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The Institutionalization of Retail

Levering Wealth Market Paradigm Shifts to Drive Growth

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Kingsley Gate Partners is transforming executive search with the introduction of Synchronous Fit. This framework focuses on improving the Accuracy, Velocity, Transparency and Accountability of our executive searches.

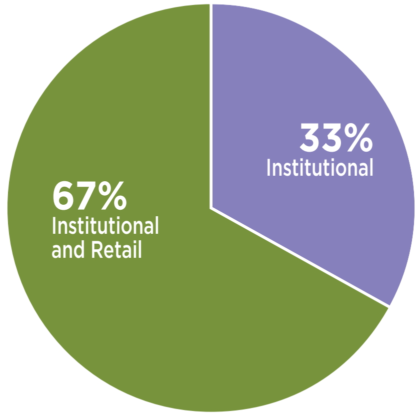
Chestnut Advisory Group provides business development consulting to asset managers. Our services encompass strategy, content and implementation.

The retail marketplace is becoming institutionalized while also growing at more than twice the rate of the institutional marketplace. Asset managers must increasingly overcome institutional-like hurdles standing between them and new retail asset flows, such as model portfolios, shrinking approved manager lists, and investment consultants.

Retail-focused asset managers are scrambling to adjust to the new paradigm. The traditional retail sales and marketing approach is no longer effective. An effective retail solutions sale today calls for sophisticated talent that can create and deliver effective client messaging and engagement, as well as success in working with investment consultants.

Institutional asset managers face an attractive long-term growth opportunity in retail today. The ability to pivot into select retail segments has driven substantial growth at several managers who have made the necessary strategic investments. Managers do not need to hire large numbers of people to successfully enter the retail space. The timing to create, restructure or upskill hybrid retail/institutional sales and marketing teams has never been better.

Most Asset Managers Have Combined Retail and Institutional Marketing Responsibilities



Source: Chestnut Advisory Group

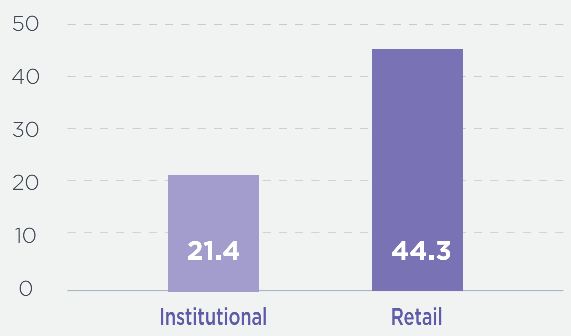
The Institutionalization of Retail

'The Institutionalization of Retail' is the term we use to describe changes in the retail investment distribution landscape. Due to these changes asset managers today can reap substantial opportunities, but must also deal with some real challenges. Based on the extensive research and experience of Chestnut Advisory Group and Kingsley Gate Partners providing strategic sales, marketing and talent management advice and services to asset managers, we have identified best practices asset managers can use to successfully grow their retail business.

Retail Assets are Growing Faster Than Institutional Assets

The retail segment of the investment marketplace is larger and growing much faster than the institutional segment. In 2019, total global retail AUM grew by 19%, while institutional AUM grew by only 13%.* Over the next five years retail assets are expected to grow by some $44 Trillion – **more than twice the growth of institutional.**

Estimated AUM Growth 2020-2025 ($ Trillion)



Source: PwC

Due to the changes in the retail investment business we describe on the following pages, **this growing pool of retail assets represents an opportunity for successful institutional asset managers.** Retail asset managers will need to up their game to maintain market share for the same reasons.

* Source: BCG

The 'Golden Age of Retail Sales' is Long Gone

In the Golden Age of Retail Sales (an era we estimate started in the 1960s and ended around 2008), a successful asset manager retail distribution strategy had four key elements:

- A broad multi-channel marketing campaign focused on brand awareness
- A large salesforce of wholesalers armed with strong relationship-building skills and generous travel and entertainment budgets
- The ability to arm the salesforce with product-pushing narratives highlighting historic investment performance
- The agility to pivot messaging to effectively promote whichever product faced the highest demand at any given time

'Golden Age' Advisors Had Wide Discretion Over Client Accounts....

In the Golden Age, most individuals invested their wealth with an advisor who had virtually full discretion over the client's portfolio. Most advisors during that time had the freedom to invest their client's assets as they saw fit, without much pressure from central decision-making authorities. Before the internet boom and more recent fintech developments, advisors faced a narrow set of competitors, most of whom were offering similar services.

...and A Relatively Narrow Set of Investment Choices

The investment choices available to advisors and their clients in the Golden Age were more limited than today. Complex regulations and the relative newness, complexity, obscurity, and illiquidity of alternative asset classes led to widespread avoidance of alts by most traditional retail advisors until recently.

