2016 FINANCIAL PERFORMANCE STUDY

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InvestmentNews

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About this study

The survey was conducted between April 19, 2016 and June 22, 2016. The data collected was analyzed and assessed by the teams at InvestmentNews Research and The Ensemble Practice. In total, qualified data was used from 222 firms who supplied financial information for their organizations, in addition to providing fee structure, marketing & business development, staffing, strategy, and management data on their practice.

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The data reported in this study was provided directly by participants to InvestmentNews Research. InvestmentNews Research was not engaged to and did not audit or review this information and, accordingly, does not express an opinion or any other form of assurance on it. The data contained in this report may not be a statistically valid representation of the entire market of financial advisory firms; rather, it is representative of the firms that elected to participate in this survey.

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InvestmentNews Research

The mission of InvestmentNews Research is to provide financial advisers with the industry’s most informative practice management studies and benchmarking reports.

Our benchmarking studies are a leading source of market intelligence for advisory firms and industry partners, such as custodians, broker-dealers, service providers and professional organizations.

In 2009, InvestmentNews acquired two bellwether benchmarking studies from Moss Adams LLP — the Adviser Compensation & Staffing Study and the Financial Performance Study of Advisory Firms. We continue to improve and expand these two critical industry studies, while we have also introduced new studies on technology and succession planning that support the growth and development of financial advisory firms.

Led by VP and InvestmentNews Publisher Suzanne Siracuse, Associate Publisher Mark Bruno, Senior Research Analyst Matt Sirinides, and Research Associate AnnMarie Pino, our studies are supported and driven by a team with over 40 years of combined experience and exposure to the ever-evolving financial advisory business.

In addition to our research studies, InvestmentNews Research also produces regular webcasts and regional workshops that arm advisers with actionable insights. Our events allow advisers to hear directly from some of the industry’s leading experts - and also network with other advisers who are looking to improve their practices and grow their businesses.

Custom research: One of the core capabilities of InvestmentNews Research is providing custodians, broker-dealers and RIAs with custom benchmarking reports and white papers that leverage our deep data and analytical expertise. For more information about custom research requests and InvestmentNews Research, please contact Mark Bruno at 212-210-0116 and mbruno@investmentnews.com, or visit research.investmentnews.com/dashboard.
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The typical independent advisory firm was established in 1997 and will celebrate its 20th anniversary next year. Independent financial advisory firms have come a long way over the last two decades. Today they represent a thriving community of successful businesses that continue to grow and attract more clients and talented employees.

It is often said that if you are good at digging, your only reward is a bigger shovel. Likewise, as entrepreneurs grow their practices into highly successful businesses, they encounter new and more complex issues:

- The industry is struggling to find a systematic way of attracting new clients, and the marketing practices of average firms are challenged in many areas.
- The industry perceives that its main competition is the wirehouse, but that is not the case. Independent firms are primarily attracting clients who did not have an adviser previously, i.e., self-directed investors. Self-directed investors are a finite resource that are quickly being depleted.
- As growth slows, many firms turn to acquisitions as a way to continue expanding. However, firms looking to sell are few and far between.
- The largest firms seem to have an advantage in attracting the best clients and achieve outstanding results in profitability and productivity.
- The gap between the largest firms and the average firm continues to grow, making the generic term “advisory firm” increasingly inaccurate.
- Industry consolidation is prominent through mergers. Mergers differ from acquisitions in that they represent a friendly combination of firms.

Let us examine each issue in detail.

**The Industry Continues to Grow and Prosper, But Growth Is Slowing Down**

Although the typical advisory firm has doubled in size since 2011, the pace of that growth slowed down considerably in 2015 (Figure 1). With markets contributing little, firms relied only on their business development efforts for the addition of assets. While the results were not necessarily poor, they disappointed the ambitions of more than half the industry.

![Figure 1: Revenue Growth Rate over the Past Five Years](image)

Note: 2011 - 2014 data sourced from previous Moss Adams/InvestmentNews annual benchmarking studies

Of the firms participating in the study, 54% reported that they missed their growth goal in the last year. The lack of better results can be attributed to a collection of poor habits in the areas of marketing and sales, where firms have much room to improve. Before we examine those habits in detail, let us spend some time on the good news.

**Revenue and Income Reach Another Peak**

Independent firms reached another peak in revenue and profitability in 2015. Throughout every firm size category, profitability was very strong and revenues continued to grow. The average firm had just shy of $4 million in revenues and achieved a 26% profit margin (Figure 2).

