

Software Distribution: The Channels Are Changing

by Ed McCarthy, CFP

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It's been interesting to observe how the distribution channels for financial advisors' software have changed in recent years. Not too long ago, it was a "captives" versus independents issue. Captive advisors, defined here as those advisors who work for large financial service institutions (FSIs) or were affiliated with broker/dealers, usually had limited control over their software selections. Perhaps they could select ancillary programs, but the home office typically chose the critical programs such as portfolio accounting software, and provided any required integration.

In contrast, independent advisors were on their own, a status that had both benefits and costs. Advisors selected a custodian—probably Schwab—but bought portfolio software directly from the developers, many of whom were small firms themselves like Financial Computer Support Inc. or Capttools Co. Although changing systems was always a challenge, apart from potential data compatibility problems, there were few restrictions on the independents' software selections.

Recently, however, there seem to be several changes in the software distribution channel. First, a number of the new vendors have been adopting a Web-based or application service provider (ASP) distribution model. No more floppy disk or CD-ROM installations to the local PC or network; instead, you run these programs over the Web via your browser. Some of these developers, notably TechFi, sold directly to independent advisors, but other ASP vendors introduced a second distribution change: Their initial marketing plans focused exclusively on FSIs and larger broker/dealers (B/Ds) and bypassed independent advisors. When asked if independent advisors would eventually gain access to the software, the usual response was, yes, after but only after we have a stable base of large customers.

There also has been a blurring of the lines between service and software providers with leading custodians starting to act as software distributors. TD Waterhouse and EAInvest, for example, have announced plans to offer Advent's software. Fidelity Investments Institutional Brokerage Group is working with Emerging Information Systems Inc. (EISI) to offer that firm's popular NaviPlan software. Some of the news on the custodian-software front has been controversial, however. In particular, Schwab's decision to restrict future sales of its Performance Technology Inc. subsidiary's Centerpiece program to advisors doing business with Schwab Institutional caused some consternation.

These changes hold potential implications for financial advisors. If numerous software developers bypass the independent RIA market, for instance, could those advisors find themselves at a competitive disadvantage? As custodians become a more active distribution channel, are their independent advisor-clients at risk of becoming de facto captives?

Overlooking the Independents

From a business perspective, software vendors' decision to focus on FSIs and B/Ds makes perfect sense: Why sell to one independent user when you can market to multiple FSI and B/D users simultaneously? Stephen Winks is an investment industry consultant and publisher of *Senior Consultant* (www.srconsultant.com), which provides advice and news for investment consultants. "The large financial services firms represent a better market at a far lower cost of delivery than individual advisors because advisors require a lot of support," he says. "If you are selling to a large firm like Citigroup or the Salomon Smith Barney affiliate or Morgan Stanley, those firms provide the support infrastructure, which means it's a more efficient means to distribute the technology. Because of the critical mass, it's typically far cheaper to work with those types of firms than to build a support mechanism for independent advisors where it's likely to be very expensive to build it and you can never provide enough support. So it's a much less complex, a much more efficient, and a much more profitable model for software developers."

If some software developers are bypassing the smaller-advisor market, will lack of access to the latest technology hurt independents' business? Winks believes it will, and he points to account aggregation software—a technology that is only now reaching the small advisor market—as an example. "It's very obvious that technology is everything. The best illustration is that today it's pretty clear that it is not possible to add value through an investment recommendation unless you can evaluate that investment recommendation in the context of all the client's assets and liabilities. Now, the kind of technology required to do that is account aggregation software and an analytical piece on the back end to evaluate all the aggregated information so it's meaningful. Without account aggregation technology, it literally is not possible for an independent advisor to add value nor is it possible for a wirehouse broker to add value."

Advisors who have been in the business for more than a few years have survived challenges from new technologies in the past and they are skeptical that technology alone will hurt their business. Joel Bruckenstein, CFP, CFS, CMF, is a financial planner in Miramar, Florida, and co-author of [Virtual Tools for a High-Margin Practice](#) (forthcoming, Bloomberg Press). Although he is one of the most technologically well-informed advisors, he often takes a cautious attitude with the latest advances. "I was just reading an article where they were talking about how clients don't want account aggregation," he says. "If anything, the brokers and the custodians want it much more than the clients do, and I think there's more than a grain of truth to that. I'm not sure that clients of big, faceless, nameless institutions are eager for those institutions to know everything about them. I'm sure my local bank would love to see every account I have, and I can't think of one good reason why I would ever want them to know that information."

Bruckenstein points out that smaller advisors often have an edge in implementing the technologies they choose to adopt. "When the Internet first came into every household that had money, we were hearing that the little advisors were going to go away and that the big guys had a big opportunity," he says. "The way it looks to me, if anything, is just the opposite. It gave the little guys an advantage because they were able to innovate faster and they were able to make decisions faster. The Internet froze a lot of the big brokerage houses and insurance companies. They didn't understand what the rules were, what the NASD required, so in typical compliance fashion, they just said, 'We're not going to do anything for a while,' and the little guys got a big head start. The good independent advisors had really slick Web sites that were useful to clients, in many cases years before many brokerage firms and insurance companies did, so I think the little guy has the advantage of being nimble."

Other advisors believe that even if the larger FSIs and B/Ds gain a head start with a particular technology, software entrepreneurs will still be willing to develop a competitive product for the RIA market. "From what I know about technology and what it can do, as much as it appears to give the big firm the big competitive advantage, the reality is that those tools aren't far behind for small advisors," says Greg Friedman, CFP, a planner with Friedman & Associates in Novato, California, and co-developer of the Junxure software. "There are going to be enough small advisors in this industry to provide enough of a market. There's not a whole lot we don't actually provide right now as an independent firm that some of the very top firms do. The bottom line for me is that the big firms may get there a little faster, but not much, and I don't know that it gives them a huge competitive advantage."