> "On the retail side, it's a brave new world. Things have completely changed from even 4-5 years ago."
>
> - Large Long-Only Asset Manager

Retail Today: Model Portfolios, Solutions, and an Outcome-Oriented Focus

Today, most advisors – whether they're at a regional broker/dealer, an RIA firm, or a wirehouse - have surrendered the investment management function to a centralized platform. Wealth advisors increasingly use model portfolios for their clients. These are designed by sophisticated investment research teams embedded in their organizations' home offices. At major wirehouses as well as at independent RIA firms, with or without a requirement to use a model portfolio, there is an increasing reliance on centralized portfolio construction and compliance. This has resulted in very little client account discretion being left to the individual advisor.

These systemic changes have freed wealth advisors to spend more time on "higher value" functions such as client acquisition, practice management and nurturing existing client relationships.

The New Gatekeepers for Retail Portfolios: Institutional Investment Consultants

Institutional investment consultants play an increasingly large role advising and creating retail portfolio models. Consultants are now advising boutique and regional RIA firms as well as the home offices of larger wirehouses. In several instances, wirehouses are purchasing consultants' manager buy lists and even completely outsourcing manager due diligence to a consultant.

As a result, receiving a strong "buy" rating from a major investment consultant's manager research team is now effectively the first step to accessing retail asset flows. This creates an excellent opportunity for institutional asset managers already skilled at navigating the consultants' research processes.

> "You can't ignore consultants – you must accept that those firms are the primary driver of your retail success going forward."
>
> - North American Head of Retail Sales,
> Large US Asset Manager

Beyond the Consultant's Buy Rating

While obtaining a consultant's buy rating is important, this is only the first step to asset growth.

> "Once we get on the buy list you still need somebody regionally/ locally to have relationships on the ground and get them to buy. We've spent a lot of time educating our wholesalers to make that approach more consultative, not just bringing pizza to the office but helping them build portfolios. We've added new functionality to do portfolio construction and risk analysis for the FAs..."
>
> - Top 20 Asset Manager

Additional strategic steps we recommend for asset managers aiming to successfully grow their retail business today include:

Institute substantial, ongoing and online advisor education programs
Financial advisors today have little interest in purely social activities sponsored by asset managers, while the social distancing brought about by the COVID-19 pandemic has for now virtually eliminated opportunities to entertain advisors in person. Asset managers most effectively engage with advisors today using virtual meeting technology to deliver relevant content, value-added programming, and advisor practice management initiatives. The goal of these programs is to prepare advisors to articulate and embrace new market trends and product use cases within client portfolios. This has significant talent implications for sales reps.

Institute consistent brand narrative campaigns that highlight relevant strategies and solutions expertise to drive traffic to your firm
Messaging must highlight the way a manager's strategies and solutions will play an important role in the wealth clients' investment portfolios – what Chestnut Advisory Group refers to as the manager's "why". Brand recognition itself doesn't go far enough any more.

Create and employ a different operating infrastructure
Asset managers will need to offer the right investment vehicles, and address retail needs in alternative asset classes (for example, alternative investment product specialists, educational seminars and access to relevant investment talent).

> "Everything we do in private wealth is intermediated. We don't sell to individuals. This channel will continue to get more complicated to sell to over time."
>
> - Top 20 Asset Manager

Organizational Commitment is Required

The changes to retail distribution we have described above have made the Golden Age sales approach of a large wholesaler network with a relationship-building focus increasingly obsolete. The COVID-19 pandemic has accelerated this trend. While there is certainly no "one-size-fits-all" approach to structuring the best team and resources to approach the reality of today's wealth segment, we believe managers building a wealth distribution effort should consider and address the following market segments:

The Wirehouses

As we noted previously, wirehouses such as Morgan Stanley, Merrill Lynch, UBS and Wells Fargo, are consolidating their manager lineups and driving toward more model-driven client portfolios. It is important to note that this trend to consolidation coincided with the DOL Conflict of Interest Rule implemented in 2017. The full implementation of this rule was delayed until 2019; however, many of these wires already made plans to adapt. The major broker/dealers are using the rule as a pretext to narrow down their product line-up and revamp asset allocations in a stricter regulatory environment. This has accelerated fee pressure and exacerbated an already competitive landscape. Therefore, we advise managers to downsize the number of resources they are allocating to the wirehouses, even though these still represent potentially large flows, and focus resources instead on other platforms like regionals and independents.

