FINANCIAL SERIES

MARK C. TIBERGIEN · KIMBERLY G. DELLAROCCA

THE ENDURING ADVISORY FIRM

HOW TO SERVE YOUR CLIENTS MORE EFFECTIVELY AND OPERATE MORE EFFICIENTLY

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How to Serve Your Clients More Effectively and Operate More Efficiently

Mark Tibergien
Kim Dellarocca

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To Arlene Tibergien, Mark's wife, companion, and rock for over 35 years.
To Nico Dellarocca, the best thing that has ever happened to his mother, Kim.

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Acknowledgments

We consider ourselves fortunate to have found work that is fulfilling and challenging. Through our combined 60-plus-year journey we have learned a lot about the kinds of investments firms need to drive success. Above all we have learned that the most important investment one can make is in others. We have learned that the quality of our relationships is the biggest driver of our happiness and success. We have learned to slow down, to be present, to think win-win, and to do our best to build others up. We have learned that sharing our talents and wisdom matters, often most to those individuals whom we may never meet. We have learned to let go and laugh more. We have learned that friendship promotes the happiness of all.

We are grateful to include here a small list of those friends who have lent their wisdom and inspiration to the book, provided coaching and opportunities along our path, and been the people we most enjoy simply sharing a laugh over a bottle of wine. They are:

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We would also like to thank each other. We have had an enduring friendship for many years, and our efforts to put this book together did not compromise our relationship as some had predicted—rather they made it stronger.

Mark Tibergien and Kim Dellarocca

Preface

Financial services firms have long operated independently. The 1980s ushered in two variations on existing business models that accelerated the growth of the entrepreneurial mindset in which practitioners became owner/operators instead of working as employees of another firm: Registered Investment Advisors (RIA) and Independent Contractor Broker/Dealer (IBD) reps.

Now we are seeing a couple of new dynamics: first, the transformation from practice to business; second, the emergence of multi-owner/multi-employee advisory firms. In this light, the notion of independence becomes a bit murkier because there are more mouths to feed, more constituencies to please, and more competition for strategic direction from multiple points of view. While ownership may be independent, the notion of making decisions without the influence of others is less true.

That said, RIAs are the purest form of independence in that they are free of broker/dealer oversight and overrides on their compensation, whereas the IBD model is subject to supervision by the broker/dealers with whom they affiliate and they must share an override on their revenue production with the broker/dealers. There is also a difference in approach to business as recognized by their different regulatory structures, i.e., the SEC vs. FINRA: the RIA model is composed of professional buyers whereas the IBD model is composed mostly of professional sellers, meaning that in the former, they get paid directly by the clients and act as fiduciaries or client advocates on all accounts; whereas broker/dealer reps get paid on a grid for the products they sell and for the most part operate under a suitability standard, though a recent ruling by the Department of Labor will change that condition for retirement accounts.

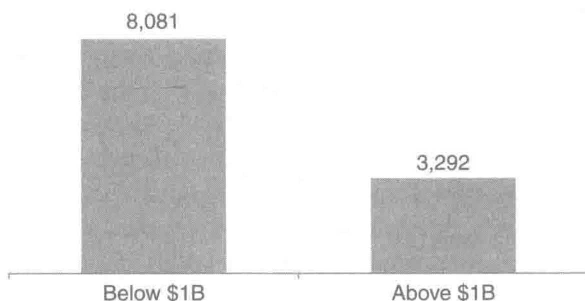
There has been some morphing of these identities in the past decade, however, as many IBD reps have either formed their own RIAs or became Investment Advisor Representatives (IAR) of their broker/dealer's corporate RIA. (Those who are registered reps and have their own RIA are known as Hybrid Advisors while those who operate under the supervision of their broker/dealer's corporate RIA are known as Dually Registered).

This background is important for understanding the transformation of the retail financial advice business and the catalyst for growth. Not only is there a big shift from brokerage to advisory, from transactional to fee revenue, or suitability to fiduciary, but from single books of businesses managed by solo practitioners to larger, professionally managed practices, many operating in multiple locations.

