

ONE-SIZE PRACTICE MANAGEMENT
DOESN'T FIT ALL, AS THE MOST
PROFITABLE FIRMS KNOW WELL

BY MAYA IVANOVA AND LORI KLASH

Small Is Beautiful

“Bigger is better.” It’s hard not to buy into it. These days it seems we’re conditioned to want the bigger house with the bigger yard with the bigger SUV in the bigger garage. It’s no surprise that this mentality has also influenced the planning industry as advisors seek to acquire new clients to bolster assets under management. While there’s nothing wrong with this approach, it ignores the fact that many smaller firms can—and do—enjoy a great deal of success without reaching the lofty AUM goals that have become the industry standard.

Believing that profitability—not AUM—should serve as the industry’s yardstick for measuring success, we at Rydex Advisor Benchmarking set out to pinpoint what separates the best from the rest within different size categories. We looked at the most profitable smaller firms (those with less than \$100 million in AUM) and compared them to their counterparts in the small firm peer group. Likewise, we examined the large firm category (those with more than \$450 million in AUM) to see how the most profitable stacked up against their peers. Interestingly, we found that best practices among small and large firms do vary. If you’re still taking a one-size-fits-all approach to practice management, we hope these findings help you tailor your efforts to achieve greater profitability and success (see *“Defining the Best” sidebar, page 48, for more on what defines a “top” firm*).

The Best Small Firm

TIP #1: COMMIT TO AN AUM RANGE THAT FEELS RIGHT.

The most profitable small firms are those that have been in business the longest. The average age for a top small firm is 14 years compared to nine years for their peers. On the surface it seems fairly intuitive that the most profitable firms are the ones with the most time and experience under their belts. Look a bit deeper, and this finding also suggests that smaller firms that have

been in business for more than 10 years have made the strategic decision to stay small. Instead of focusing exclusively on asset gathering, the most profitable small firms emphasize increasing efficiencies and maximizing existing client relationships.

With approximately \$80 million in assets under management, Harrisburg, Pennsylvania-based TEAM Financial Services has been in business for more than 20 years. According to principal James Dailey, the demographics of the firm’s geographic market play a large role in determining appropriate AUM goals. “The vast majority of our clients are middle-class Americans. They’re teachers and government workers—salt-of-the-earth people who would not meet the large account minimums imposed by firms that might be based in wealthier regions such as Philadelphia or New York, for instance.”

Instead of struggling to become one of the larger firms on the block, TEAM Financial focuses on enhancing existing client relationships. “Traditionally it’s been the high net-worth individuals that have received the most attention from advisors,” explains Dailey. “But our specialty has been to bring an extremely high level of service to the middle class. We’re very high touch in the way we manage client relationships, and it has paid off for us.”

For those small firms that are contemplating getting bigger, Dailey encourages advisors to be honest with themselves about



their motives and expectations. “There’s a lot of self-imposed pressure in this industry aimed at increasing AUM,” he says. “But I’d urge advisors to take some time for reflection and determine who they are and what business model is going to work best for them.”

TIP #2: CLEARLY DEFINE YOUR MARKET NICHE.

Along with knowing what differentiates your firm from competitors, it’s important to know what sets your ideal clients apart from the masses. Advisors who periodically examine their client base and consider what their best clients have in common can more effectively market their services. Rydex AdvisorBenchmarking findings show that the most successful small firms demonstrate a better ability to define their market niche compared to their peers. While advisors traditionally consider wealth range first when selecting potential clients, our research suggests that they may be well served to look beyond this broad characteristic to better define their target market. Top small firms have a tendency to select clients based on specific investment needs or specific age groups. They also place a higher emphasis on selecting clients based on careers and lifestyles and, in some cases, even hobbies.

