The Biggest Asset Managers Are Playing to Win. What Are the Rest Doing?

By Steven Miyao

The asset management industry is facing a time of significant disruption. Over the past year, I have been focused on helping our clients understand four mega-shifts in the market that every executive has to tackle. I view these shifts as a wake-up call to all executives who believe that incremental changes are sufficient to position your organizations for the future.

ARTIFICIAL INTELLIGENCE

Machine learning, natural language processing, and advanced analytics will move the needle on technology that can replicate human interactions. Artificial intelligence (AI) is already part of our consumer experience in the form of machine-generated content and recommendations. As the asset management industry continues to evolve, there will be an ever-growing chasm between those organizations that embrace data and technology and those that don't. In fact, I believe that in the very near future it will be a competitive requirement that asset managers utilize AI throughout their distribution, operations, and portfolio management functions. These technologies will allow distribution teams to focus the right resources on the right advisors with the message at the right time. Although the large, scale players in the industry may find it easier to invest in AI and machine learning (as they did throughout 2017), one could argue that these technologies are potentially even more critical for small and mid-size managers, who cannot afford to compete using traditional approaches to running sales and marketing. It is critical that firms identify and add the right resources (through hires or acquisitions) or partner with third parties that already have technology infrastructure and analytics expertise.

DISINTERMEDIATION

As data become more available, market players merge and new forms of advice appear. The middle layers of distribution and service consolidate. The result will bring customers closer to manufacturers. A few broker-dealers and platform providers already are building out their own investment products, including the creation of proprietary exchange-traded funds (ETFs) and mutual funds. They also are increasing their investment advisor capacity by acquiring asset managers or partnering with investment consultants. A number of asset managers already have acquired or built technology and automated portfolio providers to provide the option of going direct to market as intermediaries take more control of the portfolio management process.

FEE COMPRESSION

Transparency and regulatory changes are compressing fees and challenging business models. They are indicative of a long-term trend that could lead to the elimination of management fees as we know them, leading to a new pricing paradigm. Investors no longer will pay for actively managed funds that do not deliver results. Asset managers need to clearly showcase the value of their products so that investors are willing to pay a premium. Otherwise, asset scale and operational scale are absolutely necessary to survive in a low-fee environment.

DECLINE OF MUTUAL FUNDS

Mutual funds have gone from being the primary option for co-mingled investing to one of many available options, a shift that has broad ramifications across the industry. Asset managers should see themselves as more than just '40 Act managers. Firms need to be flexible and thoughtful in the delivery of their intellectual property to distributors by prudently considering how each investment strategy can be optimized to deliver on investment objectives and minimize the impact of cost and tax on returns. This requires the consideration of multiple product wrappers, such as ETFs, separately managed accounts, interval funds, etc. It also means examining how technology assists in the application of these options in client portfolios.

STAYING AHEAD OF CHANGE

I believe it will be hard for us to recognize the industry in five to 10 years. I urge all executives to force themselves to think about these four mega-shifts and assess how nimble and bold they must be to adjust to this new era of asset and wealth management.

Asset managers need to consider making the changes discussed below, and advisors must rethink their businesses for the future to provide holistic wealth management. Technology has changed the game already, even before the likes of a technology giant such as Amazon or Google enter the market and disrupt the space.

Investors will start questioning the need to pay a human 125 basis points (bps) for asset allocation when a robo-advisor charges 0–75 bps for the same service. Advisors will have to provide holistic wealth management that supports clients with a host of major life decisions, from retirement planning to their kids' college applications. In fact, the majority of wirehouse (73 percent) and independent broker-dealer (67 percent) advisors already believe that their continued transition to advisory platforms enables them to take a more holistic approach to managing client assets.

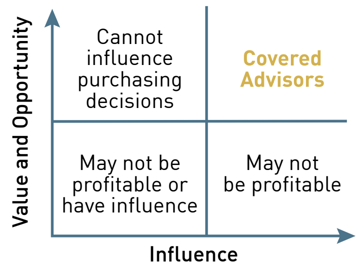
The long-term winners are going to be registered investment advisors, already the fastest-growing advice segment, and other fee-only advisors who service the high-net-worth investors. The remaining investors don't have enough assets for wealth management firms to support them with humans, so they will be serviced through mostly or fully automated advice. This likely will lead to substantial advisor consolidation as the role of technology increases.

Many executives are fearful of the change that is coming to the industry and simply hoping for the glory days to return. But many of the largest asset managers are taking the turmoil in the industry seriously, investing heavily in data and national accounts, changing the role of wholesaling, and de-channelizing.