Perhaps the biggest leap in the evolution of independent advisory businesses is the shift from small to medium-sized firms. Consider this: The U.S. Small Business Administration (SBA) regards Financial Investment firms (NAIS Code 523) such as securities brokerage, portfolio management, investment advice, or trust & fiduciary firms as small businesses when their annual revenue is below $38.5 million. An advisory firm with $1 billion of assets charging an average of 80 bps would be generating under $10 million of annual revenue, so to exceed the small business threshold, an advisory firm would need to be managing somewhere between $3 and $4 billion of assets. While there are few who fit into that mid-sized category of advisory firm today, it is clear it won't be long before there is a meaningful cluster of such firms with more and more merging, acquiring, or growing organically to a new level of critical mass.

Just a decade ago, for example, it was a big deal for independent advisory firms to achieve $1 billion of assets under management (AUM). According to Evolution Revolution, produced by the Investment Advisor's Association in March 2015, more than half of all SEC-registered advisors have AUM between $100 million and $1 billion. Today, there are more than 3,000 RIA firms that manage more than $1 billion of assets (Figure P.1). Even more significant is that according to the 2016 Investment News Study on Compensation & Staffing sponsored by Pershing Advisor Solutions, there are now more employees within advisory firms than there are owners. Few things mark the emergence of a real business than this dynamic.

FIGURE P.1 Number of SEC-registered investment advisors above and below $1 billion real assets under management in 2015



Source: Investment Advisors' Association, Evolution Revolution 2015

For many firms that have become bigger, it may feel like those of us over 35 who seem to add a pound for every year we are on the planet. It's insidious, it's persistent, and it's maddening. Principals in larger advisory firms look around at their holiday parties and wonder how the guest list got so big! It is a management dilemma to experience challenges inherent in being a small practice but with the added complexity of a larger business.

Growth of these firms has come organically for the most part with the addition of new staff and new advisors. In other cases, growth came through mergers or acquisitions. Oftentimes, the growth was not conscious but merely reactive to the increasing demands for their services as their brands became stronger and their value became more appreciated.

Over the years, we've come to recognize that advisory firms hit a series a walls when they add more staff, almost in accordance with the Fibonacci sequence (a pattern of numbers where each number is the sum of the two preceding numbers). They hit a wall at 5 people, 8, 13, 21, and so forth. By hitting a wall, I mean that quality control, staff supervision and management, and the client experience each get strained.

In this scenario, each advisor seems to have their own approach to working with clients, developing recommendations and in some cases, even in how they produce reports. But far worse than applying a different approach to clients is when teams of individuals form cliques to pursue and serve clients a specific way for a specific need that is different from the firm's stated strategy. Often there is no consistent method of training, of quality control, or of staff development. The unevenness ultimately hurts the firm brand because clients are having distinctly different experiences depending on with whom they work. Even certain employees feel disadvantaged if they are on a team that is less productive or effective than another.

The good news is that the strain is caused by business growth and therefore the problem is eminently fixable. The bad news is that partners and employees often grow attached to their way of doing business so changing their behavior requires mutual sacrifice for the good of the enterprise.

When advisory firms evolve from small to medium size, relationships get strained and profitability suffers. But like adolescence when your clothes don't fit and mood swings become more frequent, one must conquer the awkwardness that this brings. When you hit the wall, ask the right questions: Is my strategy still relevant? Am I structured right to achieve my strategic goals? Do I have the right people doing the right things? Am I clear on what success looks like? Are we all in agreement about the goal and how we get there?

With this book, we have attempted to take a fresh look at the business of financial advice. Clearly, much has happened since the pioneers in financial

services climbed the mountains and swam the streams to find a new and effective way to help individuals achieve their financial goals. The early leaders in this movement had less of a desire to work with partners and employees than the people coming into this business today. But that leaves the next generation of leaders at a loss as to what successful business models look like.

