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TD Ameritrade
Institutional Benchmarking

Celebrating
10Years

*of The FA Insight Study
of Advisory Firms*

Executive Summary

The 2018
FA Insight Study
of Advisory Firms:

Growth by Design



Ameritrade
Institutional



About the Survey

The objective of this research was to understand attitudes and experiences related to growth including strategic planning, pricing, marketing, client demographics, technology and operational practices.

The research was completed from February 2018 to March 2018 through an online survey with 321 independent RIAs. All survey respondents have been in business for at least one year, generate a minimum of \$150,000 in annual gross revenue and serve individuals or households as primary clients.

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Celebrating 10 Years

This year marks the 10th anniversary of *The FA Insight Study of Advisory Firms!* Over the years the study has sought to better understand the challenges and opportunities advisory firms face as they grow from a practice to a business and ultimately into an enterprise. Thousands of firms have participated in this important research study since its inception, establishing the study as one of the industry's leading advisor benchmarking studies.

With *Growth by Design* as this year's theme, the study concentrates on growth trends throughout the industry as well as *how* advisory firms are driving accelerated growth. The study examines strategic planning processes, operational efficiency, productivity, the use of technology, pricing, marketing, business development and more.

2017: A Banner Year for Growth, Mostly

After a challenging 2016, advisory firms seem to have experienced a healthy comeback in 2017 across the majority of growth indicators, with nearly three quarters of firms reporting significant growth. Median annual client growth, the growth metric most indicative of business expansion, hit a record high of 7.8%. Growth in assets under management was nearly as impressive with AUM growth for the typical firm coming in at 19.9% in 2017 versus 13.0% the year prior, and nearly equal to the record AUM growth reached in 2009.

Figure 1
Median Growth Rates



To keep up with accelerated business growth, firms brought on new talent. The growth rate for full-time equivalents (FTEs) in 2017 was 7.4% across all firms, and 10% for Pacesetters, our largest peer group within the study, generating \$8 million or more in annual revenue. With expansion, however, comes expense. Greater compensation costs for revenue generating roles as well as infrastructure reinvestment caused profit margins to dip down to 19.7% from 24.4% in 2016. These necessary improvements and investments in staff may have been deferred from 2016 where diminished revenue growth caused firms to proceed more cautiously. Over the long-term, these expenditures can be strong growth drivers for advisory firms looking to increase revenue and profitability.

It's Not Just Market Tail Winds

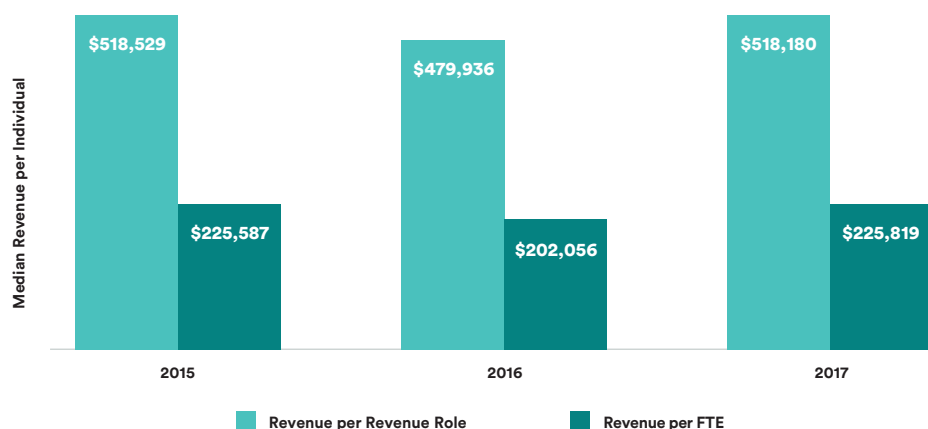
While some might speculate that the stellar growth experienced in 2017 can be highly attributed to security market performance due to the strong preference for tying fees to AUM among firms, there are other contributing factors to consider. The typical 60/40 portfolio was up 13.5% in 2017¹, suggesting that only about two-thirds of firm AUM growth was influenced by market performance. An important part of the revenue growth story is the continued proven ability of firms to attract new clients. With firms attracting more clients and investable assets, advisors reported 15.8% revenue growth, twice 2016's rate. Median AUM per client also climbed higher in 2017, increasing 6.8% to reach nearly \$1,000,000.

