

The Economist

Investment management

The rise of BlackRock

In 25 years, BlackRock has become the world's biggest investor. Is its dominance a problem?

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ASK conspiracy theorists who they think really runs the world, and they will probably point to global banks, such as Citigroup, Bank of America and JPMorgan Chase. Oil giants such as Exxon Mobil and Shell may also earn a mention. Or perhaps they would focus on the consumer-goods firms that hold billions in their thrall: Apple, McDonald's or Nestlé.

One firm unlikely to feature on their list is BlackRock, an investment manager whose name rings few bells outside financial circles. Yet it is the single biggest shareholder in all the companies listed above. It owns a stake in almost every listed company not just in America but globally. (Indeed, it is the biggest shareholder in Pearson, in turn the biggest shareholder in *The*

Economist.) Its reach extends further: to corporate bonds, sovereign debt, commodities, hedge funds and beyond. It is easily the biggest investor in the world, with \$4.1 trillion of directly controlled assets (almost as much as all private-equity and hedge funds put together) and another \$11 trillion it oversees through its trading platform, Aladdin (see [article](http://www.economist.com/news/briefing/21591164-getting-15-trillion-assets-single-risk-management-system-huge-achievement) (<http://www.economist.com/news/briefing/21591164-getting-15-trillion-assets-single-risk-management-system-huge-achievement>)).

Established in 1988 by a group of Wall Streeters led by Larry Fink, BlackRock succeeded in part by offering “passive” investment products, such as exchange-traded funds, which aim to track indices such as the S&P 500. These are cheap alternatives to traditional mutual funds, which often do more to enrich money managers than clients (though BlackRock offers plenty of those, too). The sector continues to grow fast, and BlackRock, partly through its iShares brand, is the largest competitor in an industry where scale brings benefits. Its clients, ranging from Arab sovereign-wealth funds to mom-and-pop investors, save billions in fees as a result.

The other reason for its success is its management of risk in its actively managed portfolio. Early on, for instance, it was a leader in mortgage-backed securities. But because it analysed their riskiness zipcode by zipcode, it not only avoided a bail-out in the chaos that followed the collapse of Lehman, but also advised the American government and others on how to keep the financial system ticking in the darkest days of 2008, and picked up profitable money-management units from struggling financial institutions in the aftermath of the crisis.

Other people's money

Compared with the many banks which are flourishing only thanks to state largesse, BlackRock's success—based on providing value to customers and paying attention to detail—is well-deserved. Yet when taxpayers have spent billions rescuing financial institutions deemed too big to fail, a 25-year-old company that has grown so vast so quickly sets nerves jangling. American regulators are therefore thinking about designating BlackRock and some of its rivals as “systemically important”. The tag might land them with hefty regulatory requirements.

If the regulators' concern is to avoid a repeat of the last crisis, they are barking up the wrong tree. Unlike banks, whose loans and deposits go on their balance-sheets as assets and liabilities, BlackRock is a mere manager of other people's money. It has control over investments it holds on behalf of others—which gives it great influence—but it neither keeps the profits nor suffers the losses on them. Whereas banks tumble if their assets lose even a fraction of their value, BlackRock can pass on any shortfalls to its clients, and withstand far greater shocks. In fact, by being on hand to pick up assets cheaply from distressed sellers, an unleveraged asset manager arguably stabilises markets rather than disrupting them.

But for regulators that want not merely to prevent a repeat of the last blow-up but also to identify the sources of future systemic perils, BlackRock raises another, subtler issue, concerning not the ownership of assets but the way buying and selling decisions are made. The \$15 trillion of assets managed on its Aladdin platform amount to around 7% of all the shares, bonds and loans in the world. As a result, those who oversee many of the world's biggest pools of money are looking at the financial world, at least in part, through a lens crafted by BlackRock. Some 17,000 traders in banks, insurance companies, sovereign-wealth funds and others rely in part on BlackRock's analytical models to guide their investing.

Aladdin's genius

That is a tribute to BlackRock's elaborate risk-management models, but it is also discomfiting. A principle of healthy markets is that a cacophony of diverse actors come to different conclusions on the price of things, based on their own idiosyncratic analyses. The value of any asset is discovered by melding all these different opinions into a single price. An ecosystem which is dominated by a single line of thinking is not healthy, in politics, in nature or in markets. Such groupthink in finance is a recipe for booms (when everyone wants to buy the same thing) and busts (when they all rush to sell). Though Aladdin advises clients on investment decisions rather than making them, it inevitably frames how they think of market risk.

The last crisis had many causes. One of them, which perhaps lay behind all the others, was that investors stopped thinking critically about what they were buying. Too many decided to trust credit-rating agencies, which assured them, for example, that packages of American subprime mortgages were extremely unlikely to default. BlackRock's models are no doubt better than the clunkers put out by Moody's or Standard & Poor's up to 2008: the firm's relative recent success has proved that. But too many investors relying on a single model spreads an unhealthy orthodoxy and is likely to make the markets more volatile than they otherwise would be.

That is probably not a serious systemic risk, for it will be self-limiting: the more money follows BlackRock, the more money there is to be made betting against it. The real danger is for investors. The more they rely on BlackRock's analysis, the smaller the upside when it gets things right and the greater the downside when it gets things wrong—as, one day, it eventually will. Until then BlackRock's single-minded focus on mastering risk is to be commended. If its peers in the financial world had taken the same approach in the run-up to 2008, much of the chaos of the past five years would have been averted.

From the print edition: Leaders

