charles SCHWAB

The power of the independent advice business model

More than one-third of RIAs have doubled their AUM and revenues since the lows of 2009

MKT Market Knowledge Tools

Results from the 2014 RIA Benchmarking Study from Charles Schwab reveal that firms have grown significantly since the market lows five years ago.

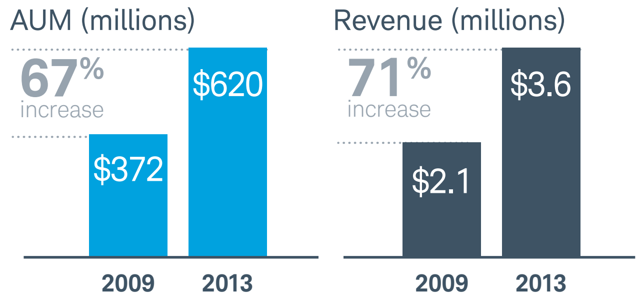
If you think back to the environment post-2008, registered investment advisors (RIAs) entered uncharted territory. The pundits were predicting that many RIAs would not survive due to the difficult operating environment. Fast-forward to the end of 2013 and we see a very different picture: More than one-third of the firms that participated in the 2014 RIA Benchmarking Study from Charles Schwab have doubled their assets under management (AUM) and revenues since 2009.

In 2013, RIAs showed record growth and the highest profitability of any year since the inception[1] of Schwab's annual Benchmarking Study. The median firm realized a 12.8% compound annual growth rate (CAGR)[2] in AUM and 13.6% in revenues. In fact, the median revenue climbed to $3.3 million, and one-third of these firms earned more than $5 million in revenues—showing that a vast majority of firms are meeting the many challenges that come with growth.

However, this remarkable growth did not come at the cost of doubling the number of clients or significantly increasing the number of professionals or support staff. The median firm added 29% more clients since 2009, or about 19 new relationships per year.

1. The first year of Schwab's RIA Benchmarking Study was 2006.
2. Median 4-year CAGR for period 2010–2013.

RIAs post strong performance



Staff and clients

	Total clients	Average total staff	Average professional staff
2009	257	18	9
2013	331	21	11

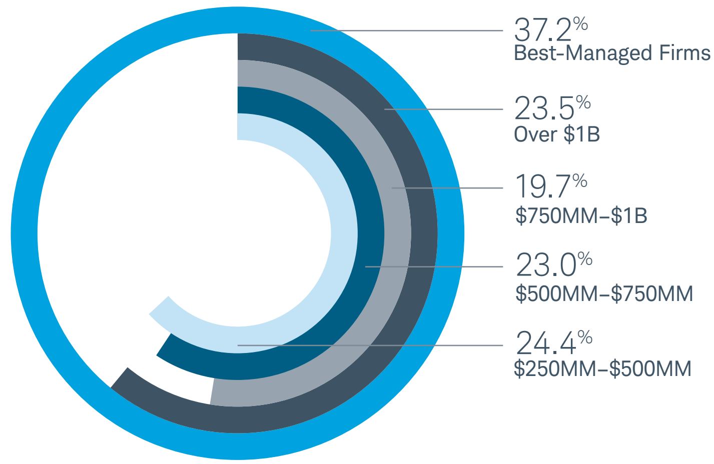
Past performance is no guarantee of future results. Median results for all firms $250 million or more in AUM that participated in both the 2010 and 2014 studies, unless otherwise noted.

These results highlight the power of the RIA model and are a testament to the significant maturity and operating discipline across the industry. RIAs have made meaningful investments in infrastructure and people, and have benefited a great deal from investors' strong preference for independent, unbiased advice. The trend over five years of Schwab's RIA Benchmarking Studies is clear: The firms that outperform are those that institutionalize their business, make growth an imperative, and create a cycle of opportunity to attract and retain top talent.

