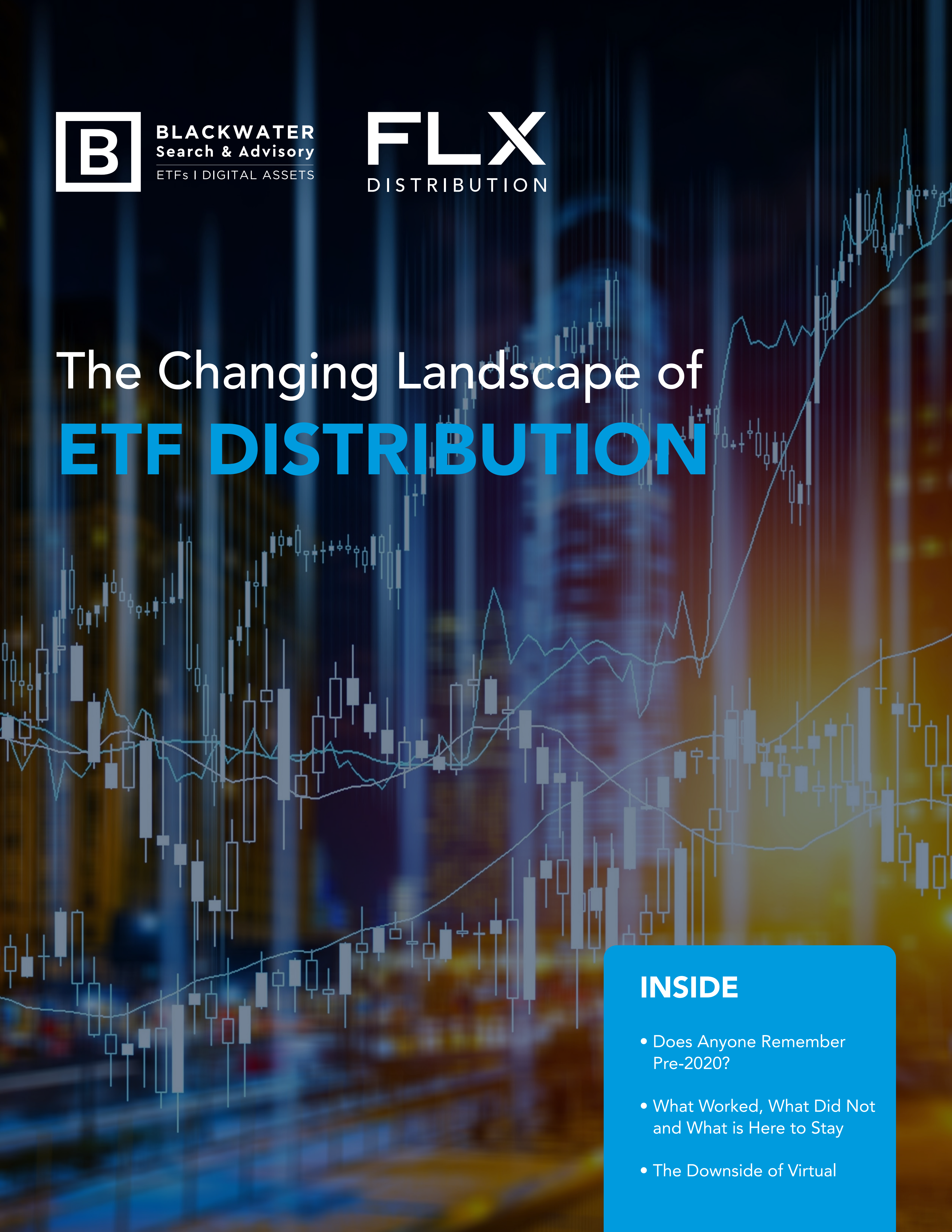

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DISTRIBUTION

The Changing Landscape of ETF DISTRIBUTION

INSIDE

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INTRODUCTION

2020 was one of those years that most of us would like to leave far behind, but it is important to look back at how the global pandemic helped reshape the future of the ETF industry. We can learn big lessons about the new direction for what many view as the lifeblood of the industry—the distribution model.