“Everyone seems to be chasing clients that meet a specific wealth range criteria, but we’ve found that this creates a vacuum for firms like ours to step in and provide financial planning to the mass affluent and middle classes,” says Dailey. “While the industry tends to focus on high- and ultra-high net worth individuals, we’re able to focus on the bread and butter. I believe that this has become our niche.”

According to Dailey, his clients’ investment needs tend to fall under the general financial planning umbrella. “We target clients who need help with the basics—budgeting, saving for retirement and planning for their kids’ college educations. We don’t need to have an in-house attorney or CPA to meet these needs and it’s definitely helped our bottom line.”

The Source of Our Numbers

This article is based on the results of the 2007 Rydex AdvisorBenchmarking survey, completed by 912 RIAs between March and June 2007. Since 1999, Rydex AdvisorBenchmarking has been conducting research focused on the RIA marketplace, providing advisors with free data and trend analysis to help them compare their practices to the most successful within the industry.

TIP #3: MOVE BEYOND AUM FEES.

For those advisors who wish to maintain a certain AUM level, it’s essential to focus on growing their practices in other ways that help boost profitability. The most successful small firms are diversifying their revenue streams by incorporating additional pricing structures.

Rydex AdvisorBenchmarking findings indicate that the most profitable small firms receive a lower percentage of their total revenue from traditional AUM fees. For the top small firms, AUM

Defining the Best

Here’s how we define “top” firms in small and large categories.

Top Small Firm Category

1. **Size of Firm:** Qualifying small firms have \$100 million or less in assets under management.
2. **Profitability:** The top small firms place in the top 10th percentile in terms of profits-per-principal.
3. **Profit Margins:** The top small firms have profit margins that are higher than the median for their size.

Top Large Firm Category

1. **Size of Firm:** Qualifying firms have assets under management in excess of \$450 million.
2. **Profitability:** Top large firms place in the top 10th percentile in terms of profits-per-principal.
3. **Profit Margins:** The top large firms have profit margins that are higher than the median for their size.

fees account for 74.25% of total revenue compared to 80.25% for their peer group. Successful small firms are moving beyond AUM fees to adopt more flexible pricing structures that may be suitable for clients who have special needs or who do not meet account minimum requirements. Revenue derived from consulting and planning fees totals 23.45% for the top small firms versus 19.41% for average small firms. A diversified pricing structure can help create a win/win for small firms and their clients. Advisors can introduce new sources of revenue, while clients can select à la carte and project-based financial planning to meet their needs.

The Best Large Firms

TIP #1: OFFER A WIDE RANGE OF SERVICES.

It’s no surprise that as firms get bigger, so do their expenses. In order to maintain attractive profit margins, large firms must continue to keep an eye on the bottom line as they grow assets. The most successful large firms realize that acquiring new clients is not the only way to increase AUM. They also offer a wide range of services to help attract new assets from existing clients. Rydex AdvisorBenchmarking findings indicate that the top large firms offer an average of six services, while their peers offer four.

With approximately \$600 million in assets under management, Pinnacle Advisory Group in Columbia, Maryland, provides its 560 clients with one-stop financial planning. According to CEO John Hill, the firm offers a robust range of financial services, including investment management expertise, estate planning and tax planning. “In a sense our approach is a bit like family CFO in that we offer services to cover just about every aspect of our clients’ financial well being.”

About one third of advisors believe that their clients use more than one financial professional. As the RIA industry becomes increasingly competitive, large firms that offer a full menu of valuable services are more likely to earn all of their clients’ business and increase assets under management in the process.

TIP #2: PROVIDE CAREER GROWTH OPPORTUNITIES.

Investing in your employees is always good practice. This is particularly important among large firms as they tend to have a greater number of employees, offer more services, and handle more processes in-house compared to their small firm counterparts. In fact, offering career growth opportunities to employees serves as a key differentiator in separating the best from the rest in the large firm category. Our findings reveal that the most successful large firms are committed to their employees' professional growth—and show it by investing in training and education.

