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## DOES CLIENT SERVICE MATTER? AND CAN “GOOD CUSTOMER SERVICE” BE DEFINED?

### Market Downturn Puts Theory into Practice

#### OVERVIEW

Many people would argue that asset management is purely a performance-driven business, where managers live and die by their performance numbers. It would be hard to argue against performance measurement as the predominant criteria by which to evaluate a manager's worth. Yet a growing contingent, not surprisingly led by client service professionals, argues that client service plays an increasingly important role in creating long-lasting client relationships. Ironically, the global financial crisis, which hit its apex in the third quarter of 2008 through the first quarter of 2009, proved to be the litmus test for this theory.

It stands to reason that poor investment performance would lead to widespread discontent with poorly performing asset managers, both on an absolute and relative basis. However, what if that was not the case? What if client satisfaction was not solely correlated to investment performance and was instead influenced more by other factors? What if subjective perception is a stronger force than objective reality?

The events of the last financial crisis have provided a unique opportunity to test the value of offering superior client service against the backdrop of a bleak empirical reality. The importance in doing so is not simply an academic exercise. Rather, it is an opportunity to determine whether or not an investment in creating a robust client service capability will be rewarded with longer-lasting and assumedly more profitable client relationships.

To evaluate the importance of superior client service, there are two fundamental questions to be answered. First, **does strong investment performance lead to strong overall satisfaction with the relationship?** In other words, are the two correlated and if so, how strong is the correlation? If they are not correlated, then what activities, in fact, are associated with satisfaction? The second question, and arguably the more important of the two, is **does strong investment performance lead to the perception that investment performance is strong?** While seemingly odd, this question highlights how perceptions can both frame and potentially alter objective frameworks.

As measurers of client experiences, Chatham Partners is well-positioned to offer observations on client perceptions of their investment managers. Chatham surveys thousands of institutional investors each year on behalf of its institutional asset management clients. Likewise, Investment Metrics, LLC, develops investment analysis, manager research databases

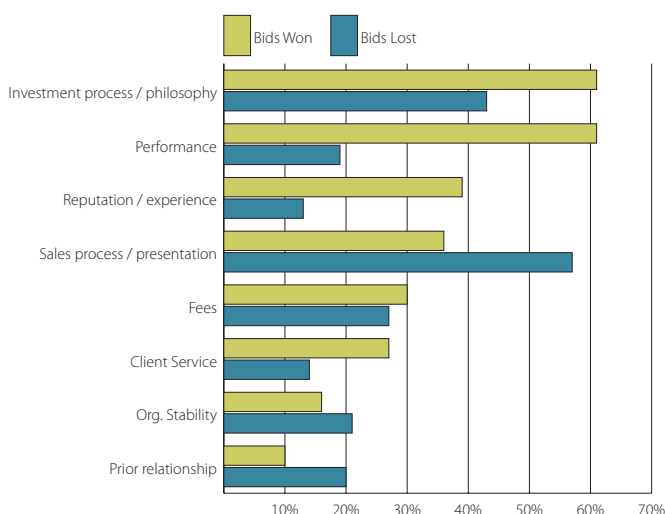
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and investment reporting solutions. Together, these organizations thought it would be useful to combine the expertise and insights of their respective firms in order to best answer the questions previously posed.

### IS INVESTMENT PERFORMANCE THE “BE-ALL, AND END-ALL”?

In addition to the client satisfaction surveys Chatham Partners conducts on behalf of its clients, Chatham interviews thousands of institutional investors to determine why they hire or do not hire specific managers. From these studies, Chatham has found, not surprisingly, that investment process/philosophy and investment performance are the most widely-cited drivers for winning new business (see Exhibit 1). In fact, over 60% of investors will cite these two drivers as the primary reasons to select a manager. Interestingly, less than 20% of investors will cite investment performance as a reason for not selecting a manager. This apparent paradox suggests that, performance being equal, there are a variety of non-performance-related attributes that factor into the decision-making process for selecting investment managers. Put another way, performance is the price of entry and hard-to-quantify attributes, such as fit, level of confidence, and desire for the business then become the determining factors that can make the difference between winning and losing a potential investment mandate.