ETF issuers faced the kind of challenge in 2020 that no one could have predicted. There was no roadmap, no plan on how to make the kind of shift they were now required to make. It became clear that it was firms' reaction to the challenge that made the difference. To understand more precisely how the tactics are evolving, we collectively sought feedback from more than 30 ETF issuers to determine exactly how distribution teams were affected and what permanent changes we face going forward.

SCOPE

We held discussions with ETF issuers in the U.S. covering approximately $1.5 trillion in AUM (as of 12/31/2020). In addition to speaking with ETF issuers, we expanded the scope to include a sampling of RIAs, home offices and trading firms. Our interviews targeted Heads of Distribution, CEOs, COOs, and CIOs to obtain a rounded set of opinions regarding what they believe has changed and what will remain moving forward. What follows is a collection of those conversations and a synopsis of where distribution is heading. Let us get into it.

Does Anyone Remember Pre-2020?

THE PAST IS THE PAST

In the past, ETF distribution teams would spend most of their time on the road, traveling from city to city, packing in as many office meetings in as possible. Some can picture this scene of the traditional salespeople hosting office lunch meetings with pizza boxes piled high to attract as many financial advisors as possible. All with the hope that one of the big producers would not only show up, but maybe even engage in conversation.

And what about the coffee cart, the smoothie bar, the five-star meals, the conferences, the drinks? All these traditional and perhaps cliché client interactions vanished in an instant. Unimaginable perhaps. But it happened, and overnight we witnessed the suspension of all in-person interaction—the key ingredient of business meetings, relationship building, and sales for ETF distribution teams.

Perhaps even more surprising: Not only did traditional distribution models get an overhaul without warning, but the new ways seemed to work—and much better than anyone one could have ever predicted. In 2020, investors added a record $507.4 billion to U.S.-listed ETFs, topping the previous record of $476.1 billion in 2017. Successful sales of ETFs in 2020 helped bring total assets under management in the U.S. to over $5 trillion.

What Worked, What Did Not, and What is Here to Stay

DISTRIBUTION TEAMS ADAPTED QUICKLY AND SMOOTHLY

Most external salespeople had already spent a portion of their time, albeit minimal, making client calls and generally working from home. This meant that in the pandemic environment, they already had access to technology—CRM databases, remote connections, etc.—needed to adapt to this new environment and given many had likely started their sales careers on an internal sales desk and had muscle memory of picking up the phone for most of their day.

Given the major adjustment—and it certainly was major—was the end of all in person engagements, once everyone was trained on how to use Zoom, Microsoft Teams and the many other options that became part of our everyday lives they were essentially good to go. Now that certainly was not without reluctance on the part of some, but many did adapt and even got creative with virtual happy hours, dinners and office hours. It frankly became easier in some senses to gather and bring important resources to clients in this virtual world.

Almost everyone we talked to said that their teams were nimble and able to efficiently operate and find a rhythm in the virtual world. Even the most old-school among them, the ones who doubted the ability to successfully sell over Zoom, were able to change stride and break ground with existing and new advisors. You could say the proof is in the 2020 ETF flows.

THE HYBRID MODEL IS HERE TO STAY

The success of adapting distribution teams and entire firms in the virtual environment has led to the general conclusion that no one anticipates returning to the "old way" of work. A more hybrid model bringing together both virtual and in-person engagement is where the world is headed, and COVID-19 simply accelerated this change.

Once we are out of the Covid woods, our conversations confirmed that no one plans to do 100% of anything—in person or virtual—but instead settle into a world that is heavily virtual with approximately a quarter to half of business done in person. There is also an expectation that we will see an increase in larger more targeted events and one-on-one meetings will be more selective and less frequent.

How did we get here? The consensus is that firms reaped the benefits of cost savings from reduced travel expenses and as a result have re-evaluated the External vs. Hybrid vs Internal sales roles and the value that salespeople are adding at each level.

What does that mean specifically? 2021 business plans and metrics are going to look quite different. Meetings will continue to be held virtually and yes, eventually will include more in-person presentations again but not back to previous levels. Compensation structures will change, headcounts may gradually be reduced, and you will see a smarter, much more integrated digital business plan with Marketing.

> "Hybrid models of remote work are likely to persist"

ETF distribution teams are not alone on this forward-looking path. In a McKinsey report from November 2020 titled called "What's Next for Remote Work," an analysis of 2,000 tasks, 800 jobs and nine countries confirmed that "hybrid models of remote work are likely to persist" and "executives have indicated in surveys that hybrid models of remote work for some employees are here to stay."