The largest RIAs…

…are expanding at a more rapid clip than other wires or broker dealers (near a 10% 5-year CAGR). The most successful advisor teams are leaving the wire platforms for smaller, nimbler aggregators (e.g., Hightower, United Capital, Rockefeller Capital, etc.) We advise managers to shift a greater proportion of their resources to these larger RIAs given their pace of growth and the way they have been inefficiently covered by managers to date.

> "Market segmentation is more important than ever for success in retail."
>
> Large Asset Manager

Independent and regional RIAs…

…are fragmented and underserved by asset managers. While penetrating this market would require managers to invest meaningful resources, these advisors generally embrace the attention they get from managers who take the time to get in front of them in a focused, pragmatic, value-added way. Shifting resources from wirehouse coverage to these client segments will likely ensure a greater long-term return on investment.

Investment Consultants

As a result of the reliance of wealth platforms on investment consultants that we noted earlier, effective asset manager coverage of this market segment is at least as critical for success in the retail marketplace today as it has been for decades in the institutional marketplace. Some managers are dedicating specific resources to covering these platform consultants, while others are augmenting existing institutional consultant relations teams with a deliberate focus on these consultant intermediaries.

National/Key Account distribution teams at asset managers…

…are a legacy of the 'Golden Age' and in many cases would benefit from a strategic realignment with the current marketplace, perhaps by more closely coordinating with, if not merging with, those firms' institutional consultant relations teams. Ironically, many asset managers continue to hire and staff traditional key accounts teams despite evidence pointing to diminishing returns.

As Retail and Institutional Markets Converge, Managers are Combining Sales and Marketing Responsibilities

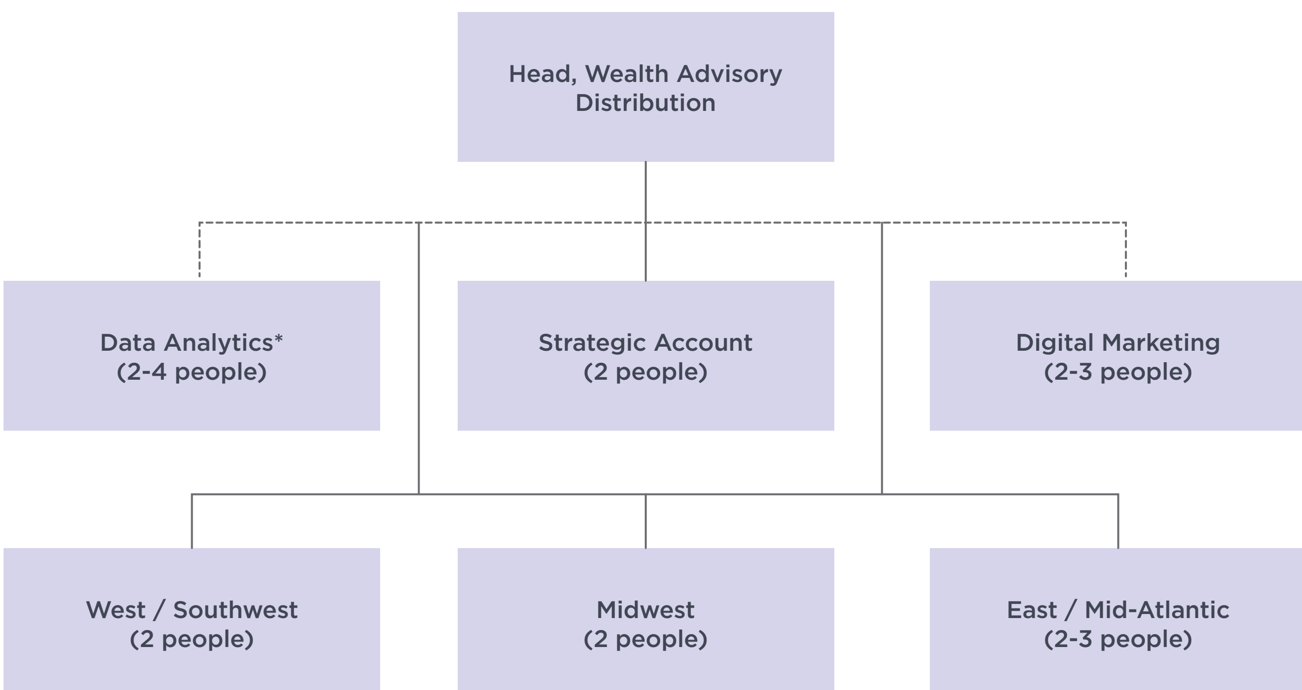
In a recent Chestnut survey of asset management Chief Marketing Officers, sixty percent of the respondents create their retail and institutional messages together. Sixty-seven percent of respondents reported that retail and institutional marketing is now managed by a single team.

