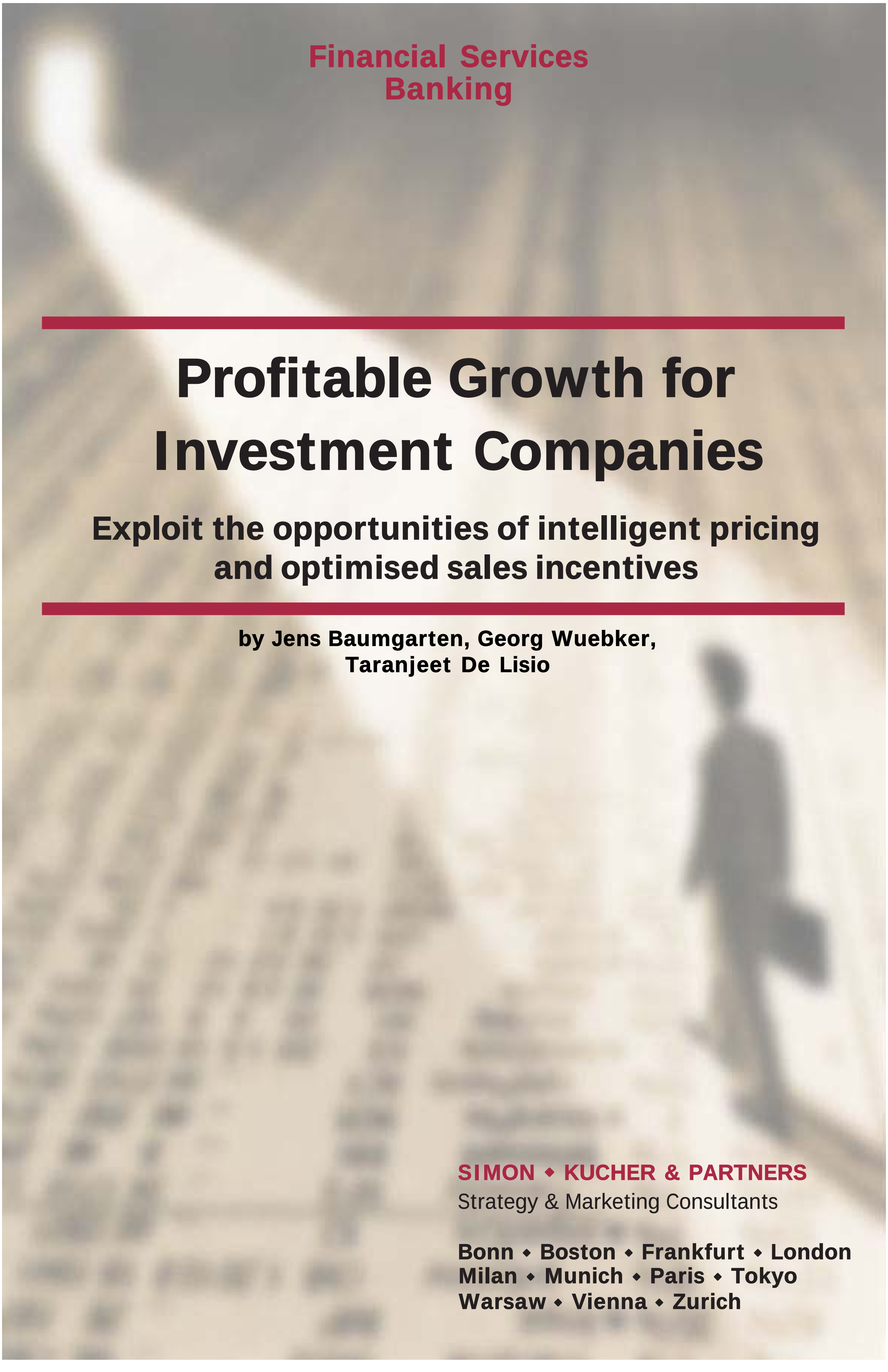

Financial Services
Banking

Profitable Growth for Investment Companies

Exploit the opportunities of intelligent pricing and optimised sales incentives

by Jens Baumgarten, Georg Wuebker,
Taranjeet De Lisio

SIMON ◆ KUCHER & PARTNERS
Strategy & Marketing Consultants

Bonn ◆ Boston ◆ Frankfurt ◆ London
Milan ◆ Munich ◆ Paris ◆ Tokyo
Warsaw ◆ Vienna ◆ Zurich