Productivity Rebounds After Being Put on the Watch List

More good news during 2017 came in the form of improved productivity, a performance metric we placed on the “watchlist” after the sharp drop experienced the previous year. Measured in terms of revenue per team member, productivity reached a record high. At about \$226,000 in 2017, productivity was up 12% after a 10% dip in 2016. Revenue per revenue generating role also rebounded to 2015 levels. The improved productivity came on top of strong growth in firm team size, with the typical firm expanding from 5.0 to 6.0 full-time equivalents.

Figure 2
Productivity Recovers Nicely from 10% Decline in 2016

Team Member Productivity, 2015–2017



Source: The 2017 FA Insight Study of Advisory Firms: People and Pay.

¹ Based on a model portfolio allocated across the following benchmarks: 35% Bloomberg Barclays U.S. Aggregate Bond, 35% S&P 500, 15% MSCI EAFE, 10% Russell 2000, and 5% Citigroup 3 Month T-Bill.

Profit Margins Soar for Firms Focused on a Target Market

Firms with a specific target market, that is those who claim at least half of their client base meets their ideal client criteria, are achieving greater rates of growth and profitability than their peers. The median operating profit margin for target-focused firms, for example, was 18% greater; median annual client growth was 35% greater. By staying laser focused on their target client these firms are able to realize greater efficiencies in servicing and marketing, which in turn reduces costs and boosts growth.



Median operating profit margin was **18% greater**; median annual client growth was **35% greater**.

Maintaining that laser focus on a target market requires discipline. While 63% of firms have defined their ideal client, exceptions are often granted which in turn dilutes the benefits of this strategy. The result is that, for many firms, a small share of clients generates a larger and disproportionate share of revenue. In fact, across all study participants, half of all revenue is generated by the top 20% of clients. Granted, firms are doing better than the generally accepted 80/20 rule which states that 80% of all revenue is generated from 20% of a firm's clients, it is still a client trend to watch.

Is Pricing Power Eroding?

The debate surrounding pricing strategies continues among advisory firms. Should firms continue to charge primarily an AUM based fee for all of their services or move to a more diversified approach including minimum and a la carte fees, advice fees on total net worth, financial planning fees and more? New entrants into the financial advice space at lower price points, changing investor preferences and challenges in articulating value are all factors contributing to what may be a period of price erosion.



One in six firm owners cites **pricing pressures** among the top factors that will **most challenge their firm's future growth**.

As a result, firms may be becoming more hesitant to pull the pricing lever as a way to generate revenue growth. Instead, advisory firms seem to be in a “wait and see” mode. Two-thirds of firms made no pricing change over the last two years and 84% of firms expect to make no changes over the next two years.


The strongest signal of eroding pricing power emerges when assets managed are compared with actual revenue collected. Study participants report that for every dollar in AUM, 71 basis points in revenue was generated in contrast to the recent peak of 78 basis points. Given the typical client size at nearly \$1 million, and the median 100 basis point reported fee on portfolios of this size, 71 basis points is well below what you might expect. Numerous factors may be at work here; however, it is most likely that pricing exceptions may be occurring at greater rate than is desirable.

The best defense against having to grant pricing concessions is a strong ability to articulate and demonstrate how you generate value for your clients. In other words, how are you earning the fee charged? Firms may also consider implementing an additional layer of approvals for pricing exception requests. This can be helpful in holding individuals more accountable in upholding firm policy and limit the negative financial impact that comes from unplanned fee waivers.

The Forces at Play: Focus on What You Can Control, But Be Aware of the Rest

By focusing on factors directly within their control, firms can continue to build on today’s success driving healthy growth and where possible minimizing the growing pains so often experienced as firms graduate from one development stage to the next. Competition is fierce and firm owners acknowledge that sustaining current growth rates will be challenging as they move forward. Key areas of focus will be increasing capabilities around marketing, client acquisition, maximizing human capital, enhancing the client experience and increasing efficiency.

Always an optimistic group, advisory firm owners fully expect growth to continue through 2018, though at a slower rate. Economic cycles, market performance, politics, “the new economy” and other factors outside of a firm owner’s direct control are forces to be aware of but not counted on as firms drive toward achieving sustainable growth and building firm value over the long-term. As firm owners move forward with their strategic plans, they need to monitor external forces, determine their impact and, if necessary, change course to take advantage of emerging opportunities.

A woman with dark, curly hair is smiling at the camera. She is wearing a white blazer over a dark top. She is sitting at a desk, and her hands are on a laptop. In the background, another person is blurred, and there are office shelves and a red chair. The overall tone is professional and positive.

Flexibility and adaptability will
be key factors in a firm's ability to
compete into the future.

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