MoneyVoices: Lines Redrawn in Active vs. Passive Debate

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With Barclays Global Investors now in hand, BlackRock stands at the threshold of the future of investment management. The firm is well-positioned to capitalize on the increased coexistence of active and passive investment solutions inside institutional and high-net-worth portfolios, as well as the incredible growth potential of the exchange-traded funds industry.

The question is: Will BlackRock be able to reconcile its well-established actively managed products with the indexing ones that BGI's iShares has built over the years? Laurence Fink, CEO of BlackRock, seems to think so. He believes the benefits of this pairing will be more "comprehensive" products and more "tailored" portfolios. In other words, Fink is not only a believer in the potential synergy of active and passive strategies; he thinks of it as a selling point and a source of increased enterprise value.

Some industry observers are not on the same page as Fink and BlackRock. They think it will be a major challenge for a gigantic firm, one characterized primarily by its actively managed products, to unite with another gigantic firm that has been defined by its indexing products. These sentiments make up the crux of the conventional wisdom held over the past 15 years that an investment manager must either be active or passive, and that to mix the two would be problematic at best.

Yet, even as this supposed orthodoxy percolated throughout the ranks of investment managers and financial advisors, all kinds of corporations, endowments and foundations had been quietly using both active and passive strategies to optimize their risk, return and asset allocation.

At the investor level, the combination of active and passive strategies started off with a label of "core and explore." However, with the proliferation of so many ETFs and index-based products, this has morphed it into a more integrated melding of passive and active products. In fact, many active products now use ETFs to effectively achieve the same goals as specific portfolios or investment strategies.

Furthermore, with the sector's fees and business models under major pressure due to the recent market turmoil, it has become increasingly important for an asset manager to be able to pick up on the new industry trends. They need to do this in order to remain relevant to the distributors of investment product and their investor clients.

So, with all of this in mind, BlackRock's decision to acquire BGI was not only driven by the desire to add a powerful and strategic retail weapon to its arsenal. It was put into motion too by a fervent belief that the asset management company of the future is highly skilled at both active and passive management, and has the capability to blend the two for both the retail and institutional markets. This stokes the debate about whether this is now the only model for the future.

While the investment management industry has long been able to host a diversity of business models, thanks in part to its tradition of high margins and great operating leverage, the maturation of the industry and the increased use of passive products will likely eclipse the viability of some business models. This will make it more imperative for management firms to get it right.

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