European capital investment companies are currently in a difficult situation. Following the disappointing performance in recent years during which the majority of customers have had to accept sensitive losses on their securities account, the long anticipated resurgence in the market is still being awaited. Although in 2004 the industry was able to collect about £130bn of net inflow this figure is still well below the level of 2002, when customer confidence was at an all time low after the burst of the internet bubble.

Nevertheless there are more funds and fund providers in the European market than ever before. Overall there are more than 30 000 UCITS funds registered for public distribution in the European Union (reaching 40 000, if property funds and specialty funds for institutional investors are included). Compared to the US, the number of equity funds alone is approximately three times higher, although their average asset volume is only £150m compared to an US average of £870m. In such a fragmented market it is not surprising that the calls for consolidation are growing louder. However, the number of registered funds rose slightly again in 2004 and appears to still be growing in 2005. As a result, the industry threatens to slide into a destructive price war: more and more players are pressing into the market, threatening the established players with price discounts and aggressive sales incentives.

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The crucial question that most managers of capital investment companies must answer is: How is it possible to grow profitably despite these adverse conditions?

Over recent years attention has most notably been on cost-cutting. In order to reduce the cost-income ratio, many capital investment companies have taken considerable steps in reducing headcounts and in process or structural improvements. Precisely because of recent accomplishments in these areas, improvements on the cost-side have been extensively exhausted. Attention now needs to shift to the revenue side, i.e. increasing volume as well as exploiting the potential of pricing. The challenge, however, is in targeting these two fields simultaneously. The solution is twofold: On the one hand, pricing processes and intelligent price measures must be established in order to identify and exploit improvements in fee structures and levels. On the other hand, the benefits generated by these activities must be intelligently reinvested into the sales incentive systems, binding important distribution partners more closely to the company whilst keeping the motivation to push sales constantly at a maximum level.

Simon, Kucher & Partners have conducted numerous studies and projects covering these topics in recent months with well-known investment companies across Europe. These have shown that in the future pricing and sales matters will be more central to the corporate policy.

Setting the right sales incentives

Strategy and structure of the sales incentive systems have to be optimised for the long-term success of the investment companies.

The majority of managers see sales as the greatest internal problem. Firstly, it is vital to attract the right type of employees. Secondly, setting the correct incentives for distribution partners is essential. In countries such as the UK, where more than two thirds of fund sales are generated through indirect distribution channels, strategy and structure of the sales incentive systems have to be optimised for the long-term success of the investment companies (see figure 1). Currently, too many sales incentive systems still use a “scattergun approach”. Instead, sales incentives should differentiate between the significance of contribution to the overall volume or profitability of a product or distribution channel.

