INDUSTRY INTERMISSION OR DEATH KNELL?

Whilst the exact origin of the death knell is unknown, the term is thought to exist from old English times when a bell was sounded to announce a death or the extinction of something. So with the New Zealand financial services industry experiencing the greatest flux for decades, the question is being asked whether we are going through an intermission or are we starting to hear the far-off tolling of the death knell?

As someone who has participated in the financial services space for nearly three decades, I believe that the New Zealand industry is on the precipice of one of the most exciting moments in recent history. Never before has the New Zealand financial services industry reached such a pronounced juncture requiring all industry participants to pick a corner. For some this will be a useful pause before opportunity raises its head, whereby for others it seems that their bell is tolling.

In preparation for this article, I attempted to gain a sense of the number of managed investment products that are available to Kiwi investors – before discovering that there really is no accurate survey available. My sense is that there is too much product available for an audience of circa four and half million potential consumers - probably less than one million consumers in reality. Outside of this world of managed investments, there are hundreds of listed companies available for direct investment, as well as countless debt instruments, properties, foreign opportunities and plenty of other investment schemes competing for the same dollar. Clearly the consumer is spoilt for choice, albeit that they are under-whelmed with quality independent research (more on that later).

Within this new paradigm investment manufacturers will increasingly differentiate themselves to attract the attention of potential investors. This differentiation will be by price or the colourful packaging of investment talents or offerings. The majority of institutional financial services entities will tend to opt more for high volume low margin offerings sold through tied or aligned distribution, with price and brand being their distinguishing proposition. Moving forward these investments will be increasingly marketed on the basis of investment philosophy or process, and away from the perils of promoting the fickle and portable talents of individuals or investment teams. The performance outcomes will tend to be index or quasi-index-like as the institutional risk management boffins seek to minimise the brand and operational risks for their masters. The natural audience for these products will be those consumers who are unable or unwilling to pay for ongoing investment advice, prefer low volatility investments (relative to meaningless benchmarks) that are managed by reliable brands, and who are comfortable accessing their investment solutions through a no / low-advice mechanism. Any true investment talent that is currently sheltering from the GFC hangover within these large institutional houses will increasingly poke their heads out in coming years, with an inevitable growth in boutique investment shops. This in itself creates a number of dilemmas for industry participants including distribution dynamics and robust capabilities research - but more about that in a moment. The price paid by consumers for the investment skills of the boutique community will be more about an alignment of interests, with performance fees being an obvious choice.

In short: there will be significant consolidation within those commoditised investment products that rely on price or brand to differentiate themselves, with the sound of the death knell getting increasingly louder. Many institutions will already be running the profit & loss ruler over each of their products, seeking ways to consolidate, increase their operational leverage or exit their shareholders from the burdens of operating under-performing products. In time this will create unique opportunities for those with investment talent and/or profiles - albeit with a number of interesting challenges along the way. The unknown factor in this puzzle will be the continued withdrawal of foreign players from the kiwi industry requiring advisors and consumers alike to undertake deeper assessments of the shareholder's commitment to the New Zealand asset gathering business. The point of this prediction is to demonstrate the increased pursuit of bottom line profits by institutional manufacturers and distributors of investment products.

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To assist, a clear winner will be those research entities who can add value by assimilating the volumes of product into a more digestible form. The trade off here is having the analytical size and capabilities to efficiently assess a large volume of information, categorising it into various buckets, and having the results add some sort of value to recipients. The shear extent of this filtration process tends to favour global (at least Australasian) researchers who have the ability to articulate their views in a concise and accurate way, and who have demonstrated over time that their approach adds some degree of value.
Whilst not wanting to appear contradictory, the size and economics of the New Zealand industry means that there is probably only room for 2 such research entities to prosper and therefore remain committed in this space. Either way, the industry support of external research will be forced to go from minimal to obligatory in the blink of a Regulatory eyelid, delivering boom times for some and the loud thunk of the death knell for others.

Those financial advisors who currently conduct their own research may find an unsympathetic ear from the Regulator when challenged to demonstrate their capabilities in this space. Contrary to popular belief (and the occasional Regulatory foot n' mouth), the objective of the New Zealand financial services watchdog is not to stifle business, but to provide a fair and equitable environment for consumers to participate. Until now, the odds have been heavily stacked against the consumer, with poor financial advice being dispensed by a financial services industry which has attracted a significant number of opportunists, and product floggers. Going forward the dispensers of financial advice will need to figure out whether they are best positioned in selling products to a low-touch audience of consumers, or operating in the abundantly competitive high touch-space.
The oncoming challenges that are being signalled by (amongst others) the Regulator will encourage many industry participants to lean towards the perceived security of institutional big brothers. In turn, they will be demanded by their new masters to promote those financial products and services that best serve the ambitions of their shareholders. To bastardise a phrase: "any colour you like as long as it's ours" will be the mantra going forward. And this is ok - as it will provide consumers with an easy to understand gateway into the world of financial services, which will largely be based on price, brand and a one-size-fits-most approach. It will also aid consumers in their differentiation between sales and advice - with the latter being a fee-for-service that will appeal to those who are able to play in the high touch space.
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intermediaries will be to convince both their masters and consumers that they deliver the most profitable link between the investor and their investment.

Those advisors who are able to play in the high touch space will be motivated to link arms with like-minded souls to assist with both the thinking, efficiencies and delivery of their trade. This will accelerate the growth in dealer groups in the New Zealand industry - or industry collaborations as their precursor.

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Whilst I suspect that the collision of healthy egos will cause some early upsets, these confederations will be also fuelled by the realisation that many of their financial advisory entities are near worthless in isolation. Due to the ageing demographics of the industry, this perspective can't be overlooked - with loads of industry participants heavily reliant upon a future trade sale to support their retirement aspirations over the next few years.

Rightly or wrongly, the consumer has already marked the financial services industry scorecard, rating it somewhere between used-car sales and real-estate agents. Whilst the industry has been unfairly tarred by the finance company, investment bank, and rouge intermediary sorority, perception is the unfortunate reality that we must all deal with. As the industry participants consider which corners they will play from, the renewed clarity around financial services, combined with improved education will enable consumers to make more robust decisions around who to share their financial aspirations with. Interestingly one community who appears to be in the “box seat” (whether by luck or by management) in this new financial services environment is the accounting fraternity. Their reputation as a trusted advisor appears to have sailed through the past decade relatively unscathed. As with everything in life, consumers will largely get what the pay for, with an increasing number of consumers opting for low cost / technologically driven financial solutions. Get ready for these – with many backyard projects in serious beta testing or about to go live, providing complete disintermediated access to the full spectrum of investments (think iPod). The death knell will ring increasingly louder for those financial advisors who believe that they can compete effectively in this space - whether institutionally aligned or otherwise.

Whilst aspects of these predictions will no doubt be challenged by those who are enjoying different experiences to those predicted, there are many within the New Zealand financial services industry who are finding things tough at the moment. You only need to cast an eye over the Tasman to see who were the winners and losers following a similar tolling of their bell after the Wallis Enquiry of the mid-nineties. Of course you can do nothing – and enjoy the soft ringing of bells in your ears.