INSIGHTS

How Will Asset Managers Find Ways to Distribute Going Forward?

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For some time now, I have been contemplating the distribution path for asset managers in a shrinking (too many players in a changing demographic and low return world) marketplace under significant (and not ending) fee compression path. If you are a large and undistinguished asset manager, you are just going to slowly bleed to death. If you are a small, niche player, you need scale, and if you have the scale and offer a mix bag (spaghetti at wall phenomenon) of active, factor and passive solutions without true distinction and differentiation, then lowering fee is the natural response in hope of starving out your opponents.

“Merge-or-innovate-or-die” model is being played out in the recordkeeping space as well. Conflicts and fiduciary prudence aside, Fidelity, Vanguard and TR Price, among other asset managers, have long figured out that owning a direct conveyor belt to the end widget users is a smart business when you are a widget maker. We all learned early in life that the shortest distance between two points is a straight line. So, a widget maker having direct access and distribution to the widget consumer is the most efficient and sticky way to sell widgets. If intermediaries (consultants, advisers, RIAs, brokers, wealth managers, etc.) want to hook onto the distribution chain, they are welcome. If the widget they want to sell comes from other widget makers, then just pay a toll charge. This almost sounds like Amazon. Recordkeepers is one group that has the superhighway (albeit a bit antiquated like the US highway, rail and port system today) to the widget users. What we need to think about is how to get recordkeepers and asset managers together and distribute directly and in competition without fear (such as a Fidelity or Vanguard) with all intermediaries. After all, intermediaries are gunning for them. Recordkeepers have the data and intermediaries want them so they can go after the widget users directly.

I have always believe that if the value you provide to and the benefits received by your clients are deficient or just common, you will lose all clients one day; it is only a matter of time. The flip side of this argument is the same. For asset managers and recordkeepers, they should not be fearful of competing with the intermediaries who bring them business. If they take no action and stay within their lanes, companies like Fidelity will own the world and peel off most clients, one day, because they are truly Omni-Channel.

So I am not surprised to see the following “opinion” piece in today’s FT. Market pressure blurs the line between US asset and wealth managers. The real question is how will asset managers find ways to distribute going forward in a world of scarcity rather than abundance. We are in the midst of a bloodbath that will continue as boomers march off to retirement at a rate of 10,000 per day. I say, be bold and disrupt yourselves by leaving your secured past behind. Otherwise, you will be disrupted and become irrelevant.

Squint just right and the US asset management industry is beginning to resemble that of Europe.[1]

American colleagues often say Europe is about proprietary distribution via bank networks, while the US is all rough-and-tumble, survival-of-the-fittest open architecture.

They point to the disproportionate share of fund flows that go to bank-owned asset managers in some of Europe’s largest markets, notably Germany and Italy, and the US’s predominantly third party marketplace. But times are changing.

In the US in the mid-2000s, the big full-service wealth managers had sizeable asset management units that pushed their products largely internally. But starting in 2005, many were offloaded due to regulatory pressure (ie, the conflict of an adviser recommending their own firm’s more profitable product over an outside one) as well as in response to the financial crisis. Merrill Lynch sold its money management business to BlackRock while Morgan Stanley offloaded Van Kampen to Invesco.

Few US asset managers sold direct to retail consumers and the overwhelming majority of flows were via intermediaries. There were a few exceptions, including Fidelity, Vanguard and T Rowe Price, but in general the roles were clearly defined: the asset managers, as “manufacturers” sold on a wholesale basis to the broker-dealers, the “distributors” that owned the retail relationships.

A similar, stark demarcation existed in the institutional arena: asset managers forged relationships with investment consultants who, in turn, advised public and private pension funds. Now the lines have blurred due to developments including the growth of passively run ETFs and downward pressure on fees, greater regulation and technology. Even so, little attention is paid to how the various players increasingly sidle on to each other’s turf and the implications of that.

More and more, the companies that own the relationship with end-investors focus on expanding their own asset management capability — a reversal of the accepted wisdom at the time of the financial crisis. Examples abound, including Raymond James’ Carillon

[1] Market pressure blurs the line between US asset and wealth managers
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https://www.ft. .com/content/b5112ee5-922b-34ea-9b5f-eb5b249bf46d?segmentId=ccb77210-8a19-54fa-1c97-2b277de6567c

Tower Advisers arm, Edward Jones' rapidly growing Bridge Builder fund line-up, and Charles Schwab's Laudus funds.

The point is best made by looking at Morgan Stanley and its Morgan Stanley Investment Management business. James Gorman, Morgan Stanley chief executive, has said he intends to double the size of MSIM to at least $1tn in assets, and that selling Van Kampen was a strategic mistake. Not unrelatedly, more asset managers have forged relationships with end investors and sell directly to them.

The size of direct-to-consumer businesses at Fidelity and Vanguard has grown dramatically, while in December BlackRock and Microsoft announced a partnership to bring technology-based investment and planning solutions to address America's vexing retirement savings shortfall.

Details of this venture are scant but my bet is it will involve investors being offered BlackRock products and services on a direct basis supported by a seamless technology platform developed by Microsoft.

The industry is seeing the change. According to Strategic Insight, of the top 10 asset managers in the US ranked by 2018 net inflows, five are either part of an institution that owns the client relationship or are companies that primarily sell direct to the consumer (not counting MSIM in 11th place).

Some of this reflects a tug of war over shrinking revenues associated with managing portfolios of investors of all stripes.

As with any industry, if the ultimate price the customer is willing to pay shrinks, providers need to cut costs to preserve margins. Wealth managers have shrunk the shelf space for outside managers and increased the price of entry to their systems, in addition to slowly taking on asset management activities. Likewise, asset managers have sought out new ways to distribute their capabilities.

Is all this a cause for concern? Do regulators need to save investors from conniving asset and wealth managers driven to bend fiduciary obligations? Time will tell, and no doubt there will be some bad actors.

Most of these developments, however, serve to lower the cost borne by investors, and the response to declining margins will more often be the consolidation of small and midsized providers, rather than anything nefarious.

There is no doubt that the environment is now more complex for asset managers. Chief executives will have to put more focus on corporate strategy and how to deploy finite resources. Some will be up for the challenge while others will wither, probably to be acquired.