allows us to leverage this capability if we chose to.
- **High-calibre Representatives** - As noted, Skyward has top-notch CPMs who execute direct sales and service functions with clients. At first glance, this might appear to favour a continued direct service focus, but unfortunately this team is nearing retirement and will soon require a succession plan. As we manage this transition, we will likely want to replace the existing team with less seasoned employees at an even lower cost. This tactic will be easier to execute than trying to attract senior industry talent to join a lower-paying captive Sales Channel.
- **Distribution Breadth** – Unlike Banks and Insurers, our business model is not a financial services supermarket. As a result, we are left on the outside looking in, without any existing client relationships in other business lines that we can internally cross-sell to. The key insight here is that Skyward needs to find ways of breaking into and leveraging financial supermarket value chains.
- **Niche Strategies** – Our existing relative return strategies and mandates are fairly generic and unlikely to generate the value proposition attractiveness we need going forward. This problem is crucial since it restrains both our ability to sell directly and our ability to gain entry to Third-Party Distribution. For instance,

Banks will only let you on to their product platform if they believe the addition of your value proposition enhances the attractiveness and uniqueness of their value proposition. If we move away from offering relative returns in the main asset classes, and we lack the cost leadership needed to play in the passive low-fee product space, through a process of elimination we are pushed towards a focus on outcome-based solutions or the management of alternative asset classes.

- **Economies of Scale** – Near-term, Skyward will be outmatched with respect to size-related cost advantages. The insights here are that we will need to remain strong or build new strengths in certain cost advantages that are not constrained by size, such as efficiency, lower-cost inputs and omitted activities. Beyond that, focusing more asset growth on fewer mandates would assist with Economies of Scale.
- **Safety Image** – From a review of the preferences by client segment we can see that a Safe Brand is typically of greater importance to Individuals and Not-for-profit customers. Our lower than average Safety Image due to size and our Omitted Activities in marketing may also hamper recruitment effectiveness under the Customization option if CPMs are reluctant to join a less financially secure company. This brand weakness would suggest that Skyward may be better off pursuing a strategic option with a client focus on Pensions, Corporations or Other Money Managers.
- **Retirement Demographics** – This opportunity stems from the changing needs of Baby Boomers transitioning to retirement, who have more interest in investment

solutions offering safety and income. The key strategic implication of this is that there will be growing preferences for Specialized Mandates that follow retirement-oriented Niche Strategies.

- **Third-party Distribution** – New openings for inclusion in Third-party Sales Channels will arise as companies eagerly seek to “retirement-ize” their product line-ups by adding more Specialized Mandates that will appeal to Baby Boomers in their next phase of life. For Skyward, these emerging shelf-space openings create important new opportunities for us to build advantages in Distribution Breadth, and ramp up our sales growth potential.
- **Economics and De-risking** – Global themes of fragile business fundamentals, low interest rates and high stock market volatility are providing additional incentives for clients to shift their assets toward Niche Strategies. These strategies are either focused on alternative asset classes to improve safety through diversification, or active risk reduction and yield enhancement disciplines in mainstream asset classes that lower volatility.
- **Demand for Customization** – This preference will likely continue to grow as clients become less interested in investment markets and more focused on the achievement of their own specific objectives. In some ways, leveraging the TD product platform would help us compete more directly and evenly with Banks, but we would need to face and accept higher Labour bargaining power in order to attract CPMs onto this platform at Skyward.

- **Increasing Low-fee Preference** – We will need to build and deliver a new value proposition that incorporates ample differentiation to gain some pricing power and protection against the trend towards lower fees.
- **Relative-return Dismay** – Clients have been disappointed with the value they have received from relative-return mandate Money Managers in general. These clients will continue to replace these assets with Specialized Mandates offering lower-fee passive money management solutions or alternatives.
- **Bank Dominance** – The most important conclusion to draw here is “if you can’t beat ‘em – join ‘em.” With their powerful brands, pre-existing client relationships, massive sales forces and convenient locations, Skyward will likely have more success if we can find a way into the value chains of larger institutions, instead of trying to compete head-on. The best way to achieve this will be through the Retirement option and offering to Sub-advisory Niche Strategies for low risk, high yield Bank products.
- **Rising Labour Power** – Lower AuM growth from lacklustre market returns and lower savings rates have caused Money Managers to be increasingly focused on attracting and retaining talent as a means of protecting and growing market share. Consequently, the bargaining power of PMs and salespeople has been growing. Going forward, Money Managers will want to look for ways to mitigate the growing Labour threat by limiting the extent to which their differentiation as inputs contributes to the Client’s willingness to pay.

