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What Ted's Thinking

LIV Golf is Asset Management in Reverse

The world of professional golf is ablaze with a new competitive threat to the established PGA Tour. Backed by funds from the Saudi Sovereign Wealth Fund and insights from former professional and savvy businessman Greg Norman, LIV Golf is plowing $1 billion into wooing golfers to compete on their new tour.

Golf may seem irrelevant to asset management. In fact, it’s been nine years since I wrote about golf, drawing lessons from the sport about when to sell a fund manager. However, the LIV Tour made headlines for both its Saudi backing and its compensation structure. The backing shines a renewed light on Saudi Arabia’s human rights abuses, but were it not the Saudis, someone else would have created the LIV Tour. That’s the nature of free market competition against an entrenched monopoly. The compensation structure is what is really gaining traction.

The compensation structure of the two golf organizations parallels models in asset management - where it has been (LIV) and where it is going (PGA). Ironically, golf is moving in the opposite direction.

The PGA Tour is the epitome of pay-for-performance, akin to incentive fees in asset management. Golfers earn money only through excellence. A typical tour event lasts four days. After two days, the top of the field “makes the cut” and plays the last two days.[1] Any golfer that misses the cut does not earn a dime. At the end of four days, golfers are paid based on their place of finish for the week. Many golfers have resumes that indicate excellence,[2] but only the very best among them earn a living in the sport.

LIV Golf introduced appearance fees, akin to management fees in our industry. Players who sign up for the tour are paid to play handsomely irrespective of their result on the course. The compensation structure is great for golfers, as they gain stability of income and potentially a greater chance to weather performance volatility. Additionally, players ranked below the upper echelons gain resources to invest in their future.[3]

The interesting question that arises is not whether the LIV Golf compensation structure (or management fee income) is good for the players (or money managers). It is whether the scheme is good for results (of both golfers and money managers). Traditional asset management is typically a management fee-only business. Managers grow assets to boost profits for the asset manager, knowing full well that size is the enemy of performance. We've all seen studies that show the industry in aggregate has failed to deliver for clients net of fees, while many money managers enriched themselves in the process.

Alternative asset managers changed the compensation structure. Once cottage industries, hedge fund, venture capital, private equity, and other alternative managers created businesses where management fees covered expenses and incentives accrued only with performance, aligning their interests with their clients. Of course, no one realized thirty years ago that alternatives would go mainstream and management fees would become a massive profit center for large managers as well, but that's a separate issue.

The trend of compensation structures in asset management is the opposite of golf. Over time, assets in sub-optimal fee structures are shifting towards incentive-based rewards and away from fixed management fees. The industry is too mature with legacy agreements between managers and clients for this to happen quickly, but the trend is the allocator's friend.

What happens with the LIV Tour will be fascinating to watch. Golfers need some stability to maximize their performance, but it remains to be seen whether that stability allows a golfer to relax and sink a clutch putt or causes them to lose their competitive edge. And what can we infer about the golfers who eschew guarantees in favor of performance-only compensation?

[1] Technically, the standard cut line for a PGA event after two rounds is the score of the 65th lowest scoring professional (where lower scores are better in the sport).
[2] Those with 'scratch' or 'plus' handicaps. A golf handicap is a measure of past performance relative to par, or the number of strokes an expert player would need for a given hole. A scratch handicap is roughly equivalent to par and a plus handicap is better than par.
[3] A concept similar to that created by Michael Schwimer for minor league baseball players in Big League Advance. Listen to Moneyball as an Investment Strategy to learn more.

My take: Incentives matter. The LIV tour will continue to expand and take share from the PGA, as golfers experience the benefits of certainty for their pocketbooks. Golf scores will get worse. Stable income is good for golfers, but I'm in favor of money management is moving towards the PGA Tour's way of doing business.

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