**Exhibit 1. Drivers of Manager Wins and Losses**



Source: Chatham Partners

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### **GOOD NEWS AND BAD NEWS**

If performance is not the sole basis for hiring or not hiring a manager, it begs the question of whether performance can really be the sole basis for retaining or firing a manager. The quick and easy answer is no. There are many reasons why managers get terminated for factors other than performance: changes in investment professionals, organizational structure, portfolio construction, asset allocation, and approach to risk management to name a few. But the question remains, how does one retain and grow profitable client relationships? To answer this question, one must understand the predictable attributes or contributors to client satisfaction.

Chatham has done extensive analysis on identifying the statistical drivers of client satisfaction. In fact, since 2001, Chatham has collected thousands of client satisfaction surveys from institutional investors across virtually all asset classes and market segments. What Chatham has found, is that while investment performance-related attributes are the leading contributors to client satisfaction at about 60%, a whopping 40% of satisfaction is attributable to client service-related attributes.

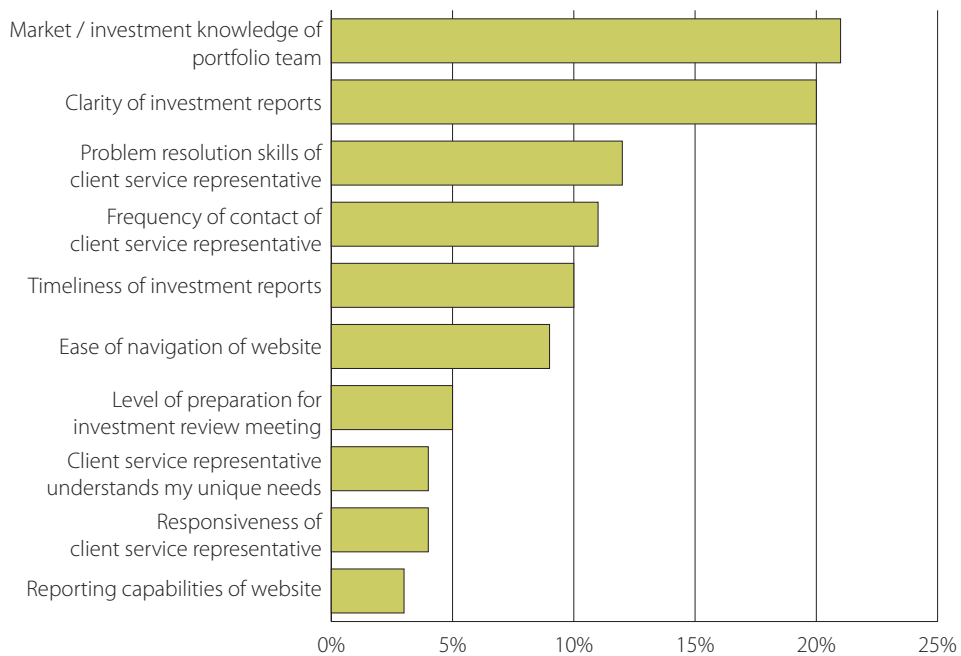
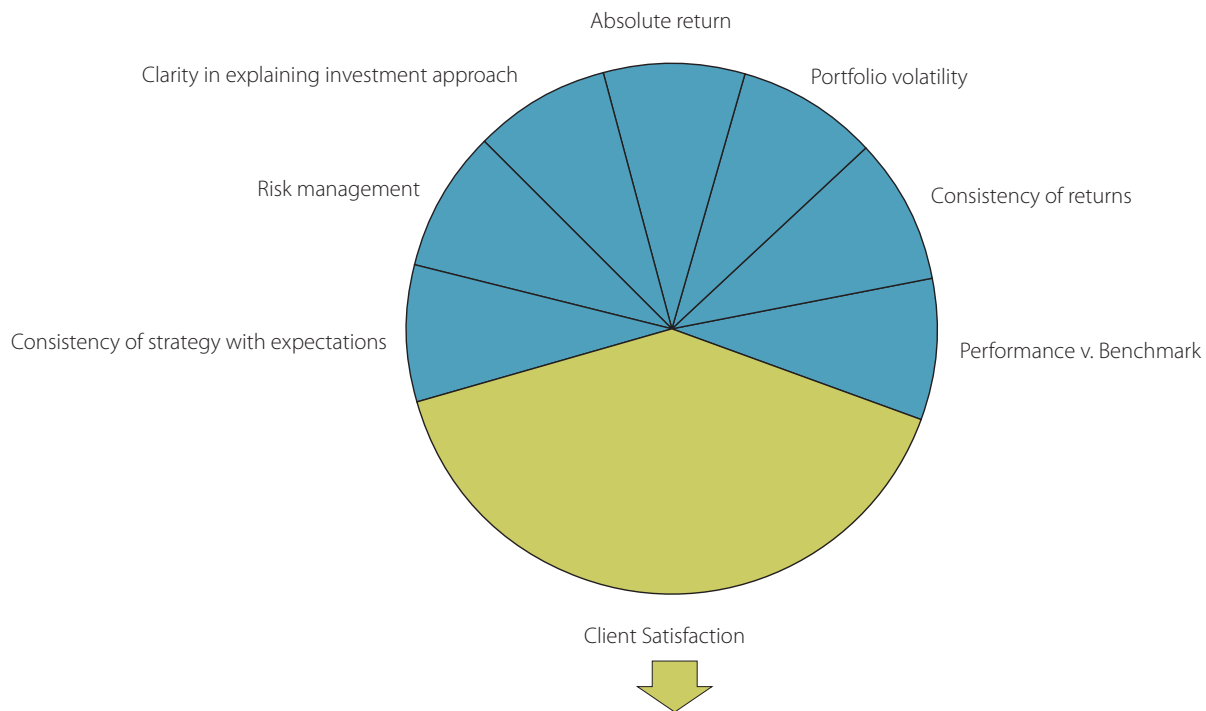
Using this data, Chatham examined the client service-related attributes most highly correlated to overall satisfaction to confirm that high-quality client service indeed impacts overall satisfaction. We then examined which specific client service-related attributes would have the greatest impact on institutional investors' satisfaction levels.