Strong markets continue to drive record assets under management (AUM), lifting asset-generated fees. Operating margins rose once again in the third quarter of 2017 and AUM grew by 13.2 percent year-over-year. This may seem like great news for the industry, and in the short term it is certainly a welcome reprieve. But when you consider the broader perspective, it actually masks the real problems facing the majority of active asset managers.

Figure 1

DISTRIBUTION TEAMS SHOULD FOCUS ON VALUE, OPPORTUNITY, AND INFLUENCE



For the past two-and-one-half years, we have seen negative flows of ~$500 billion in active funds and active ETFs. At the same time, more than $1.3 trillion have poured into passive funds and ETFs. What will happen if the eight-year bull market stops and markets no longer drive assets and fees higher?

The biggest asset managers are not waiting to find out; they are choosing to take action now. Here are five observations that I have made about how the largest firms are reacting:

The largest firms believe that data-driven insights drive distribution strategies. The largest firms are investing heavily in data infrastructure and analytics. They have elevated or hired a senior distribution executive to oversee business intelligence efforts, brought in data scientists, and are ingesting broker-dealer data packs for both mutual funds and ETFs. On the flip side, business intelligence teams at many other firms are underfunded and underappreciated, mostly focused on reporting and tactical campaign support. The leading firms also are redefining how they think about opportunities in the market. Traditionally, asset managers have focused territory design and segmentation approaches on a simplistic understanding of where opportunity existed. Opportunity was viewed as all sales—the more, the better. Leading firms are recognizing that they need to take a more-sophisticated approach to targeting that takes the real opportunity into consideration, as well as their ability to influence the sale.

An asset manager's true opportunity is based on the specific buying habits of an advisor or advisory team. If the manager's products are not competitive regarding fee or performance, relative to the products used by that advisory team, then there likely isn't an opportunity to generate sales. At the same time, salespeople are unable to influence all advisors to sell their product. In fact, our research, in association with Horsesmouth, has found that only 36 percent of advisors directly control investment decisions for their clients, with the remainder outsourcing decision-making to other members of their teams, home offices, or third parties. Some leading asset managers already are recognizing the importance of utilizing as many data sources as possible to identify true opportunity and "influence-ability," enabling them to cover only the right advisors.

Resources are being shifted away from sales to national accounts. Recognizing this shift in decision-making from individual advisors to the home office, third-party models, or other members of teams, most asset managers plan to expand their national accounts efforts by adding more people to cover their focus firms. It is important for asset managers to increase the size of their teams, as well as to align their marketing efforts with that of their national accounts team.

The role of the wholesaler is changing and firms are rebranding salespeople. As financial advisors' practices evolve to offer a holistic suite of services to clients, salespeople from asset management firms are having to evolve likewise. No longer called "wholesalers," these advisor consultants, investment consultants, market leaders, and other recently retooled wholesalers are starting to provide holistic solutions for the advisors they support. Leading firms are elevating their rising stars to head sales-training efforts, ensuring that their salespeople can face off against the most-sophisticated advisors.

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The industry generally is moving away from channelized sales. Many asset management firms are using business intelligence to model sales territories and cover their best opportunities, regardless of which channel they are in. These firms are recognizing that the lines between traditional distribution channels have blurred significantly. For some asset managers, this means having multiple people in a territory, including internal salespeople, hybrid salespeople, client portfolio managers, and external salespeople. Overall, sales teams are getting more targeted and operating more strategically, all driven by the recognition that they should cover only those advisors who influence the ultimate investment decisions with salespeople.

Are internals still working? At most firms, internal salespeople have experienced a significant drop in call volume. Many are now shifting resources from internal sales teams to analytics or hybrid wholesalers. Some are bucking that trend and increasing the size of their internal sales teams, but doing so by arming them with data that provides them with specific opportunities. These organizations believe that the right analytics can make internal salespeople successful. Our research shows that internal salespeople can be successful if they target the right advisors, know what those advisors hold in their portfolios, and are able to have in-depth, portfolio-level discussions.

CONCLUSION

I believe the industry will change more in the next decade than it has in the past 30 years, and only half of existing asset managers and broker-dealers will survive the next five to 10 years. My recent discussions with senior executives across the industry have bolstered my views. Many of the largest firms are actively questioning every aspect of their strategies. Much of the rest of the industry, meanwhile, appears to be taking a far less ambitious approach—tweaking, rather than fundamentally rethinking, their distribution strategies.

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