To sum up the study so far, we have seen that although past asset growth and profits have been strong, a lower investment return environment, growing price-sensitivity and a behavioural shift from saving to spending may mute overall industry growth going forward. In particular, the elements of poor investor returns and stagnating industry growth are compressing profit margins and intensifying competitive industry forces.

Industry forces negatively impact both revenues and costs. For instance, we have seen that Clients are responding to diminished investment returns by threatening to force down profits through an increased Lower Fee preference and their ability to backward-integrate. Additionally, the industry's main Labour Suppliers of PMs and salespeople are leveraging their investment performance and client relationship bargaining power to squeeze Money Manager profits from the cost side.

The assessment of Skyward's main competitive advantages and disadvantages has been instructive. With respect to costs, we have seen that our limited assets per mandate are a concern, and this could be improved by focusing on broader marketing of fewer mandates to gain more Economies of Scale. We have also noted that cost savings through Operational Efficiency can be achieved by using systematic investment approaches that lower the level of ongoing PM manpower inputs required. This suggests that Skyward may benefit from developing and executing investment strategies that are purely rules-based as a means of reducing the Investment Group size and cost.

With respect to differentiation advantages, the source for Skyward that is most scarce amongst our adversaries is that of Compelling Research. To leverage this most

effectively, our firm should compete primarily in new product areas that benefit from some form of investment discipline innovation. In particular, Skyward should explore seizing the leading opportunity around the rapidly growing preference for retirement solution Specialized Mandates, which is being driven by social trend of Aging Demographics. To make this happen, our firm could use its Compelling Research to build and market novel Niche Strategies that offer greater safety and income.

## 6: Skyward Strategic Alternatives

This section will elaborate on the three strategic alternatives our firm is considering and seek to determine which one is most likely to maximize our growth. Each option will be further defined and evaluated in terms of how well it addresses our goals and Skyward' Strengths, Weaknesses, Opportunities and Threats. Given our firm's value proposition challenges, minimal distribution and tight resources, the key objective is to determine which strategic approach will best help Skyward upgrade its value proposition and add more clients, within a limited implementation budget.

As you may recall, to improve our strategic position at Skyward our Executive Team has been considering approaches focused around Performance, Customization or Retirement. Each of these alternatives aims to acquire clients in different ways. The diagram below helps visualize how Skyward would gain clients and asset flows under each strategic option.

### Performance



Increases referrals to our existing Client Portfolio Managers

### Customization



Hires new Client Portfolio Managers who bring their clients to our firm

### Retirement



Sells our Sub-advisory through external Salespeople

Below, Table 5 lays out the key elements of each business strategy being considered. Additional explanations of each of the alternatives will be provided next.

*Table 5: Strategic Option Summary*

Option Name	Performance	Customization	Retirement
<b>Target Clients</b>	Direct to B.C. Individuals and Not-for-profits	Direct to Canadian Individuals	Discretionary Brokerage and Investment Funds Sales Channels
<b>Value Proposition</b>	High-octane money management to maximize returns	Custom-built solutions to better meet unique client needs	Proven low-risk, high-yield investment strategy for use in new retirement solution products
<b>Source of Advantage</b>	Star Portfolio Managers	Custom Capabilities with somewhat improved Distribution Breadth	Niche Strategy, Compelling Research and Distribution Breadth
<b>Operational Approach</b>	Hire new Star Portfolio Managers through Sub-advisory to execute all security selection functions	Employ the flexible TD Waterhouse investment platform to enable delivery of fully-tailored portfolios to Individuals	Use Ramkit to develop a new retirement solution Niche Strategy, proven historically to reduce losses and add income
<b>Distribution Approach</b>	Use educational events and revenue-sharing programs to promote client referrals from external parties.	Hire or acquire CPMs who will bring clients with them to Skyward, and attract the new CPMs with higher compensation and access to TD investment platform.	Offer the retirement Niche Strategy through Sub-advisory to gain Third-party Distribution in the Discretionary Brokerage and Investment Funds Sales Channels.