> "We have found the retail sales process is extremely similar to the institutional sales process. It makes perfect sense for a marketing team to have oversight of both."
>
> \- Medium Manager

> "The caliber of the wholesalers has gone way up. We are investing a lot in our salespeople so they can talk the talk and that will only increase from here."
>
> \- Large Asset Manager

Asset managers trying to move with the changing marketplace face challenging decisions around talent management
Should they attempt to re-train or upskill existing employees? Or is it more effective longer-term to hire and train new wholesalers who bring the education, training and sophistication level which is now needed? Either way, the new breed of sales professional (often requiring a CFA or similar designation) must be able to engage in technical conversations around products and portfolios – but still build strong relationships.

Addressing these challenges need not require large-scale hiring. The diagram below, provided by Kingsley Gate Partners, illustrates how a fledgling wealth advisory distribution team could be structured within the context of an institutional asset manager:



*May or may not report directly to Head of Weaith Advisory or may have dual reporting to central marketing or digital / I.T. structures.

To manage talent effectively, it is imperative that asset managers properly align the sales incentive structure

Net flows need to be the performance measure, not new flows, as salespeople should also be compensated for retention of clients. They also must be compensated for what is now a significantly longer sales cycle, which means using trailers or discretionary bonuses to drive desired retention and servicing activities.

Organizational and talent issues extend beyond the sales team

Institutional asset managers entering the retail arena must also consider whether they can get "buy in" from portfolio managers accustomed to managing portfolios for non-taxable clients. Portfolio managers, product specialists and client reporting teams also must learn and adjust to the servicing requirements unique to taxable clients.

Conclusion – The Institutionalization of Retail is Here

Retail platforms have already changed the way they do business with asset managers, how they hire and deploy their own people, and how they leverage technology. Many traditional retail asset managers have not evolved with this reality, leaving an attractive opening for managers who can exploit these dislocations to build their own relationships and drive net new AUM growth in a far more focused and cost-effective way. Institutional managers willing to make the long-term business commitment will find themselves well-suited to benefit from this new reality.

ABOUT THE AUTHORS

Paige C. Scott

Paige Scott is a Senior Partner and Leader of the Asset Management Practice at Kingsley Gate Partners. She was most recently Managing Director and Head of the U.S. Asset Management Practice and member of the U.S. Executive Committee of a global financial services retained search firm. Over a career that spans more than two decades, Paige has had leading roles in building out the U.S. Asset Management Practice of Sextant Search Partners and served as a Senior Client Partner in the Asset Management Practice at Korn/Ferry International. She infuses this experience with Kingsley Gate's state of the art scientific, cloud based tools to assess candidates to ensure the executives that she places have the best holistic fit with her clients.

Paige has placed countless investment professionals spanning CEOs, CIOs, PMs, and Senior Analysts (multiple asset classes); Heads of Distribution across institutional, retirement, sub-advisory and intermediary channels; Strategic Relationship Leaders; strategic & digital marketing experts; solutions and product experts throughout North America. When using Kingsley Gate's Synchronous Fit® framework, she utilizes relevant data from hundreds of these searches to ensure success. She is considered a thought leader on topics such as compensation structure and design and is a regular speaker at the European Institutional Investor Institute, The Global Fixed Income Forum and the European Institute. She was an organizing member of 100 Women in Finance, Boston and serves on the Advisory Council of 100 Women in Finance.

Paige earned a bachelor's degree in French Literature from Wheaton College in Norton, Massachusetts. In addition to serving on the Advisory Council of 100 Women in Finance, Paige currently serves as President of the PRT at San Carlos Learning Center, California's first established Charter School. Paige is based out of the firm's San Francisco location.

Amanda Tepper

Amanda Tepper is the founder and CEO of Chestnut Advisory Group. Amanda honed her expertise in asset management business development throughout her investment management career. Prior to founding Chestnut, Amanda served as Global Director of AllianceBernstein's senior portfolio management team, a group that crafted and delivered the firm's investment insights to institutional and retail clients and consultants. Amanda developed deep experience in sell-side equity research as Associate Director of Equity Research at Bank of America and as an *Institutional Investor* All-America Team- ranked analyst at JPMorgan. Before moving to the sell-side, Amanda spent five years as an investment banker in JPMorgan's retail industries group. She began her investment career on a corporate bond trading desk.

Amanda holds an MBA from The Wharton School and a BA from Brown University, Phi Beta Kappa. Amanda is a member of the Investment Advisory Committee for the Endowment of the Art Students League of New York. She also serves on the Andover Development Board of Phillips Academy, and is a former member of the Global Advisory Council for 100 Women in Finance.

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