This economic structure is a near match to the 40%-35%-25% relationship pioneered by Mark Tibergien, founder and innovator of practice management for advisers. Mark proposed 20 years ago that the direct expense for a firm should be no higher than 40% and overhead no higher than 35%, resulting in a 25% operating profit. Today, the average firm in the industry has achieved that goal, and owners are enjoying record incomes.
Throughout this study, we will refer to “Ensemble” firms, which are firms that have more than one professional. We categorize these firms into three types, defined by their size: Ensembles, Enterprise Ensembles and Super Ensembles. The first category, Ensembles, includes multi-professional firms with revenue up to $5 million. Ensembles are a fast-growing category that represents organizations that are transforming from an individual practice to a team-based firm, as well as established firms that are highly productive and quickly advancing toward the Enterprise Ensemble category. Enterprise Ensembles are defined as those with between $5M-$10M in annual revenue, while Super Ensembles generate greater than $10M in firm revenue annually.

**Figure 2: Average Revenue and Operating Profit by Firm Size**

![Average Revenue and Operating Profit by Firm Size](image)

The differences between Super Ensembles and the rest of the industry may be irreconcilable. The largest firms work with a very different client base, have a very different economic structure and, ultimately, experience a different set of challenges than smaller firms. The typical Super Ensemble has client relationships that are nearly three times larger, twice the income per owner and as many as seven times more employees than smaller firms.

We are not suggesting smaller firms are becoming extinct, noncompetitive or unsuccessful. However, they are dramatically different than their former cohorts, the Super Ensembles. What began as a cohesive community of independent practitioners in the 1990s has today, 25 years later, become a saturated industry consisting of firms that are increasingly different in nature.

**THE GAP BETWEEN SMALL AND LARGE WIDENS**

While success is present in every corner of the industry, the gap between the largest Super Ensembles and all other firms continues to grow (Figure 3). The differences are so significant that it is becoming more difficult to generalize the industry as any single type of business.

**Figure 3: Average Revenue of All Firms vs. Super Ensembles Over the Past Five Years**

![Average Revenue of All Firms vs. Super Ensembles Over the Past Five Years](image)

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**TOP PERFORMERS: SELECTIVITY AND SERVICE DRIVE PROFITS**

With that, an emphasis on sound financial management – regardless of firm size – will be more important than ever. The purpose of this study is to provide you with an overview of the key trends driving growth, productivity and financial performance throughout the industry.
The firm leaders who truly embrace the importance of managing both sides of the ledger—the revenue and expenses—in tandem to create a business, rather than a practice, have seen their firms produce superior results over an extended period. To better understand these firms and their financial management characteristics, we have created a category of “Top Performers” (see Appendix, p. 50) in our studies. In this year’s study, our Top Performers—the top-quartile of all participants in this study—were inherently the most profitable in the business and demonstrated an ability to produce profit margins that approached 40% in 2015 (Figure 4).

On a relative basis, their expenses and overhead are in line with all other firms. Yet, the industry’s top firms, size notwithstanding, often rely on highly productive partners to attract and oversee key—and ultimately larger—accounts than all others firms.

**Figure 4: Tale of the Tape: Top Performers vs. All Others**

<table>
<thead>
<tr>
<th></th>
<th>Top Performers</th>
<th>All Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>$4,693,219</td>
<td>$3,624,227</td>
</tr>
<tr>
<td>Revenue Growth</td>
<td>11.6%</td>
<td>7.0%</td>
</tr>
<tr>
<td>Operating Margin</td>
<td>39.2%</td>
<td>18.5%</td>
</tr>
<tr>
<td>AUM per Partner</td>
<td>$146,253,340</td>
<td>$99,842,375</td>
</tr>
<tr>
<td>AUM per Professional</td>
<td>$91,533,333</td>
<td>$51,923,589</td>
</tr>
</tbody>
</table>

It is worth noting that in 2015, Top Performers saw virtually no change in their overall asset levels, yet still managed significant revenue increases (the remaining 75% of participants saw assets increase by an average of 7.0% last year). This speaks to a key characteristic of Top Performing firms, which will be addressed throughout the study as we examine various firm types: The industry’s most profitable firms are those that attract the highest quality relationships—and command a premium for the services that they deliver to these clients (Figure 5). This is evidenced by the fact that the typical Top Performer generates $10,600 in revenue per client—35% more in annual revenue than the rest of the industry—despite having only a slightly larger size typical client size.