### 6.1.1 Performance Alternative

**Description:** This first strategic alternative would focus on serving the higher net-worth Individual and Not-for-profit client segments in the province of B.C., and the value proposition would centre around providing access to Specialized Mandates focused on outperforming the markets through disciplines executed by Star Portfolio Managers.

Operationally speaking, this strategic approach would require Skyward to replace all existing in-house PMs and external Sub-advisors who currently execute the security selection functions for our mandates. In their stead, Skyward would exclusively hire new external Sub-advisors who have strong reputations and recent track records. By doing this, we could build and leverage the industry source of advantage relating to Star Portfolio Managers.

Under this scenario, Skyward would go into maintenance mode with the legacy client segments of Pensions and Corporations. This is because these clients tend to use consultants to select their managers and they prefer direct security selection and service versus Sub-advisory products. Furthermore, we would have to terminate relationships where we act as Sub-advisors to Other Money Managers like Manulife Mutual Funds and Scotia McLeod. This is because in these instances, we have been the stock-picking PM, and if we terminate our in-house security selection operations, we would no longer have these services available to sell. These client terminations would result in Skyward having to give up 6.5% of our current revenue, but this may be worthwhile if it enables greater focus on a stronger strategy.

Beyond bolstering our value proposition along the client preference for attractive Investment Performance, this strategic alternative would also improve our sales and marketing effectiveness through a strengthened focus on generating client referrals. People who introduce clients to Money Managers will do so either on a non-revenue-sharing or on a revenue-sharing basis. Non-revenue-sharing client referrals typically come from existing clients, accountants and lawyers. Under their respective regulatory bodies, Accountants and Lawyers are not allowed to make referrals to Money Managers on a revenue-sharing basis. Consequently, these professionals do so either for pure client benefit or in hope of receiving reciprocal client referrals from Money Managers. In terms of the revenue-sharing referral opportunity, some Planners and Agents prefer to introduce clients directly to Money Managers for a fee instead of selling Investment Funds products themselves. They do this because it cuts mutual fund dealers and insurance agencies out of the revenue split equation, and reduces their workload because the Money Manager takes over client service. It may also eliminate much of the liability.

From my observations, the number of revenue-sharing and non-revenue-sharing introductions is quite even. So if the Performance strategic option is selected, it would be wise to implement marketing programs that promote both types of referral sources. Fortunately, the most successful tactic for generating introductions is source independent and involves hosting fun and educational events that enable people to extend invitations to potential clients they know.

### 6.1.2 Customization Alternative

**Description:** Under this second option, Skyward would aim to serve Canadian Individuals who have a strong preference for Portfolio Customization. We would seek to satisfy their needs by providing custom-built portfolios that have a more precise fit with each client's investment philosophy and personal objectives.

In serving this Individual customer segment, it makes more sense to follow the Starbucks mass-customization approach of having a large selection of ingredients and combining them in somewhat different ways to create somewhat unique beverages for each customer. Skyward could execute a similar approach by using the TD Waterhouse investment platform to substantially expand the range of investments (ingredients) our Client Portfolio Managers could access and combine. Currently, our CPMs can only access fifteen proprietary pooled investment trusts, which is a low number compared to most of our competitors. Using the TD platform would enable endless customized combinations for portfolios by adding hundreds of new investment options including a complete range of market-traded securities and a broad list of additional Investment Funds products.

While this Customization strategic alternative does not make use of an existing Distribution Breadth capability, it would help us improve our Distribution Breadth over time by allowing us to add new Client Portfolio Managers who would bring their clients to our firm. The TD platform is also non-captive, and this feature is helpful from a recruitment standpoint; successful CPMs will not move to a captive Sales Channel due to its limited investment options and lower pay. To attract these top CPMs, it would be

necessary to compensate above what the Banks offer on the same platform, so targeting only larger CPMs would also be essential to capture adequate profit per employee. Fortunately, the broad nature of the TD platform would also make it easier to acquire boutique firms since it increases the likelihood that the other firm's assets could be imported to Skyward in kind. This reduces disruption to clients and helps ensure a smoother transition.