This quantitative analysis produced both good news and bad news. The good news is that client service indeed matters. While performance is still king, accounting for 60% of client satisfaction, there is clearly an opportunity for asset managers to differentiate themselves through superior client service. The bad news is that the research does not reveal any one client service attribute or “silver bullet” that when performed extremely well, leads to high overall satisfaction levels. Instead, there are a collection of service-related activities, shown in Exhibit 2, that together drive client satisfaction.

Exhibit 2 illustrates the drivers of satisfaction from data collected over multiple years from all of Chatham's investment management clients. Although performance-related attributes are collectively more dominant than service-related attributes, the variety of factors cited demonstrates that empirical investment performance is not the sole determinant in driving or predicting client satisfaction. In fact, Chatham's analysis suggests that it is only slightly more than half the story.

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Exhibit 2. Drivers of Satisfaction



Driver analysis is based on a multivariate regression analysis of survey responses 2001- 2008. The percentages represent the standardized beta coefficients divided by the sum of the coefficients.

Source: Chatham Partners

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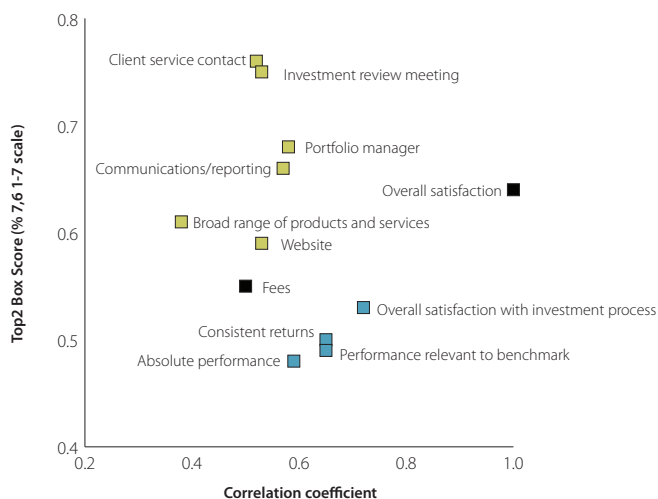
## HOW TO SATISFY CLIENTS IN CHALLENGING TIMES

Similar to the results shown through multivariate regression analysis, simple correlation analysis reveals that client satisfaction is the result of nuance, rather than an absolute judgment based purely on performance measures.

Exhibit 3 illustrates the correlation of various attributes relating to clients’ satisfaction with their managers. Whereas the drivers in Exhibit 2 were derived from surveys collected over a number of years, the correlation and level of satisfaction with particular attributes in Exhibit 3 spotlights only the 12-month period ending December 31, 2008, a year of disappointing performance results to say the least. The vertical axis in Exhibit 3 represents the level of satisfaction (based on a 7-point scale where 7 is very satisfied and 1 is very dissatisfied). The horizontal axis is the correlation coefficient with “overall satisfaction.” It can be seen that there are generally higher correlations among performance-related attributes than service-related attributes. However, the satisfaction levels of non-performance-related attributes are higher than those that are strictly performance-related. Paradoxically, the score for “overall satisfaction” is higher than one might assume given the challenges that 2008 presented.

