The 2015 FA Insight Study of Advisory Firms: **People and Pay**

Acknowledgments

The FA Insight team would like to acknowledge the hundreds of firms that responded to *The 2015 FA Insight Study of Advisory Firms: People and Pay.* We appreciate the time and effort that you put forth to share detailed information on your firms and look forward to your participation in the 2016 FA Insight Study. We also thank our media partner, *Financial Planning* magazine, for promoting the study to its readers.

The FA Insight team is pleased to be able to share with you the industry trends and insights presented within *The 2015 FA Insight Study of Advisory Firms: People and Pay*. We believe this study will be a valuable business-building resource for your firm.

Founded in 2008, FA Insight is both a *consulting* and *research* firm that works exclusively within the financial services industry. We have grown to become a trusted partner for many of the industry's most successful independent advisory firms as well as major custodians, broker-dealers, banks, fund companies, and trade associations. FA Insight works closely with shareholders of advisory firms and executives of financial services institutions to solve challenging business management issues. Our team brings deep industry knowledge and management expertise to those we serve.

For Advisory Firms: Driving Business Growth, Succession Options, and Shareholder Value

- **Strategic Planning:** Creating a competitive advantage in an unpredictable operating environment does not happen by chance. Applying industry trends and best practices, FA Insight helps advisory firm shareholders develop strategies that will support their growth aspirations and create sustainable value.
- **Human Capital Management:** On average, people-related expenses account for approximately 75 cents of every dollar for the typical advisory firm. To optimize this investment, FA Insight's human capital services support firms in order to best attract, organize, motivate, and retain talent through effective organizational design, compensation planning, performance management, and succession preparedness.

For Financial Services Institutions: Driving Advisor and Institutional Success

- **Performance Benchmarking:** FA Insight specializes in survey research, data compilation, tool development, and analysis which all enable firms to gauge their performance relative to peers and to identify where to focus for improved performance.

- **"Best Practices" Research:** Drawing upon both our research findings and years of experience consulting in the field, FA Insight offers guidelines, reports, and white papers on how the best advisory firms are approaching special issues and marketplace challenges.

- **Program Development:** FA Insight helps our clients deliver impactful business management training to their advisory firm clients, supporting firms across a range of management disciplines.

- **Market Research:** FA Insight collaborates with clients to better understand their competitive environment and assess appropriate strategic options, including identification of target markets that will drive new client acquisition.

The industry's leading firms depend on FA Insight for valuable advice and insight on how to address key management issues and business challenges. For more information on how we can help you, please contact the FA Insight team at answers@fainsight.com or 206-826-4382. Further detail is also available on the FA Insight Web site at www.fainsight.com.

Financial Planning

Financial Planning's mission is to deliver the essential information independent financial advisors need to make informed decisions about their business and the clients they serve. Financial-Planning.com is the only website dedicated to the needs of the independent financial planner. Whatever the medium, *Financial Planning's* purpose remains the same: to provide advisors with the most up-to-date information and cutting-edge analysis on client relationships, business management and investments. *Financial Planning* is the most trusted resource for advisors who know their success depends on helping investors achieve their financial dreams.

Executive Summary

People: The Most Essential Ingredient

Sustaining growth and increasing enterprise value cannot be achieved without a deliberate approach for managing people. Human capital is overwhelmingly the most essential ingredient for an advisory firm's success. For several years, personnel-related expenses have consistently accounted for about three-quarters of a firm's annual expenditures. Now, as firms expand their teams at a rate faster than ever before, the need for good people management practices grows only more critical.

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The 2015 FA Insight Study of Advisory Firms: People and Pay is the seventh annual study effort from FA Insight and the fourth to feature the *People and Pay* theme. With a record 351 firms meeting the standard for a complete survey submission this year, the study currently attracts more participants than any other industry-wide benchmarking effort.

From this data, *People and Pay* offers insight into the best practices related to organizing, motivating, developing, and retaining people. As featured in last year's *Growth by Design* study from FA Insight, firms often overlook the specific activities that must take place in order to achieve a firm's overarching business goals. A prime example is people practices, where putting the right people in place and incenting them to work in alignment with the overall vision of the firm are vital stepping stones for implementing any firm's growth strategy.