“Having the best possible employees you can get is critical for today’s success, as well as for moving forward,” says Hill, who employs a staff of 20 plus three partners at Pinnacle Advisory. “People are definitely the backbone to our success, and we work diligently to create growth opportunities to keep them engaged.”

In addition to employee training and education, Pinnacle places an emphasis on cross-training to provide staff with exposure to new opportunities. According to Hill, two employees in the firm’s operations unit will be working towards their CFP and may eventually transition into a financial planning role.

TIP #3: GIVE EMPLOYEES ATTRACTIVE COMPENSATION.

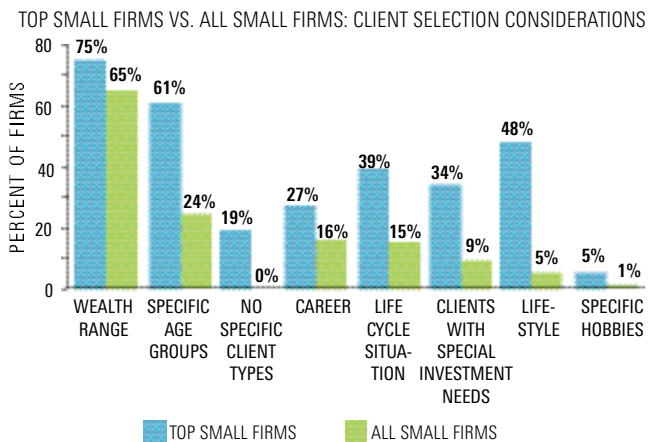
When it comes to giving employees a raise, the RIA industry as a whole tends to drag its feet. Our findings reveal a slight decrease in staff compensation as part of RIAs’ overall expense allocation, from 22% in 2005 to 21% in 2006. The most successful large firms, however, realize the importance of paying employees well and allocate 37% of expenses to staff compensation.

Providing staff with fair and attractive compensation is just one part of the equation for Pinnacle. Hill also stresses the importance of adding staff to efficiently manage client and AUM growth. “As soon as you get to a place where you start to feel comfortable, you need to consider adding staff,” says Hill. “Holding off puts too much pressure on existing employees and threatens the quality of client service. This is one of those areas where firms need to bite the bullet to reap long-term benefits.”

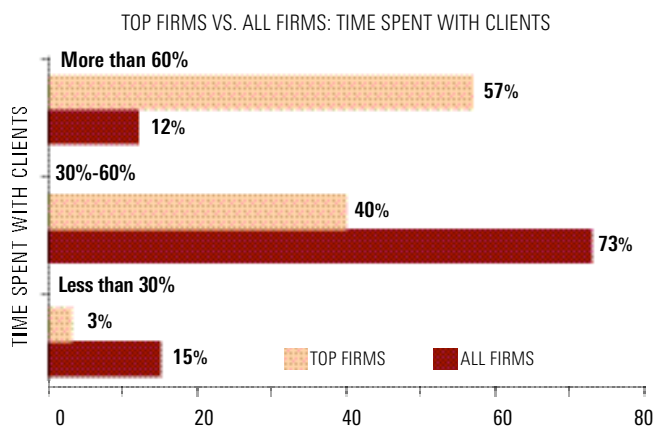
There’s no doubt that both small and large firms can achieve greater success by shedding the one-size-fits-all approach to practice management. Firms of any size, however, can benefit from adopting a few tried and true best practices. Rydex AdvisorBenchmarking consistently finds that the top firms among all size categories tend to spend more time with their clients. It makes sense that advisors who better understand their clients’ needs and who have cultivated a high level of trust tend to be more profitable. They also tend to do a better job of retaining their clients and sidestepping the profit drain associated with high client rotation ratios. And finally, the most profitable firms establish mutually beneficial partnerships with other professionals, such as CPAs and lawyers. Not only can these partnerships help advisors provide a range of services that may be outside their realm of expertise, but they can also lead to new client referrals.

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