TARGETED AND INTELLIGENT COMMUNICATION

Within this evolving model, targeted and intelligent digital communication has become key. Tapping into internal resources along with investment strategy teams and marketing helped determine the most impactful way to communicate a firm's message to clients. The benefits of integrating these teams in a more targeted and resourceful way has become a key focus for many. Additionally, the firms that showed the capability to increase their engagement with their marketing and data analytics teams succeeded in delivering a customized client experience.

Personalized digital marketing tracking rooted in big data analytics is now non-negotiable and critical to success. There are hundreds of thousands of advisors and although not a new concept, the virtual environment further highlighted that a traditional sales team can only cover so many relationships and prospects.

One respondent's comment summed it up the opinion of most: "Top-tier clients will still want to get one-on-one attention, but the masses will be covered digitally. Firms are learning more about the costs and ROI of distribution and will continue to focus investment on their more profitable clients. As such, the 80/20 rule will be in full effect. The top 20% or maybe 10% of clients will be the focus, everything else will likely get digital coverage."

> The **80/20** rule will be in full effect

This brings an important upside for smaller firms. Not only does this targeted digital communication level the playing field, but it also makes it easier for them to reach a broader audience.

SMALLER SHOPS ARE ADOPTING A DIGITAL SALES APPROACH

New ETF issuers who do not have the assets or track record to gain access to platforms or model portfolios are circumventing this issue by utilizing digital e-marketing. No longer casting a net of thousands of emails that will go into an unread email vortex, this digital-marketing approach provides access to qualified leads by creating algorithm-driven targeted campaigns based on where the product interest is via SeekingAlpha, Barron's, Bloomberg, CNBC, Reddit, etc.

This digital-first sales approach has also expanded to targeting end investors via social media platforms like Twitter, LinkedIn and YouTube. And because these combined digital methods are working for some, many confirmed that they do not have plans to amass a large salesforce but instead rely more on an approach that prioritizes digital marketing. It's important to remember that the vast majority of ETFs are still "sold, not bought" and while digital marketing is a critical component of all distribution strategies, there is still need for salespeople—now what that role looks like moving forward is certainly changing.

While salespeople may not like the sound of that, guess who does? Advisors. In a February 2020 report written by ETF Trends and ETFdb a survey of 675 advisors found that, "only 10% of advisors want to meet with issuers one-on-one, most preferring webcasts and other digital education efforts." The title was appropriately called, "Advisors Are Hanging Up on ETF Issuer Reps." And remember, this survey was completed before the WFH lockdown—does Tom Lydon have a crystal ball?

GOODBYE GORDON GEKKO

The role of sales is changing—so put a fork in the era of steak dinners and open bar tabs. Sales teams need to have more technical knowledge and take a more consultative approach with their clients. In short, they need to be problem solvers and not just relationship builders. Relationships still matter and help get your call or email returned but advisors are looking more and more for diversified offerings and value-added services. The schtick pitches just will not work anymore—it is critical to intimately understand the advisors so well that you know their needs before they do.

Business travel will resume but will be much more targeted and much less frequent. Travel budgets are feeling the squeeze and the beloved expense accounts of the past will evolve to meet the new demands. The need to travel every day of the week? Gone. Flying from one coast to the other for a meeting or two? Not happening anymore.

Why spend so much on travel, lavish dinners, drinks and other entertainment if sales teams were just as efficient and effective with video meetings? Unfortunately, those who built their businesses around such interactions and saw them as critical to maintaining relationships are in for a shock as management is in support of the reduced travel budget, we saw in 2020. What better way to test how much a firm can cut costs than a mandatory WFH environment?

That is the million dollar question we did not fully explore but would love to know—how much did firms on average save on client entertainment and travel expenses in 2020??

The Downside of Virtual

PROSPECTING NEW CONTACTS

Not exclusive to ETF sales teams, the common denominator and biggest complaint was the lack of ability to connect with new relationships. Many found breaking in with new advisors and relationships their biggest struggle.