Schwab's annual Benchmarking Study is the largest of its kind focused exclusively on RIAs. This year 1,132 firms representing nearly three-quarters of a trillion dollars in AUM completed the survey, reflecting their experiences in 2013 as well as their annual growth rates from 2010 to 2013. The results in the following pages, unless otherwise noted, include all firms with at least $250 million in AUM, representing the vast majority of total assets managed by this year's participants.

Standardized operating margin

Median results by peer group (AUM)



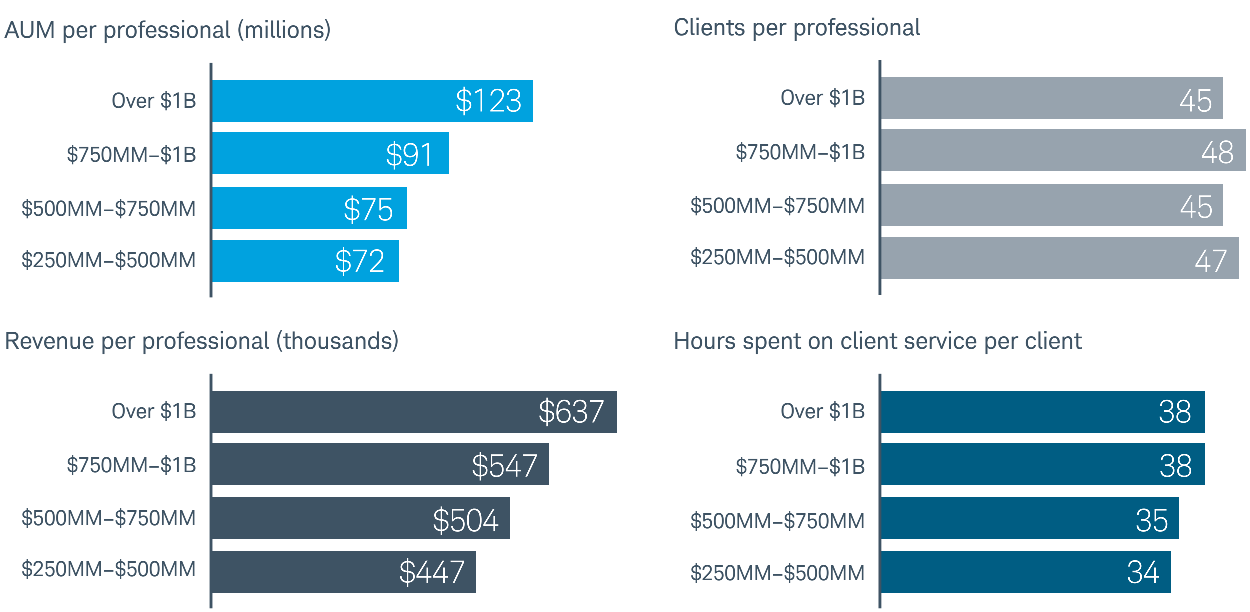
Creating enduring enterprises

As independent advisory firms have evolved through their lifecycle, many firms have developed a similar philosophy, both in terms of what they want their business to become and what they would like it to do for them, and for good reason. Over the past five years, the median standardized operating margin increased 38%, reaching 25% at the median, and revenue per professional jumped 37%, reaching $530,000 at the median. For firms that manage more than $1 billion in AUM, revenue per professional increased considerably to more than $637,000 at the median. However, this is not a result of managing more relationships per professional or spending more time per client—both remain consistent regardless of firm size. The data shows that larger firms serve clients with more assets.

With this prosperity, we found that many RIAs are more interested in building enduring businesses that identify next-generation leaders and owners from within. Our interviews with Best-Managed Firms—the top 20% of firms surveyed that excelled in growth, productivity, and profitability—and the results they reported show a remarkable consistency in the approaches and

The benefits of scale

Median results by peer group (AUM)



attributes that help them grow faster than firms at the median. To accomplish this, all felt that strong organic client growth—the change in assets from existing clients, new clients, and assets lost to client attrition—was imperative.