This paradox, in and of itself, raises a more far-reaching question: are perceptions of performance in fact reflective of actual performance? In other words, what factors really drive satisfaction with investment performance? Are clients satisfied strictly by objective criteria and measurement or are they potentially influenced by subjective criteria which have little to do with their managers’ actual skill? Further, how are perceptions of such important

**Exhibit 3. Correlation with Overall Satisfaction (Chatham Universe)**



Source: Chatham Partners

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attributes such as performance, fees, and client service capabilities correlated to the level of satisfaction with an investment manager? Is it reflective of a particular point of time or is it constructed over a longer period and if so, what is that period?

### **PUTTING PERFORMANCE INTO PERSPECTIVE**

To answer the questions posed above, we analyzed Chatham Partners' data and Investment Metrics' InvestWorks investment manager peer universe rankings. Opinion Scores were based upon the Chatham Partners' survey data. Clients who were the most satisfied based on the Chatham survey data were given "highly satisfied" opinion scores, while those clients that were the least satisfied in the Chatham survey were given "dissatisfied" opinion scores. Performance Scores were based on peer universe rankings of institutional separately managed accounts/composites and commingled funds found in InvestWorks, where "high performance" scores ranked above median and "low performance" scores ranked below median.

The link between the Chatham Partners' data and the InvestWorks peer universe data was established by identifying common investment vehicles by asset management firm, asset class and style. For example, the Chatham survey shows that Investor A has a U.S. Large Cap Core Equity separate account investment with Manager D. A similar investment vehicle managed by Manager D was identified in the InvestWorks database, and used to estimate the peer universe rankings for Investor A's separate account. The peer rankings mentioned below relate to specific time periods ranging from short (one year) to long (five years). Analysis of these two discrete yet associated datasets reveals a variety of insights into the correlation of satisfaction with a particular function or outcome and overall satisfaction with an investment manager. Insights include:

#### **Long periods of high performance tend to mask short periods of under-performance.**

Clients tended to be highly satisfied with their investment managers and client servicing teams overall during long periods of high performance as well as during short periods of under performance. Further, this correlation holds true when examining performance on an absolute basis and through the lens of the consistency of the investment returns.

#### **Both investment performance and client service matter.**

During long periods of high performance, more than two-thirds of clients were highly satisfied with their investment managers and client servicing teams.

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During short periods of under-performance, more than half of all clients remained highly satisfied with their investment managers and client servicing teams.



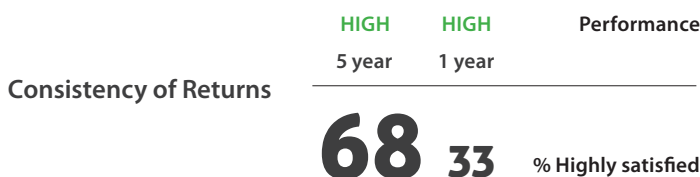
More than half of all clients that were highly satisfied with their absolute performance had high performance rankings over a long investment period.



More than two-thirds of all clients that were highly satisfied with their absolute performance had low performance rankings over a short investment period.



Over two-thirds of all clients who were highly satisfied with the consistency of their returns had high performance rankings over a long investment period.



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On average, 31% of clients who were dissatisfied with the consistency of their returns had high performance rankings.



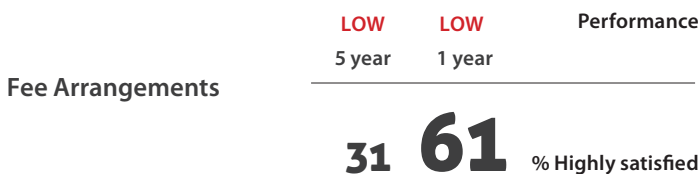
**Conclusion:** Clients are more apt to be highly satisfied during sustained periods of high performance, while giving some leeway to their managers during shorter periods of low performance.

### The correlation between fees and investment performance.

Over two-thirds of all clients who were highly satisfied with their fee arrangements had high performance rankings over a long investment period.



Nearly two-thirds of all clients were highly satisfied with their fee arrangements during short periods of under performance.



Nearly half of all clients were dissatisfied with their fee arrangements despite their performance rankings over a short period.