Continued Industry Success

Market forces have aligned in favor of advisory firms over the last few years. Firms' recent run of success is the strongest in nearly a decade. Double-digit appreciation in security markets has supported accelerated revenue growth. An aging population in need of objective financial advice has helped to fuel service demand. Improving business practices are further enhancing profitability.

For the typical advisory firm, performance in 2014 was nearly as impressive as in 2013, when virtually every major indicator achieved a record best. Only 2014 growth rates for clients and assets under management failed to surpass 2013 performance. While median client growth slipped just half a percentage point to 6.0% in 2014, median growth in assets under management fell from 17.1% in 2013 to 10.9% in 2014 due in part to cooling security markets.

Despite strong business growth, firm owners are improving efficiency and maintaining tight control on costs. Overhead expenses as a share of revenue for the typical firm plunged to 33.6% in 2014, which is more than three percentage points lower than in 2013. The expense drop, coupled with 14.0% revenue growth, fueled a dramatic four-percentage-point jump in median profit margin, which reached a record 26.1% in 2014.

Teams Expand While Productivity Outpaces Pay

As firms increased business volume, headcount grew as well. The typical firm jumped from 6.0 to 6.8 full-time equivalents (FTEs) during 2014, with firm owners indicating that teams will expand further still in 2015. The rising demand for talent is pushing up compensation levels. Productivity measures, however, suggest that firms are getting an increasingly good return on their people.

Since 2009, advisory firm compensation for many typical positions is increasing at rates faster than the U.S. all-industry average. The fastest pay growth is occurring outside of advisory positions. These positions are increasing in value as firms recognize their importance in helping advisors to better focus their time on client management and revenue generation.

Despite rising compensation, profitability remains high as a result of productivity outpacing pay increases. From 2009 through 2014, productivity with respect to median revenue per professional grew at a compound annual growth rate of 6.4%, reaching a record $528,500 per professional in 2014. Revenue per total firm FTEs reached a record high for the year as well.

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Warning Signs

The typical advisory firm has clearly enjoyed unprecedented success in recent years, but there are no guarantees that this will continue. While client growth rates are expected to increase slightly in 2015, a significant slowdown in AUM growth is affecting revenues. Median expected growth for 2015, at 9.9%, is considerably less than the 14.0% revenue increase achieved in 2014.

The bull market for securities will invariably subside at some point in the near future, if it has not happened already. Traditional rates of growth in advice demand cannot be relied upon either. The bump in need created by baby boomers may soon come to pass. Additionally, new forms of providers are posed to emerge and compete for a potentially shrinking advice market.

However, the greatest concern for advisory firms may be people. Aging firm owners and advisors are increasingly closer to retirement. The average age of a working owner, now 51.8 years, continues to progress higher in comparison with a 50.1-year average in 2011.

The median age for a lead advisor in 2015 (including owners and employees) is now at 50, up from 47 years old in 2011. Of further concern, lead advisors significantly outnumber the available “reserve pool” of associate advisors. As of 2014, the industry averaged just one associate advisor for approximately every two lead advisors, which makes for an insufficient pipeline of replacements.

No Better Time

While many competitive factors may be outside their control, firm owners are fully capable of successfully addressing key human capital challenges. With profits available for investment and a clear need, there may be no better time for owners to improve upon their ability to attract, develop, and retain people.

Facing rapid growth, many firms are tempted to make a reactionary hire where the overworked firm looks to quickly onboard an individual. While the rushed hire might address an immediate need, the firm risks a host of unfavorable consequences if the hire fails to fit within the context of an overall human capital strategy. These consequences could potentially include increased inefficiency, lower productivity, organizational dysfunction, and cultural conflict.

Preferably, firm owners oversee their people more deliberately, applying foresight that better ensures long-term payback from investments in personnel. This approach is the focus of *People and Pay*. While our study examines many ways that firms can more effectively deploy human capital, we prominently feature organizational structure, compensation, and people development practices.