Skeptics may point out that the last five years of RIA growth coincided with a steady run-up in the market from record lows to record highs. And while market returns played an important role in the significant gains in AUM and revenues, RIAs have experienced nearly 50% of their AUM growth as the result of new client acquisitions and existing client share-of-wallet increases. RIAs in every peer group showed remarkable consistency in adding new clients.

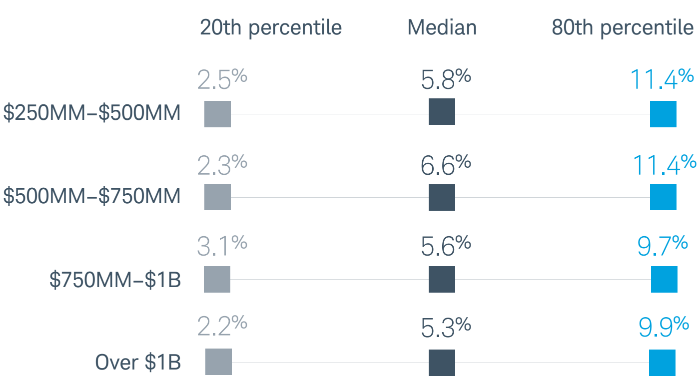
Contrast in performance

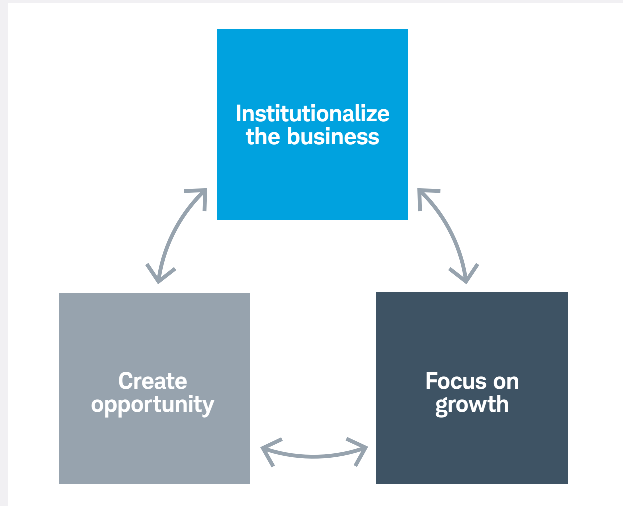
The median firm in the study grew at a 12.8% CAGR,[3] which translates to a 62% increase in AUM over the prior four years. These results include firms that grew much faster than the median firm. The top 20% of firms saw AUM growth of 18.7%. This translates to a doubling in AUM over the prior four years.

While all firms added new clients, we saw a significant contrast in growth rates across firms in the study. Successfully adding new client relationships through effective execution of a referral marketing strategy remains the top way firms outperform in each peer group. The fastest-growing firms—top 20% of firms surveyed as determined by the 4-year net organic CAGR—added approximately 30% more new clients and experienced 3.6 times more organic growth than all other firms at the median in 2013. The results of the study show that firm size is not correlated to a firm's ability to successfully execute on its growth strategy. The firms that are bringing on the most new clients and have the greatest AUM growth are in every peer group.

2013 Growth from new clients

Results by peer group (AUM)





Firms that institutionalize their business, make growth a strategic focus, and create a cycle of opportunity to attract and retain top talent tend to outperform their peers.

The virtuous cycle of growth

The leaders of Best-Managed Firms told us what was important to them in building an enduring and thriving enterprise. They spoke about how institutionalizing client relationships and creating scalable operations were foundational for each of them. They also noted the need to create a strategic approach to attracting new clients and said they continued to take steps to attract, incent, and train the talent they needed to further grow organically. Finally, each felt the need to create a cycle of opportunity that would allow talented employees to share in the growth of the firm. This translated in most cases to creating a formal path to equity ownership for key employees.

