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BlackRock bets on Aladdin as genie of growth

World's biggest asset manager plans to extend industry's use of its technology

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Aladdin, the hero of the *Arabian Nights*, is a complex character. Clever and wily, he also has an insatiable appetite for riches, for bigger and better things. His desire to flaunt his wealth nearly causes his downfall.

Another Aladdin, a technology system developed by BlackRock, the world's largest asset manager, is also clever. It analyses the risks of investing in particular stocks, figures out where to sell bonds to get the best prices, and tracks those trades. And it is wily too, combing through huge data sets to find vital pieces of information for investors.

Since its inception in 1988, when it was developed as an internal risk tool for BlackRock employees, Aladdin has become bigger, better and far more influential. It is now one of the best-known pieces of technology in the fund industry and is widely used by BlackRock's rivals, including Deutsche Asset Management, the $733bn investment house, and Schroders, the UK's largest listed fund manager.

But as Aladdin — which stands for Asset Liability and Debt and Derivatives Investment Network — has grown, concerns have mounted about its influence on markets. There are also questions about whether Aladdin can maintain or increase its hold on the asset management industry as rival technologies emerge.

"Everyone [in asset management] is asking the question whether they should look at Aladdin and whether it is suitable for them. That is not to say Aladdin is suitable for everyone," says Greg Faragher-Thomas, director at Alpha FMC, the consultancy. "Aladdin has pros and cons."

Aladdin started out as a technology to analyse risk but has evolved into a so-called enterprise system, meaning it supports a range of business functions and processes. In a fund house, Aladdin can be used by many people, from portfolio managers right through to those working in compliance, because it combines risk analytics, portfolio management, trading and operation tools on to one system.

First used externally in the mid-1990s, Aladdin is now found at 85 asset managers and institutional investors that have about $20tn in total assets, up from an estimated $11tn just four years ago. The technology carries out 250,000 trades and billions of financial calculations every day.

But with more and more investors using Aladdin, there are concerns about its impact on markets. The argument is that if trillions of dollars are being managed by people using the same risk system, those individuals may be more likely to make the same mistakes.

One senior executive who works in financial technology, who did not want to be named, says: “Do I think there is systemic risk there [with Aladdin]? I don’t know. But obviously some significant error or bug could cause problems for markets. It is a question regulators should be looking at.”

Jody Kochansky, head of the Aladdin product group at BlackRock, dismisses this concern, arguing that fund houses can tailor the system to their own views. “Each Aladdin client uses the system in a way that suits their objectives. Every Aladdin client has their own risk department, which looks deeply at the model and overlays its own views.”

15%

Aladdin’s share of the insurance market

Mr Kochansky adds that asset managers are the fastest-growing source of new business for Aladdin, in a sign that the investment community is not concerned about these potential issues. Aladdin has a 9 per cent share of the 250 largest asset managers and a 15 per cent share of the insurance market, according to Credit Suisse, the Swiss bank.

Many asset managers have recently begun the slow process of overhauling their technology systems after years of neglect. Previously, fund houses often had hundreds of different systems, but Aladdin and similar enterprise platforms allow businesses to cut out huge chunks of IT, reducing costs and jobs in the process.

At the same time, running money has become more complex and there is more regulatory scrutiny of investment decisions. This has meant that fund houses have been forced to assess how technology can help their investment processes.

"Money management is very tricky these days. Any tool that can help you with decisions is going to be highly in demand," says Denise Valentine, senior analyst at Aite Group, the consultancy. "These [enterprise systems] are so core to a money manager. They are the spine of the business."

This rising demand for better technology has helped to boost revenues at BlackRock, which last year stood at $11.2bn. In 2016, Aladdin's revenues rose 13 per cent compared with the previous year. In contrast, BlackRock's management fees in its investment business declined slightly.

30%

Percentage of BlackRock's revenues Lary Fink wants Aladdin and the wider solutions business to account for in five years, compared with 7% per cent currently

Under plans by Larry Fink, BlackRock's chief executive, Aladdin will become an even more important source of cash for the fund giant. Mr Fink recently said that his goal is for Aladdin and the wider BlackRock solutions business to account for about 30 per cent of revenues in five years, compared with 7 per cent currently.

BlackRock's push to diversify its revenue sources comes at a time of turmoil for the asset management industry, where profit margins are falling and there is severe pressure to cut fees. According to Casey Quirk, the consultancy owned by Deloitte, the professional services firm, the average profit margin has fallen from 34 per cent in 2014 to 32 per cent in 2015.

Credit Suisse analysts said in March that Aladdin will play an important role in ensuring profit growth at BlackRock. "We view the solutions business, including Aladdin, as a source of stable revenues," they wrote.

But others question whether Aladdin can maintain its brisk growth. The business faces tough competition from companies such as SimCorp, Bloomberg and Charles River.

The chief executive of a large fund house in Europe, which is reviewing its technology systems, said his business had considered rolling out Aladdin but decided against it. “Aladdin is very expensive and it is not the best out there,” he said.

Several other European asset managers, such as Aegon Asset Management, Generali and Unigestion, have also recently chosen SimCorp’s Dimension platform instead of Aladdin.

One of the oft-mentioned criticisms of Aladdin is that investors are forced to take on the whole system, rather than just parts of it, something rival systems allow. There are also complaints that while Aladdin is strong in areas such as risk analytics, other parts of the system, such as accounting functions, are disappointing.

Mr Kochansky disagrees, saying it is possible to take parts of the system. “When you compare to the other platforms, Aladdin is known in the marketplace as being much more comprehensive,” he said.

Even if there is a stumble in demand, BlackRock is already eyeing up other avenues for Aladdin.

In the past two years, it began promoting Aladdin, which comprises 25m lines of code, in the retail investment space, targeting wealth managers and brokers.

Last week, UBS Wealth Management Americas became the first wealth manager to say it will use Aladdin for risk management and portfolio construction.

Mr Fink has bigger and better ambitions for Aladdin. During an earnings call this year, he was clear about his belief in the system.

“Technology has always been a key differentiator for BlackRock. It is more essential to our business than ever before. We believe technology can transform our industry,” he said.

The competition: SimCorp's Dimension gains on Aladdin

Just before Christmas last year, SimCorp, a rival to BlackRock, announced a coup. Generali Investments, the Italian fund house with €450bn in assets under management, had decided to use SimCorp's Dimension platform over BlackRock's Aladdin and other options.

At the time, Klaus Holse, chief executive of SimCorp, described the Generali deal as an "important client win".

SimCorp started off as a business offering accountancy software but built this out to create technology that covers a large array of functions for investment houses.

Generali is just the latest of several big European asset managers that have begun using SimCorp in recent years. Others include Aegon Asset Management, which rolled out the SimCorp system in 2014; Unigestion, which went live with Dimension in 2015; Axa Investment Managers, which announced a deal with the technology company in 2015; and UBS Global Asset Management, which SimCorp officially announced as a client in 2015.

Stephen Butcher, managing director of SimCorp for the UK, Ireland and the Middle East, says about $20tn of assets are run on its Dimension system now, not far behind Aladdin's assets. "In Europe in the past two years, we have added $2tn in assets under management on to our front-office platform alone," he adds.

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