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**Conclusion:** The majority of clients who were the most satisfied with their fee arrangements had high performance rankings over longer periods or low performance rankings over shorter periods.

**Perceptions of long-term investment performance are shaped by perceptions of client service.**

In rating client service satisfaction levels, survey respondents were asked to consider all forms of contact ranging from direct person-to-person as well as published communications.

Performance rankings correlate with customer service.



The majority of clients were dissatisfied with their client service contact when performance was low over a long period.



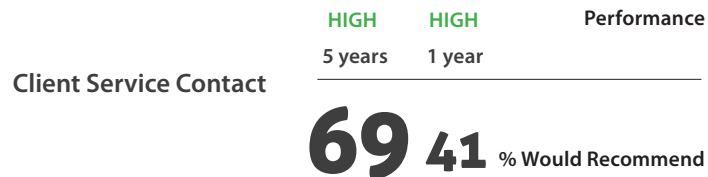
Two-thirds of all clients felt like they were treated as an important client of the firm during long periods of high performance.



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Over two-thirds of all clients who had high performance rankings over a long period would be more inclined to recommend their managers to others.



**Conclusion:** Nearly half of all clients with high performance rankings over a long period were highly satisfied with their client service contact.

### SUMMARY

The Chatham survey data compared with the InvestWorks peer ranking data reveals some critical insights for client service professionals in the asset management industry. Investment process/philosophy and investment performance were identified as the most widely-cited drivers for winning new business in the Chatham survey (Exhibit 1). Investment performance-related attributes were the leading contributor to client satisfaction, roughly 60%, versus client service attributes as the leading contributor to client satisfaction, at roughly 40% (Exhibit 2). When the Chatham survey responses were compared to the InvestWorks performance data, the results revealed that the majority of clients with longer periods of high performance (five years) were highly satisfied overall with their investment managers and client servicing teams compared to clients with a shorter period (one year) of high performance.

Does this finding imply that “newer” clients who are in the honeymoon phase of a firm’s relationship (<= one year) with good performance do not require as much attention from their client service teams as clients who had not-so-good performance? Looking at performance on an absolute basis over a short investment period, it appears that the majority of clients (>2/3) remained highly satisfied overall despite low performance rankings. In contrast, less than one third remained highly satisfied even though they had high performance rankings. More surprising is that less than half (42%) of clients with high performance rankings over a short period felt as though they were treated as a highly important client of the firm. This begs another question: are client servicing teams overperforming when clients are underperforming? Maybe not. It could also depend on the length of the relationship.

Roughly two-thirds of clients with high performance rankings over a longer period (five years) felt they were being treated as a highly important client. In other words, twice as many “established” clients with high performance rankings felt they were treated as a highly important client as compared to newer clients with the same high performance ranking

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status. Moreover, clients with longer relationships and good performance appear to be more willing to recommend their managers. Certainly there are a number of other, subjective factors that could have influenced client opinions here; however, the scores used for these comparisons were based on the overall ratings given by each client who participated in the survey.

Managers with longer tenure tend to get more leeway in terms of performance because there is a perception of a relationship and trust earned. Even though a manager with shorter tenure might have better performance, the relationship is generally defined by empirical measures. Client service is the embodiment or delivery mechanism by which one establishes a relationship and trust. To shortchange this dynamic is to cede one's future to the cyclical nature of investment performance.

### **METHODOLOGY**

The analysis compares the opinions of 1,726 survey participants to investment performance results. From 2007-2009, Chatham Partners surveyed the institutional clients of asset management firms to gather investors' overall satisfaction levels with their investment and client servicing teams, as well as their portfolio performance. Each institutional investment portfolio was then matched to comparable investment vehicles in Investment Metrics' manager research platform, InvestWorks, for an estimation of performance results.

Opinion Scores were based on the Chatham Partners' survey data. Chatham interviews thousands of institutional investors each year to help asset managers better understand why they get hired, or not. Clients who were the most satisfied based on the Chatham survey data were given "highly satisfied" opinion scores, while those clients that were the least satisfied in the Chatham survey were given "dissatisfied" opinion scores.

Performance Scores were based on the InvestWorks institutional database of separately managed accounts/composites and commingled funds. The data was segmented by asset class into sub-style categories and statistically ranked for comparison purposes. Over 40 style classifications were included in the analysis, representing U.S., International and Global Equity, Fixed Income, Balanced, Tactical Asset Allocation and Real Estate Investment Trust (REIT) strategies. The total combined asset value for all investment firms in the survey was approximately \$4.4 trillion.