Institutionalizing the business

Since 2009, a substantial number of firms have evolved from advisory practices into well-managed businesses with more organizational structure, disciplined processes, and dedicated management.

Planning is now part of the fabric of most well-managed RIAs—61% of firms have a written strategic plan, up from 52% last year. Interestingly, we see an inflection point with strategic planning as firms grow in size. Nearly 75% of firms with $500 million to $750 million in assets have a written strategic plan, compared with half of firms in the $250 million to $500 million peer group. One-third of firms across the study are focused on enhancing and executing their strategic business plan as a top initiative this year. These firms recognize that managing growth and maximizing profitability require documented business planning and help them better prepare for a changing competitive landscape.

3. Median 4-year CAGR for period 2010–2013.

Firms are also creating long-term opportunities and building enduring businesses through succession planning. The percentage of firms that have a written succession plan continues to increase each year to nearly 50% in 2013. The majority of firms in the study plan to add or promote principals from within and are documenting the path to partnership to retain and incent their people. This path to partnership creates an owner-operated or shared ownership model that can supercharge a firm's growth. It is one of the most important value drivers a firm can put into place to ensure continuity, and when in place, valuations can be higher for firms seeking third-party funding or participation in a merger.

In addition, successful firms seek to apply operational discipline. One-third of firms in the study report they are focused on implementing a client segmentation strategy. This will enable them to create a more productive operating environment and deliver their high-touch client experience to more people while they continue growing.

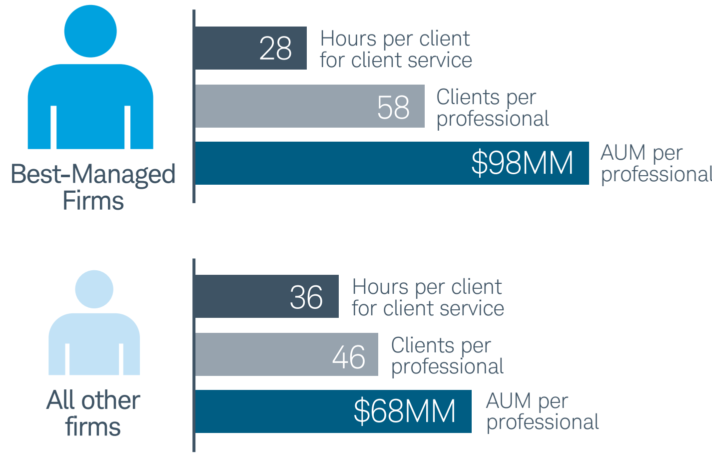
As a business matures, it is challenged to simultaneously maximize performance against client needs and against the firm's goals for operational and financial performance. We consistently see that Best-Managed Firms meet those challenges, serving more clients and larger clients per professional, while spending approximately one-quarter fewer hours per client for client service.

For many firms, building a foundation of efficiency starts with bringing on dedicated management to run the business. Forty-seven percent of firms with more than $1 billion in assets have a chief operating officer to actively manage the day-to-day operations, affording firm principals the time and capacity to focus on managing clients and growing the business. In most cases, the skills of dedicated management and firm principals complement each other and ensure a firm is poised to maximize its success.

Technology is another important enabler of productivity and efficiency that continues to evolve into an essential part of the client and service experience. Many more firms are addressing how they can improve the client experience through an increased focus on technology that allows electronic interactions with clients.