### **6.1.3 Retirement Alternative**

**Description:** This option would specifically target Third-party Distribution by offering Niche Strategy Sub-advisory to Other Money Managers who already have spots on Discretionary Brokerage and Investment Funds Sales Channels. Other Money Manager clients in this case would be mutual fund companies and investment dealers who want to increase their share of the Baby Boomers' wallets by adding new retirement product solutions to their line-ups.

Operationally, this strategic alternative would involve using our Compelling Research capability through Ramkit to create and prove the effectiveness of a new and innovative retirement Niche Strategies. These outcome-oriented disciplines would ideally target certain safety goals such as no losses over any three-year periods, or have objectives like providing a 6% annual cash flow, paid monthly.

To maximize distribution, we would look for opportunities where we could offer Sub-advisory to Other Money Manager products that are already on platforms with large and expanding asset levels. A big part of being a good jockey is choosing the best

horse to ride, and the most attractive horses are certainly the Banks given their substantial advantage in Distribution Breadth.

## 6.2 Evaluation of Skyward Alternatives

This part of the analysis will lay out the main criteria to be used in the assessment of our three strategic options. These goals will be ranked and weighted according to their relative importance in the strategy selection process. Our strategic alternatives will then be scored against these weighted goals to determine which business approach has the best overall fit.

### 6.2.1 Identification of Key Goals

The following provides a brief description of each selection criteria.

- **Value Proposition Improvement** – Given the lower appeal of our existing offerings, it is essential that we change our value proposition to add attractiveness and uniqueness. Since our diminutive size limits our cost reduction options, enhancing willingness to pay will become even more important.
- **Distribution Upgrade** – This dimension is all about having more people in more places promoting and selling Skyward-managed mandates. You can have the world's best products or services but if they're not available for sale anywhere, no one will buy them.
- **Opportunity Pursuit** – To attain the profit growth we want, Skyward will also need to seize opportunities by fishing where the fish are; if we can find lakes with more fish and fewer fish boats, even better.

- **Leverage Strength** – To achieve success, we will need to focus on what we are good at or quickly add new skills and resources to enhance our capabilities where required.
- **Mitigate Threat** – Several potentially negative external industry factors may hamper our success and should ideally be minimized where possible.
- **Side-step Weakness** – Strategy execution is more effective when it seeks to circumvent weaknesses as opposed to building unnecessary strengths in the same areas.

### 6.2.2 Key Goal Weightings

In evaluating our strategic alternatives, it makes sense to employ an approach that places greater emphasis on criteria that hold greater importance in their potential contribution to our firm’s future success. To begin this process, in the following table, I will assign percentage weightings to each of the six goals identified above. If a particular goal has been given a 20% allocation that means its appeal under that criterion will account for 20% of the overall scoring for each of the strategic options to be assessed.

*Table 6: Evaluation Goal Weightings*

Key Goals	Value Proposition Improvement	Distribution Upgrade	Opportunity Pursuit	Leverage Strength	Mitigate Threat	Side-step Weakness
Goal Weightings	30%	20%	15%	15%	10%	10%

The rationale for the weighting choices shown in the table are given below. Value Proposition Improvement ranks first overall since the attractiveness of a firm's offerings are of primary importance to a company's success. Distribution Upgrade is positioned second since its improvement is essential to achieving the revenue growth Skyward needs. Opportunity Pursuit ranks high as well since these opportunities must be seized, and should also shape the value proposition. Leveraging Strengths is given equal significance because strong suits should be played as a means to seize opportunities. The decision-making prominence of Mitigate Threat and Side-step Weakness ranks lower, given the competitive philosophy that "the best defence is a good offence". All the same, Weaknesses and Threats are still part of the key goal evaluation framework in recognition of their deserved attention.

### **6.2.3 Assessment of Alternatives against Key Goals**

In this part of the report, I will score each of the three strategic options against the key goals and weightings outlined in the previous section. In the table below, I will indicate the scores I have assigned using a range of 1 to 5, with 1 being worst and 5 being best.

