How companies innovate, and the implications for boutique asset managers like Unigestion

Previously, we looked at the importance of financial innovation to the economy and possible sources of future innovation. In this second of two papers, we discuss how companies innovate and the role that boutique asset management companies like Unigestion have to play in this process.

Putting in place the conditions for innovation

Becoming innovative can require some cultural transformation within an organisation, such as creating space for experimentation and fostering a willingness to learn and a tolerance of failure. In this respect, asset management companies can learn from the digital giants.

Two key characteristics of innovation are simplicity of purpose – which means achieving an easily defined goal for the customer – and simplicity of user experience – which means keeping the complexity of the mechanism to achieve that goal hidden. Companies such as Google, which efficiently catalogues websites on the Internet, Apple, with its simple-to-use products, and Amazon, which seamlessly sells and delivers a vast range of items to shoppers, are excellent examples of how to do this.

What all these organisations have in common is that they deliver huge value to their customers while making the user experience extremely simple. Their users are not burdened by the complex algorithms or supply chains running in the background.

This is a lesson the investment management industry could learn. Managing money is a complicated business, and the environment changes every day. Developing investment processes involves taking ideas – sometimes complicated ones – and turning them into workable concepts. But this complexity should not blur the simple purpose of what we are there to achieve: delivering the risk-adjusted performance our clients expect of us.

Hollywood usually portrays innovation as the brainchild of a lone genius working in isolation. The reality couldn’t be further from the truth. It nearly always involves teams of people, often from different disciplines, who contribute their experiences and knowledge and share ideas to build a new concept.

Innovation occurs from the bottom up in most successful organisations. At Unigestion we encourage our employees to collaborate to come up with ideas for new funds or to find more effective ways to serve our clients. We use a programme similar to those developed by 3M, Google and Hewlett-Packard, whereby our employees can block-book a day from their regular agenda, usually together with other colleagues, to brainstorm on how to evolve our techniques and processes.

We have also learned to look outside our organisation – particularly towards academia – for new ways of thinking. Academics are constantly probing for deeper insights and coming up with new concepts. That’s why Unigestion works closely with EPFL, EDHEC and Cass Business School in London to gain insights into their latest research about markets and investing.

Increasingly, innovation within one industry is a result of looking to another to see how it has solved similar problems. For example, managing risk is an integral part of asset management, but risk management is vital in a wide range of industries. A technique that we have carried over from the medical community into our investment processes is cluster analysis, which was originally devised to detect symptoms in patients. However, the methods involved have proved useful for grouping ‘clusters’ of stocks together in terms of their correlations to help build diversified portfolios. Another example is that the military invented a range of tools to detect submarines, and this involved removing all the non-relevant noise in the background. In an investment setting this ‘noise cancellation’ technique is used to isolate risk factors.

Ideas fuel innovation. But ideas alone are not sufficient: they must be able to be implemented to be useful. There are few eureka moments when we do research. Rather, it is a long journey, with booms

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Fiona Frick, CEO of Unigestion

“The most successful innovators deliver huge value while keeping the user experience extremely simple.”

“Innovation increasingly involves looking to other industries.”
and busts in terms of its results and the frustration we feel when we find that a practical matter ruins the idea. This is why we need to define a framework to convert new ideas into implementable innovations. That research is a lengthy journey is true in all industries: it took decades for the Internet to develop from its beginnings at CERN, and of course a huge amount of research and work has been done to transform it into a means of mass-market communication. We have to take into account the long-lasting and iterative nature of innovation when defining research objectives.

Sometimes an innovation doesn’t respond to an investor’s immediate concerns. For example, we started proposing risk-managed equity portfolios to our clients in 1995. But at that time, most of our clients did not want to reduce volatility — they wanted to increase it in the midst of the bull market of the 1990s. It was only with the stock market falls of 2001 and 2008 that our product really gained traction among investors.

Active managers should innovate while staying true to their DNA

One of the most obvious trends in the investment management industry today is the polarisation between passive and active investment strategies. This is why it’s vital for a boutique active manager to innovate in order to survive. Innovation by companies like ours is driven by the force of commoditisation from big passive players. Without innovation, active products and processes run the risk of becoming commoditised or obsolete, or the victim of price wars. A boutique is too small to win the price war, so it must develop better products and services. It must also make sure it provides a more personalised offering and that it always has in its armoury the next generation of products that will keep it ahead of the competition.

Of course, passive investment approaches have become very popular as they involve low management fees. What’s more, many mainstream fund management firms take an almost industrial approach by mass-manufacturing investment products based around index replication strategies. They then sell these products in huge volumes to the public. This has been very successful from a marketing perspective.

But for many investors this ‘mass-market’ approach is not enough. Thanks to technology, people are becoming used to customisation in other areas of their lives, and they’ll increasingly expect it when it comes to the management of their assets. The changes taking place in the industry are creating excellent opportunities for smaller, more nimble investment management firms to come up with new and creative solutions that meet investors’ need for customisation.

The asset management industry is facing similar challenges to those faced by the watch industry some decades ago. When digital watches disrupted the watch industry, traditional watchmakers had to reinvent themselves by highlighting their authenticity and craftsmanship.

Excelling at investment management is another form of craftsmanship, and this will be even more important in the future. Helping clients meet their goals means drawing on deep knowledge and experience, innovating, and always being on the lookout for ways to improve. Solutions customised to investors’ specific needs will form the next big trend in the investment industry, and that is precisely where active boutiques will have a major role to play.

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