Custodians as Distributors

Individual advisory firms might lack the market clout needed to attract software developers, but the custodian firms serving these firms can offer the volume the vendors need. It would seem to be a natural business relationship for custodians to serve as intermediaries: Advisors gain access to technology and the custodian adds value to its offering, as well.

Fidelity, Schwab, TD Waterhouse and newcomer EAIInvest have recognized this opportunity. Fidelity recently started selling Winnipeg-based EISI's NaviPlan software at a discount to its advisor-clients. In addition to the cost savings, NaviPlan can exchange brokerage data with Advisor CHANNEL®, Fidelity's proprietary analysis, trading and reporting platform. Both TD Waterhouse and EAIInvest plan to offer Advent software as part of their offerings to their RIA clients. "We are going to integrate the Advent platform," says Tom Bradley, president of TD Waterhouse's Institutional Services, which is based in Manhattan. "It's the Axy's portfolio management system, the Moxy, which is their trade management system, and Qube, which is their contact management system for advisors. The key advantage to advisors is that, one, they will have an integrated platform that will be easier to use, very user-friendly. Two, they will be able to significantly reduce their out-of-pocket costs because we will, depending on the levels of business they give us, probably be able to support monetarily a good portion, if not all, of the Advent software costs. We also will be running that system on our servers, so advisors will not have to run it and maintain it on their servers. We will also be scrubbing all of the data, so the

data will be much cleaner."

San Francisco-based EAIInvest has forged a similar deal with Advent. According to Chuck Siegel, EAIInvest's vice president of sales and marketing, his firm and Advent have created the Advent Office™ Essentials Web-based platform for advisors with less than \$50 million in assets under management. As with the TD Waterhouse offering, advisors who custody sufficient assets with EAIInvest will have access to the Advent package at a reduced rate and possibly free of charge. The Office Essentials package was announced late last year, and Siegel anticipates that 10 to 12 advisors will have signed up by the end of this year's second quarter.

The advisors we contacted for this article generally welcomed these alliances. But they have been less keen on Schwab's moves to limit distribution of Centerpiece and Junxure software to Schwab Institutional customers. To some extent, that sentiment is not surprising, as Schwab seems to be a frequent target of advisors' criticism. Jon Meyer is president of Boeckermann, Grafstrom & Mayer, P.A., a CPA and wealth management firm in Bloomington, Minnesota. His firm uses several Schwab/PTI software packages, and he agrees that having a large corporate parent can improve a program. "I think the improvement you see is due to the fact that they have a large budget to work with when they put their mind to doing something," he says. "For example, with Centerpiece, they're improving it now to allow for better accounting for bonds. We do a lot of bonds with our clients, so for us, that would be a huge benefit. And that's where Schwab's ownership can be a large advantage because when advisor-clients had PTI on its own, they were so small that they couldn't always put into the technology what they wanted."

While he appreciates Schwab's deep pockets, Meyer is still concerned that his firm is becoming too dependent on Schwab. "As we get more and more tied into them this way, if I decided tomorrow that I wanted to switch to Fidelity, let's say, my entire system would have to be overhauled. Not only would it be very expensive, but also the process would be so labor intensive that it could really mess your business up for months, if not years. We previously transferred from Advent to Centerpiece and that shut us down for almost a year from the standpoint that, for the first quarters, we never had clean reports. Everything was messed up. As you work through it, you learn that you don't want to do it again. As we get more tied into Schwab, I don't want to get to that point where if I do decide to change something, it's going to muck up anything."

Joel Bruckenstein points out that changing systems is never easy, but a software vendor or custodian can influence the transition's difficulty. "I think certainly in the case of Schwab that they are trying to structure it to make it more difficult for advisors to leave," he says. "One could make the same argument with Waterhouse, although I think with Waterhouse there is a clearer exit path. It is not going to be very easy either way, but for the same reason it is not easy changing software, either. If you've used Centerpiece for years and you want to migrate to Advent or if you've used Advent and want to migrate to Centerpiece, or if you use one financial planning program such as NaviPlan and you want to switch to Moneyguide Pro, it's going to be a problem all the time. That's the nature of the beast. So the question is, is anybody putting additional impediments in your way or are some custodians at least trying to provide you with a clear exit path that will make it a little easier?"

From Schwab's perspective, the decision to restrict future Centerpiece sales to advisors with business relationships to Schwab Institutional makes sense. "We no longer sell to new clients, or a class of prospective clients, who are not also planning to or doing business with Schwab Institutional in a custody and trading mode," says David Peck, a senior vice president with Schwab Institutional. "With those prospective clients, if they called us, we would send them demo packages. Now, we screen them a little more thoroughly than we used to and if it looks like they don't intend to have a relationship with Schwab Institutional now or in the future, we will refer them to other providers."

Peck also points to Schwab's recent launch of the Advisor WebCenter as proof that his firm is not out to "capture" advisors. This Web site development and hosting service, which will work initially with Centerpiece and with Advent by year-end, will provide account aggregation, portfolio performance reports, research and online communications tools.

The distribution channels for advisors' software continue to evolve. Developers' desire for marketing scales of economy, the Web, and custodians' desire to move beyond providing transactions and portfolio record keeping are all influencing how advisors obtain the software they need to run their practices. Although there will always be a role for the enterprising developers who decide to sell directly to advisors, direct sales might soon become the exception instead of the rule.

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