In March, when we thought WFH would be a short-term blip on the proverbial radar, sales teams were largely spending their time talking with advisors about the volatility in markets, how to adjust to this environment and other non-product related topics. When it became clear that we were in this for the long haul and had to figure out how to effectively sell virtually, the challenge of prospecting or reaching those you did not have a relationship with reared its head. If you lacked a more direct line into an advisor, you were forced to rely on email interactions along with the sea of hundreds of others.

However, if you did manage to get through and better yet, schedule a Zoom call, an interesting and brand-new experience was unveiled—the connection that comes from peering into someone's living room. The humor and even empathy that is created when you see someone's quirky home workspace (wow, look at all the embroidered throw pillows!), the executive's lapdog barking in the background, or the adorable kid who comes bounding into the room. Those funny, disarming, occasionally awkward moments could never have been experienced in a traditional office—the forced virtual environment made those experiences available. And those moments created different connections no one could have predicted before March 2020.

WORKING MORE HOURS THAN EVER

Both in the interviews we conducted for this report and in our day-to-day discussions with industry peers, almost everyone said he or she was working more than ever and were incredibly busy. You wake up, check your emails, have a cup of coffee and almost immediately begin working. The much-maligned office commute was instantly replaced with an extra hour or two of work. If you were an internal salesperson, you did not have the team banter that naturally breaks up the workday, the gym break, or even a social lunch that goes a little longer than an hour. All gone, replaced with more work. With everything closed, there was nothing else to tempt you, right? And for the externals, all that time spent driving between appointments, waiting in airport lines, flight delays, conferences, were all taken for granted—as we quickly realized they provided a needed reprieve from the incessant workday.

Many of our respondents commented that the advisors are also tired of the long workdays, particularly the Zoom calls and webcasts. While firms were creative and managed to provide a workaround with increased webcasts featuring stellar content, those too got old. As the months progressed, it became markedly harder to get advisors to commit to such things.

On the flip side, some commented that the virtual engagement was more impactful because landing a one-on-one Zoom meeting illustrated the willingness of the advisor to engage. A very different scenario versus the branch lunch where everyone would attend, mostly for the free pizza.

A LOST CULTURE

Culture, and particularly maintaining it, was a consist and meaningful challenge we heard for everyone. Whether it was onboarding a new employee or keeping up the energy and comradery of an internal sales desk, there were things that just were not the same in a virtual world. Ever mistaken a sales desk for the accounting department? Much respect to our friends in accounting, but the sales team is always buzzing with activity. Filled with type-A personalities and quota-driven go-getters, sales desks exude a contagious culture highlighting a desire to succeed and pull each other along through the challenging times. There is a snowball effect in this team environment that firms have sought to harness since the Mad Men era of the 1950s.

Everyone wants to be the top salesperson for that quarter and when you see your colleague cranking out calls, your natural competitive nature will prompt you to do the same. Maintaining a team culture while virtual, seamlessly onboarding new employees, and creatively thinking of ways to promote a positive experience with work-life integration were concerns shared by many of our interviewees. It is almost impossible to create in a fully virtual environment.

POTENTIAL CHANGES IN HEADCOUNT

Thankfully, everyone agreed that there will always be roles for good salespeople who add value. Although there are no plans to return to that old way of operating, there will be new opportunities for the technologically inclined as sales teams integrate in smarter ways with data-driven targeting and marketing efforts. Newly designed business plans that entail reduced travel will open more opportunities within distribution ranks. Work-from-home parents who would have found the 80% travel requirements too much before will now be able to adjust to a more virtually minded world. Imagine the pool of talent in smaller, ex-urban cities who either cannot or do not want to work at big-city firms who now might have that opportunity.

WILDCARD QUESTIONS AND THOUGHT-PROVOKING COMMENTS

In this ever-evolving industry we wanted to take the opportunity to add in a few wildcard questions that related to current news. Two examples being where is the money going to flow this year and how will mutual fund firms adjust their distribution teams to support new ETF launches? Below are responses to those questions along with some other thought-provoking comments.