Table 7: Evaluation of Strategic Alternatives

Key Goals	Goal Weightings	Option #1 Performance	Option #2 Customization	Option #3 Retirement
Value Proposition Improvement	30%	3	5	5
Distribution Upgrade	20%	2	3	5
Opportunity Pursuit	15%	1	2	4
Leverage Strength	15%	5	1	3
Mitigate Threat	5%	2	3	4
Side-step Weakness	5%	1	2	5
	<b>Total</b>	<b>2.35</b>	<b>2.80</b>	<b>4.00</b>

The following sections offer reasoning for the strategy evaluation scores shown in the preceding table.

#### 6.2.3.1 Value Proposition Improvement

On this dimension the Performance strategy rated lowest of the three. Although it has some appeal when it's working, the fleeting nature of PM outperformance can lead to a value proposition that lacks delivery reliability going forward. We have also learned that investors are losing confidence in the idea that PMs are even capable of beating the



markets after fees, and are hence moving assets away from relative-return focused firms. Customization and Retirement are tied for the lead here. The strong client desire for uniqueness and perfect-fit solutions gives strength to the Customization approach, while Specialized Mandates to meet retirement goals would likely have an equal number of fans.

#### **6.2.3.2 Distribution Upgrade**

On this objective the Performance alternative scored lowest since referrals would add to sales effectiveness of the existing CPMs but not expand our sales force. Gaining referrals is also a two-stage process. First, we would need to get people interested in referring clients to us. Then, they would need to influence those Individuals to sign up as clients. For comparison, the Customization strategy scored in the middle for its Distribution Breadth. Under this scenario, we need to convince Client Portfolio Managers at other firms that they should join Skyward, and that may take a while. Fortunately, if we hire the right individuals, typically two thirds of their clients will follow so they can maintain their existing personal relationships. The third option of Retirement would likely be the most powerful in terms of distribution, since it involves offering a broadly appealing, low-risk/high income mandate through Sub-advisory to gain access to broad Third-party Distribution.

### 6.2.3.3 Opportunity Pursuit

As listed earlier in this paper, I believe the industry's leading opportunities for growth will result from leveraging Aging Demographics, Third-party Distribution, Economics and De-risking and Demand for Customization. With respect to the importance of going after these opportunities, the Performance strategy fails to land a punch on any target, and hence scores lowest. The Customization alternative, on the other hand, which scored in the middle, can be used to build tailored retirement portfolios one by one, and will obviously help capture general demand for customization. The main drawback to the Customization approach is that, as a jack-of-all-trades, we may not stand out as being excellent at any particular kind of money management. Also, prospective profits under the Customization approach are held back since solutions need to be one-offs, making gains in scale difficult. However, the Retirement alternative rated highest; holding ourselves out as retirement specialists would attract assets from clients wanting retirement-specific solutions such as a lower-risk/higher income stock strategy. Moreover, economic conditions of low interest rates and high stock market volatility are pushing all client segments toward safer stock strategies that also add income. I believe the Retirement option comes out on top because offering a widely attractive outcome-based strategy should enable faster sales growth in fewer mandates, and hence enable greater scale and maximum profits.

#### **6.2.3.4 Leverage Strength**

Skyward's main strengths consist of our Captive Sales Channel, Compelling Research, Custom Capabilities, High-calibre Representatives and Exceptional Service. Because of these strengths, the strategic option of Performance is tied for first place since our High-calibre Representatives and Exceptional Service strengths would enhance this option's focus on client referrals. Furthermore, all assets referred would flow into our current products that benefit from lower-cost inputs. The Performance strategy would also build a new advantage because Skyward would hire Star Portfolio Managers through Sub-advice. The Customization option scored lowest since it leverages our Custom Capabilities, but the addition of pricey new CPMs would result in a loss of our Low-cost Inputs advantage. The third option of Retirement scored in the middle since it leverages our Compelling Research, maintains our lower-cost inputs, and builds a new Niche Strategies strength.