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Standouts Minimize Costs and Maximize Productivity

To assist with analysis and illustrations FA Insight often looks to the Standout firms that emerged from study participants. Similar to our past annual studies, Standouts represent the top-performing firms at each stage of firm development based on their ability to grow revenue and generate income for their owners.

Year after year, the superior performance of Standout firms stems from minimizing overhead expenses and maximizing team member productivity relative to their peers. For Standout firms, a large portion of expense savings is attributable to lower overall costs for personnel. On a per position basis, however, Standouts tend to pay at a premium compared with other firms. In doing so, the Standout firm can attract and retain talent that yields greater productivity and ultimately keeps total costs low.

Well-Defined Organizational Structure Provides Foundation

Expenses, pay levels, and productivity provide an introduction for how the use of people drives outperformance. The foundation for maximizing a firm's human capital investment, however, relates to a well-defined organizational structure. As firms increase in size and complexity, growth makes deliberate organizational planning increasingly vital.

While the majority of firms do well in terms of defining their existing organizational structure, a much lower percentage are adequately relating organizational requirements to the future needs of the firm. Less than 50% of firms maintain documented and updated job descriptions. Just 19% of firms maintain a documented plan for their future structure.

Firms intent on sustaining growth address organizational structure questions in advance and avoid making hasty (and costly) people decisions on the fly. It is no coincidence that organizational clarity, particularly in terms of a vision for the future organizational structure, is a distinguishing characteristic of the largest Standout firms.

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Growing Their Own

Projecting from study participant data, FA Insight estimates that for roughly every $260,000 in revenue growth, a firm will add a full-time equivalent (either a professional or non-professional). For every $620,000 in revenue, one of the added FTEs will be a professional position.

To meet staffing demands, firms are trending away from targeting experienced talent within the financial services arena. As experienced labor becomes scarce and the number of college financial planning programs increases, firms today are most likely to look to recent college graduates as a primary source for new labor.

Standouts exhibit the greatest tendency to target college graduates when expanding their teams. Cultivating less experienced talent has the strongest impact when combined with a good internal development program. Larger Standout firms, for example, are more prone to offer a defined career path for team members to more readily progress to higher levels of responsibility.

Improving Pay's Payback

Compensation can be an important factor in recruiting new talent to a firm in addition to playing a critical role in retaining and incenting a firm's existing team members. Determining appropriate compensation is not only dependent upon on how much is paid but also how pay is structured. Of particular importance for influencing work behavior is the portion of pay that is variable.

Performance-based incentive pay, dependent upon achieving defined objectives, tends to be the most effective form of variable pay. Cited by two-thirds of firms, "encouraging team members to focus on the overall success of the firm" was the most often mentioned impact that incentive pay has had on their business.

Despite the potential for performance-based incentive pay to better align team member conduct with the overall objectives of the firm, many firms remain apprehensive. When asked what prevents greater use of performance-based incentive pay, the majority of firm owners (51%) were simply unsure of how to best implement an incentive pay program. The key for success with an incentive pay program is to strike the right balance between the firm-related and individual-related objectives that drive the incentive award.

Succession Preparedness Hinges on People Development

While good people practices can correlate with immediate rewards, their ultimate benefit is to drive shareholder value over the longer term. Succession preparedness is one important example of how a focus on people helps to perpetuate firm success.

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The average owner is aging and the share of firms with owners who are within three years of retirement has more than doubled in the past four years. Despite this, less than half of study participants (44%) have an adequate succession plan in 2015. To better understand what key practices contributed to preparedness, FA Insight separated these firms for further analysis.

The greatest distinguishing factor of firms that are best prepared for succession is the way in which they recruit, position, and develop their people. The right approach widens a firm's succession options, particularly for the majority of owners who have a preference for implementing an internal succession. (Firms were three times more likely to promote an existing employee to ownership over bringing in a new owner from outside the firm.)

In general, firms with adequate succession plans were often more capable of taking on inexperienced hires and progressing all team members to higher levels of responsibility. Succession-prepared firms, for example, show a greater tendency to maintain organizational structures that support internal career paths. These firms are also more prone to offer individual development plans and are more likely to provide access to formal training.