**Figure 5: Top Performers Service Larger Clients – and Command Higher Premiums**

<table>
<thead>
<tr>
<th>Client size</th>
<th>Top Performers Servicing</th>
<th>All Others Servicing</th>
<th>Top Performer - Average Fee</th>
<th>All Others - Average Fee</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100,000</td>
<td>25%</td>
<td>50%</td>
<td>1.30%</td>
<td>1.21%</td>
</tr>
<tr>
<td>$250,000</td>
<td>42%</td>
<td>64%</td>
<td>1.23%</td>
<td>1.20%</td>
</tr>
<tr>
<td>$500,000</td>
<td>72%</td>
<td>78%</td>
<td>1.11%</td>
<td>1.08%</td>
</tr>
<tr>
<td>$1,000,000</td>
<td>91%</td>
<td>88%</td>
<td>1.01%</td>
<td>0.98%</td>
</tr>
<tr>
<td>$5,000,000</td>
<td>83%</td>
<td>83%</td>
<td>0.91%</td>
<td>0.89%</td>
</tr>
<tr>
<td>$10,000,000</td>
<td>85%</td>
<td>79%</td>
<td>0.75%</td>
<td>0.75%</td>
</tr>
<tr>
<td>$25,000,000</td>
<td>70%</td>
<td>59%</td>
<td>0.59%</td>
<td>0.60%</td>
</tr>
</tbody>
</table>

To enable this, it is worth noting that 74% of Top Performers enforce a minimum asset level, vs. 61% of all others, indicating that Top Performers are more selective in the clients they take on, and by extension, more targeted in their sales efforts. To this end, the average client size for a Top Performing firm is $1.5M in assets; for all other firms, meanwhile, the average is $850,000.

**TOP FIRMS ATTRACT TOP CLIENTS**

The advantage of the largest firms does not lie in their technology budgets or the glamour of their offices. Rather, it is their ability to attract better clients. The relationship between the size of the firm and the size of that firm’s clients is well known, but it is always worth repeating. Consider the chart on the following page (Figure 6).
If we look at the correlation between the revenue per client and the size of the firm, the pattern is obvious; the larger the firm, the larger its client relationships. As competition intensifies, this relationship is likely to become very important. Indeed, we believe that competition is in fact intensifying because the typical firm’s primary source of new clients may not be a sustainable one.

**INDEPENDENTS ATTRACT SELF-DIRECTED INVESTORS**

The perception in the independent advisory industry has always been that independent firms compete fiercely for clients with large brokerage firms (i.e., wirehouses) and banks. The reality, however, could not be more different. The overwhelming majority of new clients are self-directed investors who did not have an adviser prior to choosing their current firm (Figure 7).

The average independent firm increased its total number of clients by 16% in 2015. Of these new clients, 74% were self-directed investors prior to choosing their current advisers. Only 16% of new clients had been working with a wirehouse firm or bank, while 10% were won from a competing independent firm. The typical firm lost 4% of its clients (in terms of number of clients rather than AUM), making the net addition of clients 13%.

Self-directed investors are a great source of new clients, but they are not a very sustainable one. After all, with every client addition, the number of self-directed investors declines. The creation of new wealth is only as fast as the economy (which is not very fast), or perhaps wealth transfers between generations. In addition, self-directed investors are also the ones courted the most by alternative platforms such as digital advice and discount options. This is why we believe that we will see competition intensify between independent firms going forward.

**FIRMS ARE NOT MEETING GROWTH TARGETS**

As aforementioned, 54% of firms in the study failed to meet their growth goals. Much of that can be attributed to poor marketing and sales methods. Consider the following:

- Sixty-two percent of firms in the study do not track the leads they generate. They do not know how many leads they had last year, nor from where those leads came.
Of leads generated, nearly half (46%) did not become “prospects” and never engaged with the firm. Imagine an initial phone call that never resulted in an appointment, or an introduction that never resulted in any other kind of contact.

Of the remaining leads, 33% were prospects who engaged with the firm but never became clients.

Only one of every five leads became a client.

Only 21% of firms set individual business development goals for their partners (a step that can greatly enhance accountability).

Of all marketing methods used, from community involvement to social media, no single method was scored “very successful” or “extremely successful” by more than 35% of firms. The majority of methods were only considered “moderately successful.”

THE PACE OF DEALS ACCELERATES

With business development and organic growth slowing, firms of all sizes are looking to make acquisitions. Forty-three percent of all firms plan to negotiate an acquisition in the next two years. Enterprise Ensembles—rather than Super Ensembles—are the most aggressive acquirers (Figure 8).

Figure 8: Firms Seeking an Acquisition or Merger in the Next Two Years

The supply of practices for sale, however, is another matter. Very few firms have the intention of selling in the next two years. Only 5% of all firms have any intention to sell according to the survey. Still, we know succession is looming. With many firms lacking an internal succession plan, we expect to see an increase in mergers between smaller firms and larger ones that employ the future generation of professionals.

CONCLUSION

As Aristotle once remarked, excellence is a habit. We see the truth in these words every year as we conduct the survey of financial advisory firms. Building the right habits and maintaining discipline in every area of business—from client service and growth, to people and operations—is the key to success.

The resources are here. Firms are profitable and have momentum. And we know from past studies and experience that most firms excel at client service. What this study reveals is that there are many habits to be corrected in the area of proactive growth.

The industry is consolidating and competition is intensifying. Firms of every size and every strategy need to elevate their performance. The industry is moving fast, and time will reveal those who can keep up with its momentum.