#### **6.2.3.5 Mitigate Threat**

In addition to growing Price-sensitivity and Bank Dominance, the other key threats are comprised of Relative-return Dismay and expanding Regulatory Demands. I rated the Performance option lowest on Threats for three reasons: interest in Relative-return is falling, the direct to client regulatory costs are expected to grow as more client risk disclosures are put in place, and there is no mitigation of Bank Dominance. The Customization alternative scored in the middle since it would employ a Bank investment platform that would enable leveraging of built-in Bank compliance resources, but the

premium compensation to CPMs needed for recruitment would make it difficult to profitably offer lower-priced solutions. The third option of Retirement ranks highest because it effectively addresses each of the threats. Retirement solution differentiation would lend some pricing power to battle sensitivity. Banks could become distribution partners instead of competitors. The value proposition moves into solutions and away from relative return mandates, and when a firm offers Sub-advisory, the product manufacturer and distributor bears most of the compliance burden.

#### **6.2.3.6 Side-step Weakness**

For this goal, I considered the extent to which each option could avoid reliance on skill and resource areas where Skyward is light. In terms of specific weaknesses, I looked at Distribution Breadth, Niche Strategies, Economies of Scale and Safety Image. First off, the Performance option fares poorly since it doesn't add distribution or move away from generic relative-return offerings, nor does it avoid our weak Safety Image. On a positive note, however, the Performance alternative would be expected to add assets to our existing mandates and help somewhat with scale. The Customization option appears equally weak because although it may add slightly to distribution as new CPMs join Skyward, the "jack of all trades and master of none" perception would not help in terms of our strength in particular Niche Strategies, endless on-off portfolios would not add to mandate scale, and our Safety Image would still be an issue.

The Retirement alternative wins since it offers the biggest potential leap in Distribution Breadth through much broader Sales Channel access, employs a unique

low-risk, high-yield Niche Strategy, may be used to Sub-advise stronger-branded products, and allows additional assets gathered to be concentrated in fewer mandates to improve our Economies of Scale.

As per the rating methodology and rationale shown above, and before considering feasibility issues, the Retirement strategic option clearly comes out on top. It earned a high score of 4, and appears most attractive in terms of its likelihood helping us achieve our overall objectives. The silver medal went to the Customization business approach, scoring 2.80, and the Performance alternative finished last with 2.35 points.

## 7: Retirement Feasibility Analysis

Since the Retirement strategic alternative ranked first in term of goal achievement and external fit, in this part of the paper, I will proceed to examine the extent to which its implementation might be practical given our firm’s existing skills and resources, or our ability to improve on those capabilities. To complete this assessment, I will employ the “Diamond-E Drill” framework, by Crossan, Killing and Fry (Fry, 2009). This model suggests measuring a strategic option against the internal capabilities of manager preferences, organization and resources. To do this, I will examine our internal competences to determine the execution requirements, capability gaps, gap-bridging solutions and solution costs. Please see Table 8 below for an at-a-glance summary.

### 7.1 Alternative Feasibility Analysis

#### 7.1.1 Retirement Implementation Assessment

##### 7.1.1.1 Manager Preferences & Expertise

- **Option Requirements** – The plan here was to offer retirement focused low-risk, high-yield strategies through Sub-advisory. We can assess our needs along both the preference for Niche Strategies of this kind as well as our comfort in pursuing Third-party Distribution. First, the head of our Investment Group has been highly interested in the science of risk reduction, and has been carrying out extensive

research in this area. As a result, Skyward has gained some particular expertise in this area and was awarded best research paper of 2011 from the Alternative Investment Management Association (AIMA). Additionally, we have a broad appetite for pursuing the sales and marketing approach of Third-party Distribution across the senior management level, and I have gained experience and knowledge of the space through previous roles.

- **Gaps Relative to Current Capabilities** – The only expertise we are missing is some specific research into the Niche Strategies that would fit perfectly with an out-come based retirement Solution product.
- **Potential Gap-bridging Solution** – With the fundamental skills and desire present, our next step to fill the gap would involve integrated product strategy and investment strategy development and testing projects, which would likely involve in-house learning through a four-month iterative process.
- **Solution Cost** – To adequately strengthen our expertise in retirement Solution products and Niche Strategies, we would incur an opportunity cost of roughly a two month Full-time Equivalent (FTE), in the form of lost productivity applied toward other initiatives. The opportunity cost would be approximately \$25,000.