In our opinion, there are five key characteristics that the best-performing advisory firms share:

1. Clear Positioning—they know who their optimal client is and create a client experience in alignment with this insight.
2. Structural Alignment—they design work flow, leverage technology, and build processes that allow them to serve their clients effectively while running their businesses efficiently.
3. People Planning—they strive to match the right people to the right jobs and create an environment where motivated people can flourish.
4. Actively Manage to Profitability—instead of viewing financial performance of their business as a consequence of their actions, they use the levers of financial management consciously to produce the right outcome.
5. Systematic Client Feedback—they incorporate a process that allows them to elicit from their clients insight into what's on their minds—not just whether they are satisfied but whether they are fulfilled and at peace with the direction they are heading.

As you read this book, we hope you will be able to recognize the different ways we suggest for incorporating these five elements into your thinking so that you can build a business to last.

Mark Tibergien and Kim Dellarocca

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PART I

The State of the Advisory Business

CHAPTER 1

Key Business Trends

Assumptions

Back in the day when individual investors were buying stocks and bonds instead of packaged solutions like mutual funds and ETFs, there was an investment analyst Mark knew in Seattle who was locally famous for his contrarian bets. His inclination was to look at companies currently out of favor with the investing public; assess their management, their culture, and their market; then take a long view of their business to determine whether it was an opportunity worth owning.

The stockbrokers who worked for this particular firm adored the man, whom we will call "Conan the Contrarian," because his reverse approach always made them look good with their clients. Today, whenever we hear some industry pundit spout conventional wisdom, we try to channel Conan. We find it helpful to ask, "What would Conan do?" whenever we see our profession fleeing from or toward an idea.

Among the beliefs most often repeated are:

- Advisors are reducing their fees.
- Young employees lack a work ethic.
- Robos/digital platforms will make it difficult for advisors to compete.
- The industry will benefit from a huge generational transfer of wealth.

There are many more, of course, but we examine these questions in light of the facts and the reality on the ground. No doubt, our opinions will stir the

ire of some but that's exactly what Conan would do—cause people to challenge convention, then act with the wisdom they've gained from the analysis.

Advisors Are Reducing Their Fees

While there are a number of advisors who claim to be experiencing some fee compression, we have found that the top-performing advisory firms have actually increased their fees in each bracket of client. Much has been written about fee compression in the industry but we struggle to find signs of such a trend. In fact, in 2010, the yield on AUM (revenue divided by AUM) was 78 basis points, compared to 77 in a 2014 study and 75 in the 2015 study.[1]

It appears those firms most under pressure are the ones whose value proposition is tied to investment performance. There are also some wealth management firms who have had more difficult conversations in the past year with clients who are experiencing percentage returns of less than 5 percent.

Those who have raised their fees claim they have had very little attrition because they have been able to demonstrate value beyond the investing relationship and even beyond the basics of financial planning. They may be giving their clients unique access to private banking or alternative investments, or they are creating a community of clients in which others want to be part.

As we have learned from observing other industries that have been commoditized (for example, coffee, retail grocery, medicine, tax accounting), those who can command a premium are those who can deliver a premium experience and who are perceived to be offering more value.

Young Employees Lack a Work Ethic

It is a curious claim among industry elders that it is a challenge to find young people who work as hard as they do. Having interacted with thousands of advisors over our careers, we would agree that advisors born in the Baby Boom era tend to value motion over movement and equate time in the office with hard work. But the amount one perspires is not a measure of perseverance.

Gen X, Y, and now Z employees seem to eschew the illusion of industriousness created by their forerunners as they seek more balance in their life to pursue other interests and devote time to their important relationships. They consistently ask their bosses to evaluate them on output, not input. This is a

---

[1] *Investment News*, "The 2015 Investment News Compensation and Staffing Study," October 18, 2015. Available at: www.investmentnews.com/section/specialreport/20151018/COMPSTAFF.

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