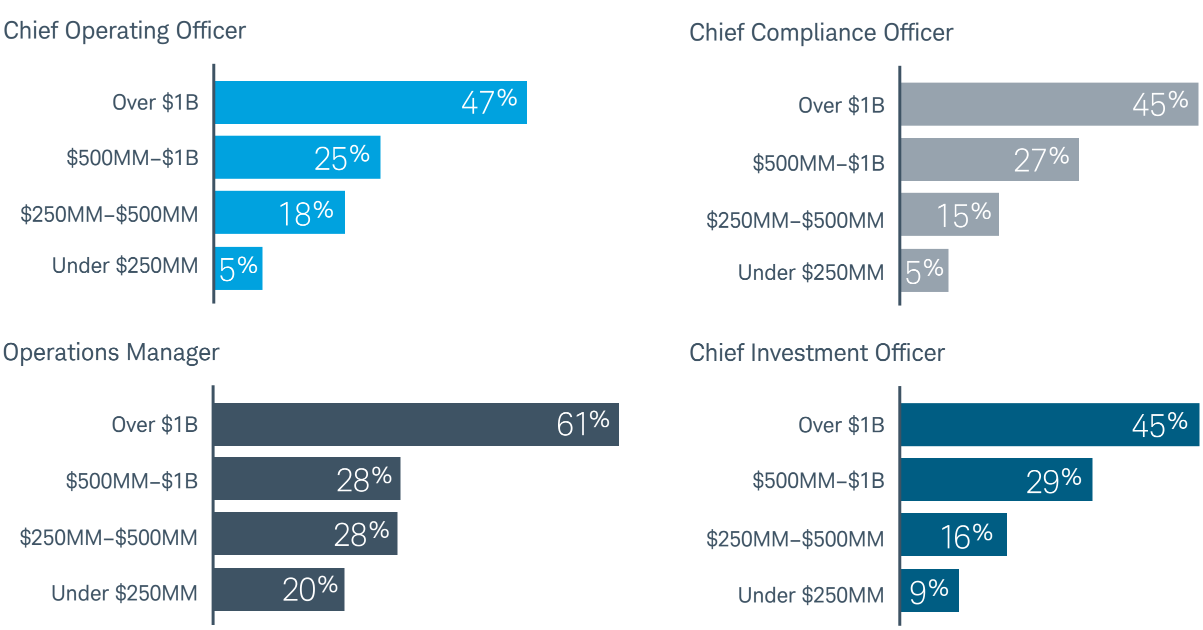
Operational discipline yields results

Best-Managed Firms vs. all other firms



Dedicated management creates capacity for growth

Percentage of firms with role



In fact, twice as many firms as in the previous year are investing in an online portal to share information with clients, and significantly more are investing in mobile account access. As firms face more competition, many are thinking about evolving their client experience to meet changing client expectations.

Relentless focus on growth

Each year nearly all advisory firms rank "acquiring new clients" as their top strategic business priority. 2014 is no exception. Approximately 25% of firms in the study expect to double in size again over the next five years or sooner. These firms are focused on growth and pursue disciplined growth strategies. Increasing the number of people in the firm who are capable of generating referrals and closing new business is something many firms are actively trying to achieve. The fastest-growing firms are focused primarily on superior organic growth, while some—nearly 25%—are also looking to make opportunistic acquisitions. As acquisitions continue to be challenging, the fastest-growers are focused on generating and closing referred business. Many are remarkably successful at bringing on more than their expected share of new clients—approximately 30% more than all other firms at the median. They also bring on larger clients, due mainly to their success with centers of influence, generating 3.6 times more organic growth than all other firms at the median.

For the majority of advisory firms, growth is a primary business concern year after year. Yet, despite widespread agreement that referrals are the main driver of growth, many firms do not dedicate the time and resources required to create a formalized initiative. For the fastest-growing firms, growth is viewed as imperative and nonnegotiable.

These outperforming firms excel at relationship marketing. They distinguish themselves by training their entire team to recognize, create, and capitalize on referable moments. They understand that investing in a referral training program not only increases referrals, but also helps attract the types of clients that the firm can serve best. This creates a virtuous cycle of engaged clients who organically promote the firm's services to friends and peers, which helps the advisor connect with the prospect from a place of greater trust and credibility and, in many cases, win the business more easily. The fastest-growing firms further believe that what brought them to their current level of success is not enough to take them to the next. They constantly look for new ways to grow.