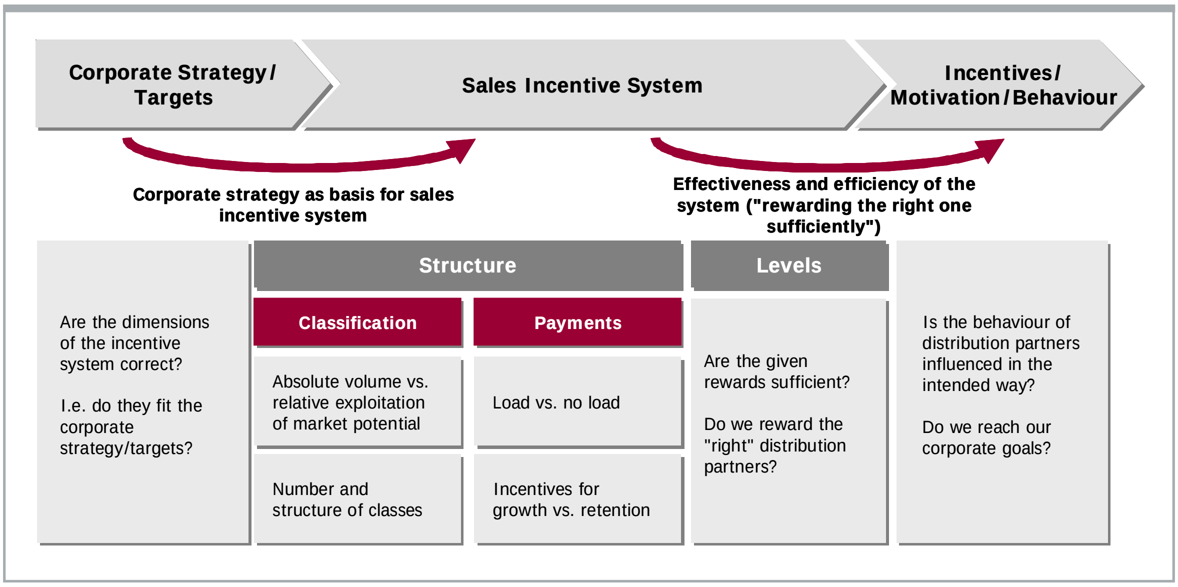

Figure 1: Challenges in Sales Incentive Systems

Exploit the full potential of pricing

A further result of the studies is extremely surprising: the significance of pricing has not yet been fully recognised. In the investment sector only approx. 10% of the businesses interviewed see an immediate need for action in terms of their pricing strategy. Central pricing questions, such as the optimal level and composition of various price components (front-end load, back-end load, management fee, securities account handling fee, etc.) are still managed inadequately. This is all the more problematic as only improved value extraction on the price side can generate the required funds to adjust the sales incentive systems (optimised structures, higher provisions).

To exploit these possibilities fully, effective pricing processes and systems must be installed and utilised.

The "power of pricing" is emphasised in the following examples: if an investment company manages £50bn, a price increase of only ten basis points leads to an immediate surplus of £50m. Or, if the average deposit return for 2 million customers was increased by £5, this would result in £10m additional profit. As these examples demonstrate, price strategy and structures should be given a much higher priority.

Optimal pricing processes as the core for profit growth

To exploit these profit growth opportunities fully, effective pricing processes and systems that integrate the relevant market information (competitor prices, customer requirements, price elasticity, etc) must be installed and utilised. The following figure shows an ideal pricing process for funds that incorporates the most relevant pricing information in a pragmatic way. This process makes it possible for pricing and sales managers to quickly identify pricing prospects and implement the right measures:

