



Ideas for generating new ideas

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By Amin Rajan

“If HP knew what HP knows, we would be three times as profitable” said late Lew Platt, former CEO of Hewlett-Packard. His observation was based on the widely accepted view that, as humans, what we speak and write every day is less than one per cent of what we actually know. The rest is tacit knowledge that cannot be articulated easily because it resides in our insights, instincts and intuitions.

The key to business success, then, is to download this knowledge wherever possible by creating special inter-personal encounters in which ideas breed new ideas. After all, creativity is not a linear process of knowledge creation; rather, it is often a product of a random explosion of energy born of frustration with the status quo.

Platt's pithy remark sparked off a world-wide interest in how to tap into tacit knowledge and leverage it to create new products, improve processes, reduce costs and increase return on capital.

LEARN FROM IBM

IBM, hitherto Hewlett-Packard's arch rival, became the most prominent convert, after posting the biggest loss in corporate history back in 1993. Paradoxically, the company had record sales that year: it was able to sell everything that it could make. The prevailing philosophy at client-end was that nobody “gets blamed for buying IBM.” The only problem was that cost exceeded revenue by

some \$5bn. Despite its renowned army of marketing specialists and technologists, it could not see that its products were getting out of date in the face of rapid miniaturisation in information technology. The problem was that people worked in silos: they did not share ideas amongst themselves or customers.

Some seven years later, IBM achieved an amazing turn-around. Lou Gerstner, its architect, linked it with many factors, not least of

which was the company's newly created elaborate personal networks where people shared ideas freely, believing that knowledge is only power if it is shared.

A NEW BEGINNING

In fund management, the centrality of tacit

knowledge cannot be exaggerated: it lies at the heart of high conviction strategies that generate alpha. Not surprisingly, therefore, attempts are made to capture and incorporate it into corporate ‘memory’ by getting portfolio managers to share their ideas freely and inviting response.

At Pimco, for example, account managers do a lot of research on their clients and share it with portfolio managers. The quality and intensity of their interaction has put Pimco in an enviable situation where it not only generates excellent investment performance but also provides top quality client service. Its client retention rate is exceptional by industry standards. Innovation comes from identifying and fixing clients' problems, and not from blue sky thinking within

unnatural silos; it comes from doing new things, not copying others.

In global fund businesses, there is a growing interest in setting up communities of interests which bring professionals together in a bid to discover what they know, share it with colleagues and create new knowledge for their firm. Their interactions are informal and usually last for an indeterminate period of time. BlackRock Merrill Lynch Investment Management and UBS Asset Management, for example, have done a lot to promote idea sharing.

THE MELLON WAY

Mellon Financial, now merged with Bank of New York, has extended this process by forming arms length alliances to create a global tactical asset allocation product covering multi asset classes with a dynamic tactical overlay, using products from various parts of the company backed by huge gearing.

The company has also adopted a market driven approach to innovation, as widely publicised by General Electric. “In order to generate internal momentum towards ideas generation, future revenue targets are also set for products that do not as yet exist in our portfolio,” says Jon Little, chairman of Mellon Investments.

Compared to other industries, these initiatives are modest. But their importance cannot be underestimated. New investment ideas come from people of diverse styles and views interacting regularly.

One of the key challenges in this decade is how to go from knowledge hoarding to knowledge

INNOVATION COMES FROM IDENTIFYING AND FIXING CLIENTS' PROBLEMS AND NOT FROM BLUE SKY THINKING

sharing. The cult of individualism is still powerful in the front office.

AN UPHILL TASK

It has created a chasm between manufacturing and distribution in numerous firms, with no clear focal point for innovation. Blame cultures are all too evident, as a result. This is a recipe for failure. In order to avoid that, fund managers worldwide are promoting product innovation in the front office via three avenues:

The **first** one promotes high conviction investment strategies by forming in-house product-based boutiques in which investment professionals have autonomy, space and accountability for generating new ideas and executing them. The **second** avenue involves creating dedicated incubators where ideas breed new ideas, some of which are then fast tracked into new products and services. The **third** one relies on the adoption of multi-manager platforms which engage independent boutiques as innovation partners.

Activities that thrive on internal expertise are being decoupled from those that thrive on external alliances, freeing up fund managers to concentrate on delivering good and consistent performance.

However, despite these developments, clients remain wary. When it comes to the latest

products now emerging on the market – e.g. LDI, hedge funds, life cycle funds – they want to see a replicable track record before venturing into anything radically different. Many clients see these products as old wines in new bottles. They are also suspicious about 'hidden' charges.

The reason is all too familiar: a legacy of distrust created by the last bear market when millions lost billions. Asset managers see further innovation as a key stepping stone to success. In particular, effort is now directed at improving one or more of the following features of the products now coming on stream:

- ◆ risk-return characteristics
- ◆ transparency
- ◆ liquidity
- ◆ volatility
- ◆ simplicity
- ◆ customisation.

CONCLUDING REMARKS

It is one thing defining improvements, quite another delivering them. In each of the above areas, progress can only be incremental, since markets are adaptive, strategies move with fashion and risk reward relationships change over time.

But one thing is for sure: it is no longer possible to confuse product innovation with proliferation. Clients have wised up on copycats. **TFB**

AMIN'S TIPS

Innovation is easier said than done. Here are Amin's top suggestions for encouraging new ideas

» BUSINESS DEVELOPMENT

CEO

- Encourage fresh thinking and original ideas
- Challenge status quo
- Provide honest and real time feedback

There are three popular business models:

1. Give autonomy to your portfolio managers through an in-house boutique, promoting conviction investing
2. Create ideas incubators, fast-tracking the best
3. Use boutiques as innovation partners through a multi-manager model.

» OPERATIONS

COO

- Recognise that bureaucracy is a kiss of death
- Give recognition to creative people
- Communicate success stories
- Knowledge sharing between teams who do not regularly interact can be rewarding
- Your distributors and institutional clients need to be brought into the innovation fold and included in the thought process if they are to welcome new product lines without track records.

» INVESTMENT

CIO

- Your portfolio managers are a rich source of ideas for the whole business. Co-ordinate with the COO to brainstorm and share
- New product lines are increasingly driven by investment teams aware of what is possible with today's technology. Interact with vendors to look forward to technology solutions
- Promote more intensive dialogue among professionals
- Create a fast-track process for capturing and assessing new ideas
- Involve clients in product development process.

» KEY SUCCESS FACTORS

- The route to realisation of ideas must be mapped out
- Encouraging employees to communicate freely across departments can be a major cultural change and should be planned as such
- Your clients and service providers can be key idea generators and reality-checkers.

CASE STUDY THOUGHTS FROM THE CEO OF A EUROPEAN HOUSE

The investor mindset has shifted irrevocably towards alpha products with large tracking errors in the long-only space. Accordingly, we have introduced what have turned out to be a number of catalytic innovations that have transformed this business.

To start with, we now accept that investment talent is more important than the process and philosophy. So, we give our long only managers a lot of autonomy and space within a boutique environment, in which they can generate fresh ideas and convictions. We have also adopted a philosophy of 'management by exception': our professionals only come to us if

they have a problem which they can't fix themselves. This hands-off approach has required a different leadership style from the top team. However, in order to discourage laissez-faire attitudes, we have also created a portfolio advisory group where the professionals bounce ideas, see suggestions and do sanity checks.

The scope of our research engine has been widened to include all industries, size and geography; and deepened to cultivate special insights through even closer proximity to companies in whom we invest. We have also created a new quant's capability to enable our long-only managers to pursue 130:30 strategies.