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Other approaches to growth include a "hire to acquire" strategy—bringing on an individual with a book of business. The primary motivator is to grow AUM, which is why 50% of firms reported that they are actively pursuing an individual advisor with transferable client assets in 2014. However, in 2013 only 13% of firms were able to implement this growth strategy. One of the reasons for this low success rate may be the difficulty they face aligning their interests.

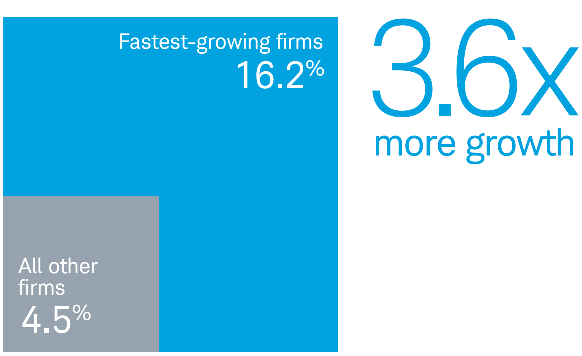
Creating a cycle of opportunity

The exceptional asset and headcount growth in the RIA channel continues to outpace the industry average.[4] We have witnessed a large migration of talent from other channels and adjacent industries—from wirehouses and banks, accounting and law firms, even from business schools and universities. We know that the independent model has resonated with investors and is winning in the marketplace. The delivery model is also resonating with talented professionals who want to participate in a growing and profitable business, and feel strongly about how they ought to deliver advice. As a result, many new advisors enter the RIA industry each year.

4. Cerulli Associates Inc.

The fastest-growing firms excel at relationship management

Median results for all firms $250 million or more in AUM



4-year net asset flows CAGR (2010–2013)

2013 net asset flows from new clients

Advisory firms continue to attract top-level talent to support their growth and help them prepare for their future. In many cases, RIAs are tapping ancillary professions to find talent. Witness the fact that for firms in the $500 million to $750 million peer group, 45% have at least one CPA on staff and 32% have at least one JD on staff. At firms over $1 billion in assets, these numbers jump to 70% and 53%, respectively. Many of these professionals are not providing legal and tax work as their primary job responsibilities. They are attracted to what an RIA firm has to offer the well-trained professional from an income, career opportunity, and lifestyle standpoint. As one would expect, across the study 79% of firms reported having at least one CFP on staff, and 65% reported having at least one CFA on staff.

Sustaining from within

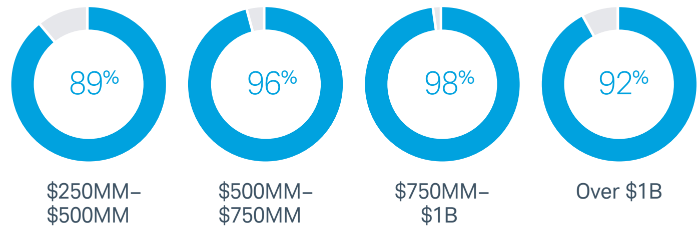
Talent is a strategic asset. Best-Managed Firms take measures to attract and retain the best talent and prevent their top performers from wandering. (Other RIA firms are a top source of new hires; 50% of new hires in 2013 left one RIA firm to join another.)

They do so by creating a path to equity ownership. Results from the study show equity is more widespread at larger firms. In fact, at firms with more than $1 billion in assets, twice as many professional staff hold equity compared with firms with $250 million to $500 million in assets. This is something growth firms are addressing in their lifecycle as they surpass $500 million in assets. These firms create opportunities for employees to become owner-operators, giving them clear career paths and cultivating the next generation of leadership.

The study shows that many firms are putting into place the second and third generations of principals who are emerging as the future leaders for their businesses. We are seeing talented people emerge with strong professional and managerial skills, taking on greater responsibility in advisory firms throughout the country and acquiring ownership as founders prepare for succession. It is

Founders and principals not only want their firms to endure, but also want continuity of the firms' people, culture, and values.