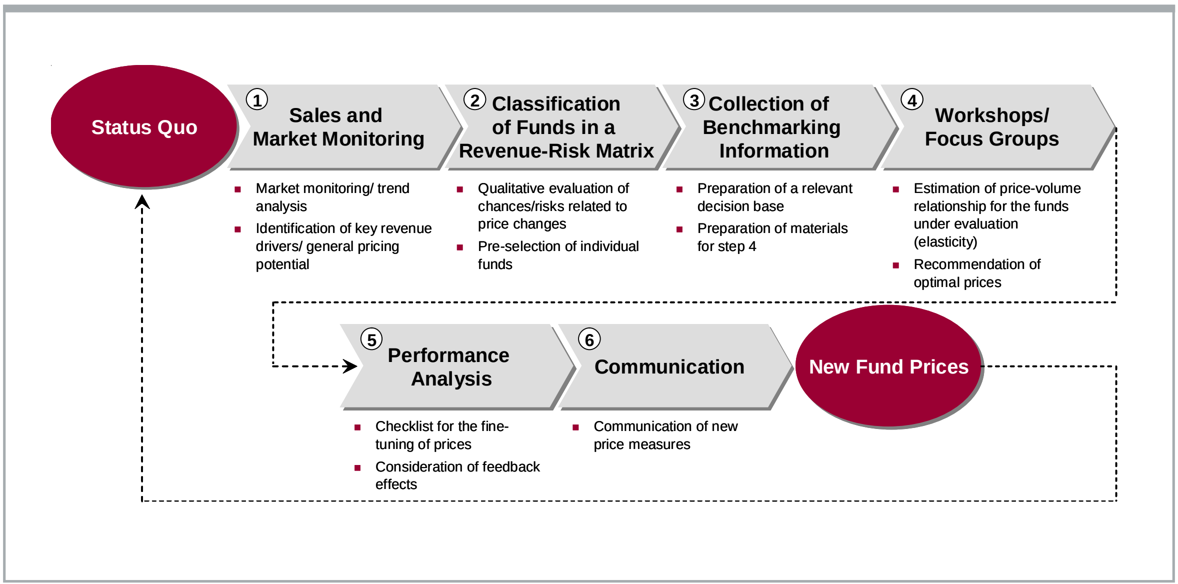

Figure 2. Optimal End Investor Pricing in the Funds Industry

One core result of the pricing process is the acquisition of knowledge about price elasticities, i.e. the expected customer reaction to price changes. For example, should the management fee for a specific fund be changed by x basis points, the effects on volume will be much higher for a short-term bonds fund than for an equity fund specialising in a certain market segment (e.g. a China growth fund). In this context, a very important step is the examination of the "price-performance relationship": It is crucial to analyse, for example, the impact of changes in the management fee on important performance ratios or rankings, especially since these factors strongly influence the perceived quality of the fund and thus customers' reaction to price variations (price elasticity).

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Optimal results can only be achieved if there is constructive co-operation from all specialists in fund management, marketing and sales. In general, studies show that the level of professionalism for pricing in the investment industry must be increased.

The following questions (amongst others) are relevant for each organisation:

1. Does a systematic pricing process exist, i.e. a type of regulation or structure specifying how to set prices?

2. Is pricing established across the organisation (pricing guidelines, pricing manager, etc.)?

3. Are the willingness-to-pay and the price elasticities of customers known, i.e. the effect a price increase/decrease has on volume or the number of customers?

4. Is the impact of price measures on performance, ranking, etc. integrated into the price setting process?

5. Has the brand value, i.e. the possible price premium due to the brand, been determined?

6. Are intelligent pricing concepts such as bundling or non-linear pricing used?

7. Are sales incentive systems optimal for different classes of sales partners?

8. Are there sufficient incentives to protect stocks adequately whilst also facilitating maximum growth in new business?

The more questions answered negatively, the higher the need for action. The responsible managers in the investment industry can still learn an immense amount from other sectors such as automotive and life sciences. In order to succeed in a consolidating investment market, companies need to begin this learning process immediately and get on track as soon as possible.

Georg Wuebker is Partner, Head of Financial Services Global

Jens Baumgarten is Director, Head of Financial Services UK

Taranjeet De Lisio is a Consultant

SIMON ◆ KUCHER & PARTNERS
Strategy & Marketing Consultants

Bonn ◆ Boston ◆ Frankfurt ◆ London
Milan ◆ Munich ◆ Paris ◆ Tokyo
Warsaw ◆ Vienna ◆ Zurich

London:
233 High Holborn
London, WC1V 7DN
United Kingdom
phone ++44/(0)20/7841 5750
fax ++44/(0)20/7841 5751
e-mail jens.baumgarten@simon-kucher.com
internet www.simon-kucher.com