#### 7.1.1.2 Organization

- **Option Requirements** – To pursue the Retirement strategic alternative, Skyward needs to have the right organizational structure, systems and culture in place.
  - On the organizational front, our company would have to coordinate tasks between departments so as to design and deliver investment

strategy and execution within the Investment Group, product strategy and marketing within the Client Group, and portfolio reporting and billing within the Operations Group. Functionally, these three departments regularly coordinate projects and programs of this sort through the Executive Team, which meets weekly.

- Skyward already has Ramkit in position for investment strategy research, and development and management. We also have all the systems needed for trade management, administration and accounting.
  - Culturally, it would be essential to have employees accept and embrace this business approach, and I believe we presently meet these requirements across the firm.
- **Gaps Relative to Current Capabilities** – Fortunately we have two existing Sub-advisory client relationships that we are managing effectively through our existing organizational structure, systems and culture, so I do not anticipate we will encounter any organizational gaps if we follow the Retirement alternative and pursue similar types of business relationships.
  - **Potential Gap-bridging Solution** – As an organization, Skyward has no structural, cultural or systems gaps that need solving.
  - **Solution Cost** – I would not expect any additional organizational related costs in executing the Retirement option.



### 7.1.1.3 Resources

- **Option Requirements** – In order to effectively develop retirement solution style Specialized Mandates and market them through Sub-advisory, Skyward would also need to have suitable operational, human and financial resources in place.
  - Operationally speaking, we would require the right physical facilities and equipment, as well as intangible items like reputation and intellectual property. In terms of equipment, over and above furniture, we mostly require computing and telecom hardware to manage our various systems. I believe we need to further build our credibility with respect to our reputation and intellectual property around low-volatility, high-yield investment, as well have a unique and proprietary Niche Strategy. Since we plan to market our mandate through Sub-advisory, this distribution method can easily be executed with our existing single location because all of the sales and service functions are handled by external Sales Channels.
  - On the topic of human resources, Skyward would require certain types of skills and experience in marketing to external Sales Channels as well as appropriate levels of systems and investment analytics to build a new investment strategy.
  - On the financial front, implementing the Retirement strategy would be extremely low-cost as it relies completely on leveraging existing corporate capabilities. So, other than some minimal opportunity costs

from allocating human resources toward this strategic option and away from other non-aligned projects and programs, there would be no additional costs expected.

- **Gaps Relative to Current Capabilities** – The only resource gaps we need to fill are related to development and intellectual protection of the new retirement security selection strategies, as well as reputation building with respect to firm capabilities and expertise in this Niche Strategy.
- **Potential Gap-bridging Solution** – To bridge the investment strategy intellectual property gap, Skyward should at least complete discipline development and ask employees to sign non-disclosure agreements to protect against leakage of our “secret sauce”. Although I’m not aware of any patented investment strategies, Skyward should also consider branding and trademarking strategy names as an extra means of defence. In terms of firm reputation building in the area of low-risk, high yield investment expertise, Skyward should seek to create and publish another White Paper on the subject, but be careful to leave out crucial details to stave off competitive replication.
- **Solution Cost** – Fortunately, all costs relating to the implementation of the Retirement alternative are soft and involve the improved allocation of existing resources, most of which are human. This is of great importance since one of the key goals of this strategic analysis was to find a way to meet our corporate goals of profit growth without needing to inject too much additional capital.

## **7.2 Preferred Alternative Identification**

Earlier in this analysis, I evaluated our three strategic alternatives with respect to their potential for goal achievement and their fit with the firm's strengths, weaknesses, opportunities and threats. Through that examination, I found that the most promising option appeared to be Retirement, and after proceeding through a feasibility assessment, I have determined that the requirement gaps and the level of financial resources needed to fill those gaps are minimal. Since the Retirement alternative scored best in terms of goal attainment potential and passed the necessary feasibility tests, I would recommend Skyward go forward to execute this strategic option.

## **8: Final Recommendation**

In this last part of the report, I will summarize the recommendation and the reasons for the selection of this option. I will also outline the best approach for executing the implementation of the Retirement strategy.