Statistical rankings were assessed on a high to low continuum for all investment vehicles within a respective style category, where median is the middle value. The rankings data corresponds with the quarter-end period that most closely aligned with the survey responses (i.e., July survey data compared against June quarter-end rankings data).

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Investment products that had high statistical values (above median) within the Investment Metrics/InvestWorks peer universe were given a "high performance" score for their results, as compared to low statistical values (below median) which were given a "low performance" score for their results.

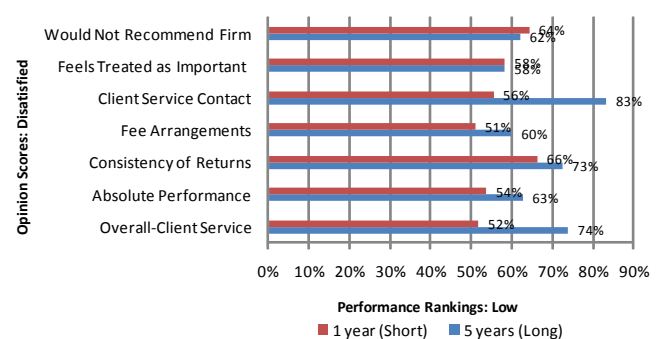
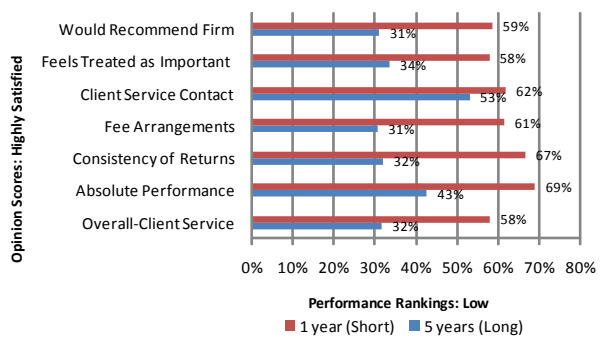
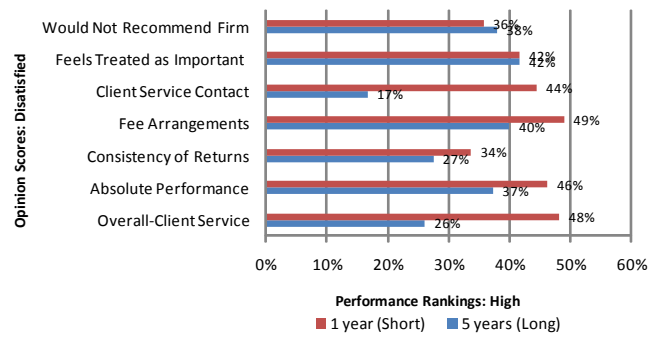
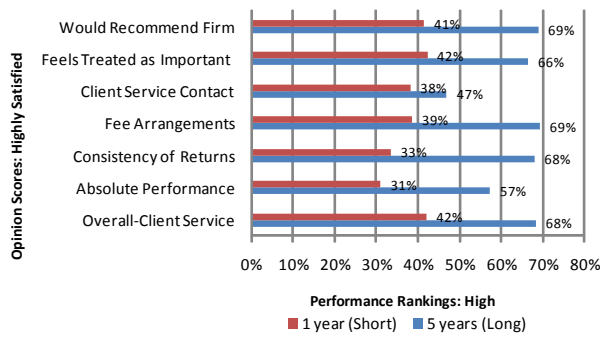
Note the opinion and performance scores were based upon two, mutually exclusive data sets.

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## APPENDIX

### Chatham Partners and Investment Metrics’ InvestWorks Data

Opinion Scores Compared with Performance Rankings



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### ABOUT CHATHAM PARTNERS

Chatham Partners provides customized market research and strategy consulting services that help businesses understand the explicit, implicit, and latent needs of clients and prospects. Our fact-based analysis and recommendations enable organizations to improve sales processes, client service/retention, product/service offerings, and market perceptions.

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### ABOUT INVESTMENT METRICS, LLC

Based in Darien, CT, Investment Metrics is an independent provider of investment performance and reporting solutions to financial professionals worldwide. Built by institutional investment consultants for investment professionals, our history of innovation dates back more than 40 years. Today, many of the world's most influential investment consultants, financial advisors and sophisticated investors rely upon the comprehensive solutions provided by Investment Metrics.

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