- **More mutual fund managers will pivot to ETFs as this is where the growth is.** No one seems to have the perfect solution for how to integrate mutual fund sales teams into the ETF world. One thing that most agreed on—the learning curve is steep, and it will take too long to train a mutual fund salesperson on ETFs. It is also nearly impossible to ingrain them into the ETF sales culture. It is just different for a whole host of reasons. Not to mention the significant behavioral challenges to consider—seeing trades daily, compensation, etc.
- **Younger millennials have made it clear that they have no intention of returning to the office** and if you want to keep your top talent within that age range you need to be flexible with your work from home arrangements going forward.
- **Marketing was already more digital and now sales is meeting that with more data** and specifics around clients' and prospects' preferences on communication, research and product resulting in more targeted efforts.
- **Those with existing relationships will thrive**
- **Expensive conferences are no longer needed.** Firms will pay less and for fewer events. Access to investors need to be present for an event to be worth the spend. No one is going to pay to simply hangout with other industry colleagues. (*Idea: sponsors should be required to bring 10–20 advisors to an event*)
- **The skill of influence is more critical than ever** as more and more decisions are being made by fewer and fewer people. Think about the due diligence teams—they are getting better, smarter and diving deeper with their nuanced questions.

- **Another theme for them is data and data driven targeting for advisors.** Business intelligence is being extended to ETFs. RIAs are still one of the biggest sales targets and as they increasingly adopt better technology and ETF issuers are benefiting.
- **Model portfolios are going to be even more important moving forward.** At this point in the game, it will be to your detriment if you ignore this fact.
- **March-May conversations had nothing to do with products**. It was instead about market volatility, fixed income ETF discounts, etc. Start dissecting how much time you used to spend on products vs time spent on other things. The ratio changed dramatically in 2020. It was less about products and more about thought leadership, services, etc. Advisors are looking for partner firms that can really give totality of services outside of products.
- **No substitute for in-person interaction** when building trust.
- **Smaller RIAs will push to lure more people back in the office.** Without a highly sophisticated tech infrastructure, small firms are not as comfortable with distributed work forces and feel the need to be around their people. Wirehouse offices will be different—why pay such a large portion of your revenue for infrastructure, etc., when it is not necessarily needed? This trend may accelerate the move towards going independent.

CONCLUSION

The improvements made in 2020 are here to stay and 2021 business plans are going to reflect a move to more hybrid sales teams with smarter, data-driven marketing and sales integrations. Humans will not be replaced completely, but technology will increasingly be used to improve the experience and prospect targeting. Like it has with other industries, the pandemic has simply accelerated the need to improve internal technology and embrace data-driven marketing, client targeting and measurements of success.

The golf-course engagements and steakhouse sales pitches will return but in much smaller numbers. To remain competitive and current, salespeople will need to be creative with tailored solutions and value-added experience with their clients and prospects. The times of dropping a product card on a desk are dead. Only those who know how to engage their investment strategy, portfolio management, and data teams will excel in this new more virtual world.

THANK YOU!

Thank you to all the firms who participated and our contacts who provided time for our questions. Like many others, while we have fully adapted and accepted virtual interactions, we are also very much looking forward to catching up in person for a drink or dinner as soon as we can safely do so.

—Andrea, Jillian, and Michael

ABOUT US

FLX Distribution

Launched in December 2019, FLX Distribution is a financial technology company and Resource & Asset Management Platform (RAMP) focused on asset management distribution. Our vision is to be the premier, cost effective, and flexible distribution solution for asset managers to effectively access and engage with experienced and proven distribution professionals.

Blackwater Search & Advisory

Blackwater Search & Advisory is a boutique global ETF and Digital Assets consulting and recruitment firm. Blackwater specializes in helping clients build their ETF platform, grow assets under management and source the best talent the industry has to offer.

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Jillian is Managing Director, Head of ETFs & Indexing at FLX Distribution. Prior to joining FLX, she was Head of ETF Distribution at J.P.Morgan Asset Management. Jillian's career includes roles at BlackRock iShares and Goldman Sachs. She also serves on the Board of Women in ETFs, the first women's group for the ETF industry, and served as Co-President from 2017–2019.

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Andrea is currently Head of Business Development at Blackwater Search & Advisory where she is responsible for expanding Blackwater's ETF consultancy business globally. Previously, Andrea was the Senior Relationship Manager covering derivative-based ETFs at ProShares. She is also co-head of the London Women in ETFs Chapter.

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Michael is the Founder and CEO of Blackwater Search & Advisory. Prior to founding Blackwater in 2019, he spent over 20 years in both Investment Banking and Asset Management at firms such as Credit Suisse, HSBC, BlackRock and JP Morgan, working within various executive product development and strategy roles.