Percentage of firms looking to develop internal successors
Results by peer group (AUM)



worth noting that most founders wish to transfer ownership gradually to insiders, rather than transfer control and ownership to third parties. Developing one or more internal successors is by far the preferred succession strategy of firms at all levels. This suggests that founders and principals not only want their firms to endure, but also want continuity of the firms' people, culture, and values.

The future is bright

We believe that the independent advice model will continue to attract talent from other industries and other advice models, helping to fuel ongoing growth. RIA firms have evolved significantly from the days when they referred to themselves as practices. Today, many firms are becoming enduring enterprises with well-documented strategic plans and succession plans in place.

Indeed, a profitable industry with high margins will attract new entrants, and advisors are aware that competition will change the landscape. Among the challenges advisory firms will likely face are pricing pressures and more choices for the investor. Perhaps more importantly, firms will experience greater competition for seasoned employees who will want to join well-managed, growing firms that present the greatest opportunities. As a result, the need to attract and retain high-quality professionals is paramount for the firm that wishes to grow and thrive.

The trend over five years of Schwab's RIA Benchmarking Studies is clear: Firms that institutionalize their business, make growth an imperative, and create a cycle of opportunity to attract and retain top talent have a demonstrable edge in an increasingly competitive industry.

About the 2014 RIA Benchmarking Study from Charles Schwab

Schwab designed this study to capture insights in the RIA industry, based on survey responses from individual firms. The 2014 study provides information on topics such as asset and revenue growth, sources of new clients, products and pricing, staffing, compensation, marketing, technology, and financial performance.

Since the inception of the study in 2006, nearly 2,800 firms have participated, with over half being repeat participants. A total of 1,132 advisory firms representing three-quarters of a trillion dollars in AUM that custody their assets with Schwab participated this year, making this the leading study in the RIA industry.

The RIA Benchmarking Study comprises self-reported data from advisory firms that custody their assets with Schwab. Schwab did not independently verify the self-reported information. Participant firms represent various sizes and business models. They are categorized into 12 peer groups—7 wealth manager groups and 5 money manager groups, by AUM size.

Best-Managed Firms represents advisors in the study who are in the top 20% of qualifying firms, ranked by productivity (2013 revenue per professional), profitability (2013 standardized operating margin), revenue growth (2009–2013 CAGR in revenue) and net asset growth (2009–2013 CAGR from net asset flows). The top 20% of firms was calculated after removing those with less than $1 million in revenue or fewer than two professional staff. Best-Managed Firms were selected without regard to peer group, and most groups are represented in the Best-Managed Firms group.

The fastest-growing firms are the top 20% of firms as determined by net organic growth (2009–2013 net organic CAGR). This cohort includes 108 firms out of 541, all of which have $250 million or more in AUM. This group represents 91% of the total assets of all firms in the study. Net organic growth—the change in assets from existing clients, new clients, and assets lost to client attrition—is the area over which RIAs have most control. Thus, it is the growth metric used for the analysis.

The study is part of Schwab's Business Consulting Services, a practice management offering for RIAs. Grounded in the best practices of leading independent advisory firms, Business Consulting Services provides insight, guidance, tools, and resources to help you strategically manage and grow your firm.

About Schwab Market Knowledge Tools® (MKT)

Based on the leadership position of Charles Schwab & Co., Inc. in the RIA marketplace (nearly 7,000 advisors and over 25 years as of this printing), we are in a position to observe what works in successful advisory firms. Through Schwab's proprietary benchmarking and in-depth qualitative research with successful firms, we are able to discover and share best practices.

This white paper is part of the Schwab MKT series, an ongoing program of industry research reports, white papers, and guides from Schwab designed to keep investment advisors on the forefront of trends and competitive challenges facing the industry today. The MKT program delivers the kind of relevant and timely information needed for business planning.

For more information

To learn more about the Schwab RIA Benchmarking Study and other Business Consulting Services resources, or if you are a Schwab client and would like to participate in the next RIA Benchmarking Study, please contact your relationship manager.

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