### **8.1 Recommended Option**

Based on a combined appraisal of both external fit and internal viability, I believe the most attractive strategic option for Skyward is Retirement. This alternative exhibited the best alignment with the SWOT, and the Diamond-E feasibility assessment indicated we already have all the essential internal capabilities needed for effective implementation. From a personal standpoint, the Retirement alternative appeals most to me since it is the most original of the three alternatives, and I believe its pioneering nature makes it the most likely option to generate sustainable profit growth. As economist Paul Romer said: “technological change – improvement in the instructions for mixing together raw materials – lies at the heart of economic growth” (Romer, 1990). Romer uses cooking as a metaphor for production and suggests that accelerated growth comes not from doing more cooking with the same recipes, but rather developing better recipes that combine ingredients in new ways to make dishes tastier.

The Retirement alternative will help Skyward reinvent our value proposition and add unique client appeal to our services. Focusing on delivering

retirement investment solutions aimed at the rapidly changing needs of Baby Boomers will also enable Skyward to effectively pursue the managed money industry's leading business opportunity. Additionally, the Retirement approach nicely leverages our Compelling Research advantage, and allows us to seize the new Third-party Distribution opportunity that is arising as Sales Channels "retirement-ize" their product line-ups. Lastly, through this strategic analysis, Bank Dominance was identified as a major threat, and the Retirement alternative turns this threat into another opportunity by seeking to piggy-back on the Distribution Strength source of advantage held by Banks.

## **8.2 Sub-recommendations**

If Skyward chooses to execute this strategic alternative, I would also recommend some specific product and marketing tactics as they do so. First, from our exploration of Porter's Five Forces, we learned that differentiated suppliers are able to exert more power and can potentially capture an increasing share of the value that is created within an industry (Porter M. E., January 2008). We have also seen that, in the managed money business, Labour is both the most powerful and hence expensive supplier. As a result, for Skyward, I would recommend marketing the investment strategy with an emphasis on process rather than star PMs. This is because the more the investment benefits are perceived to be derived from personal skills, rather than the discipline as a proprietary firm resource, the greater the PM differentiation and its associated cost will be.

The Retirement option offers the potential to maximize distribution expansion and gain near-term sales simultaneously if we target very specific opportunities. For

instance, I believe a successful tactic would be to seek out Sub-advisory opportunities for existing products that are already on a strong distribution platform. That way, if we win the contract, we gain assets and revenue instantly, as well as increased distribution exposure on Discretionary Brokerage or Investment Funds Sales Channels.

Another tactic worth considering relates to brand. We have seen that Skyward is relatively weak versus competitors regarding its Safety Image, and fortunately, this is largely side-stepped since the Sub-advisory client segment has a lower interest in this preference. Happily, as we enter Sales Channels of participants with stronger brands, we can leverage and benefit from external sources of advantage that we do not own.

Beyond this, there are also tactics we may want to consider to better brand our own Specialized Mandates. One effective method would be to turn our retirement investment strategies into systematic indices that are calculated by well-known Suppliers such as S&P and Dow Jones. These firms will create custom indices for clients that enable promotion and leverage of their very powerful brands.

If Skyward opts to turn its retirement investment strategies into well-branded custom indices, it would also enable the sale of our Sub-advisory services to mutual fund companies that manufacture ETFs. This is good because ETFs are the fastest growing type of Investment Funds Product Format. Since ETFs are market-listed, they are accessible to all market participants, and accordingly, they can be used both as an end product and as an input into other money management products. This is fantastic because it allows ETFs to achieve sales in both the Money Manager and Sales Channel parts of the value chain. For example, Independent Counsel Firms can include ETFs as an

input to the pooled Investment Funds they sell to Pension clients, and Advisors who work at Banks can sell ETFs as a finished good to their Individual clients.

### **8.3 Time for Action**

In this final part of the study, I will briefly outline a suggested timeframe for implementing the Retirement option.

**May 2013** – Executive team discussion and finalization of strategic details followed by presentation and confirmation with the Skyward Board of Directors.

**June 2013** – Form a Retirement Product Committee made up of marketing and investment team members then create a product specifications document defining the target market, branding, features, benefits and investment philosophy.

**July 2013 through September 2013** – Complete an iterative design process to complete the product investment discipline and marketing materials.

**October 2013** - Instruct the institutional sales team to execute a cross-country product promotional product launch.

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