Making Good Things Happen

Whether it is better positioning the firm for a life beyond its founders, improving the quality of the client experience, creating more opportunities for team members, or simply building greater enterprise value, good things happen when firm owners pay serious attention to their people.

While owners cannot control, nor rely on, continued favorable market conditions for future success, their deployment and oversight of people is an area over which they can have tremendous positive influence. As firms rapidly increase the size of their teams, the importance of better positioning, developing, and motivating talent becomes all the more critical.

This includes defining the firm's organizational structure and how it evolves with future growth, adding supporting roles that can better focus advisors on revenue generation, offering career paths, and unlocking the power of performance-based pay for encouraging the right work behaviors. Never has the timing been more critical for firm owners to invest and improve in these areas in order to better maximize their return on people—the industry's most important resource.

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Table of Contents

Acknowledgments i
- FA Insight ii
- Financial Planning iii

Executive Summary v
- People: The Most Essential Ingredient v
- Continued Industry Success v
- Teams Expand While Productivity Outpaces Pay vi
- Warning Signs vi
- No Better Time vii
- Standouts Minimize Costs and Maximize Productivity vii
- Well-Defined Organizational Structure Provides Foundation viii
- Growing Their Own viii
- Improving Pay's Payback ix
- Succession Preparedness Hinges on People Development ix
- Making Good Things Happen x

Methodology 1
- Data Collection and Compilation 1
- Averages and Medians 2

Chapter 1: Another Banner Year 3
- Chapter Summary 3
- The Good Times Roll—But for How Much Longer? 4
- Expenses Reach Record Low; Profits Hit Record High 5
- People Hold the Power 6
- Productivity Outpaces Compensation 8
- Non-professional Positions Increase in Value 9
- New Advisor Development Is Critical to Sustainability 10
- Past Performance Does Not Guarantee Future Results 11

Chapter 2: Standout Firms Deploy People Prudently 13
- Chapter Summary 13
- Uncovering Insight Across Every Development Stage 13
- Four Stages of Development 14
- Defining Standout Firms 15
- Lower Costs Are a Consistent Standout Characteristic 15
- Premium Pay Pays Off 17
- Organizational Structure and Pay Practices Provide a Competitive Edge 18

Chapter 3: People Procurement and Placement 19
- Chapter Summary 19
- Organizational Planning Is Fundamental to Business Strategy 19
- Organizational Practices Show Progress; More Improvements Needed 21
- Biggest and Best Firms Tend Toward Organizational Clarity 21
- Projecting Required FTEs 22

Determining Position Types Needed 23
Sourcing Talent 23
Standouts Emphasize Developing Talent from Within 24
Chapter 4: Linking Pay to Performance 25
Chapter Summary 25
Compensation Critical for Human Capital Success 26
How to Pay As Important As What to Pay 27
Performance-Based Incentive Pay Yields Benefits 28
Lack of Knowledge Creates Reluctance 29
Balance Needed Between Firm and Individual-Related Drivers 30
While Certain Drivers Typical, Customization Required 31
Chapter 5: Perpetuating Success 33
Chapter Summary 33
Succession Preparedness Hinges on Progressing People 33
Planning Is Getting Better, but More to Be Done 34
The Time Is Now 34
Understanding Succession Preparedness 36
Leveraging a Well-Defined Organizational Structure 36
A Human Capital Infrastructure That Facilitates Development 37
Distribution and Transition of Equity 38
Too Important to Be Left to Chance 39
Conclusion 40
Borrowing Time 40
An Opportune Time for Investing in People 40
Realizing Return 40
Until Next Year 41
Disclaimer 42
Copyright 42
Appendix 43
Study Terms 43
General Definitions 43
Income Statement Definitions 45
Position Descriptions 48
Income Statement Tables 53
Common-Sized Income Statement Tables 57
Performance Indicator Tables 61
Survey Details 65
Position Data 74
Professionals 74
Management 76
Technical Specialists 80
Support Staff 84
Administrative Staff 87

Table of Figures

Figure 1: Participating Firms by Gross Annual Revenue 1

Figure 2: Participating Firms by Affiliation Model 1

Figure 3: Growth Cools Some, but Remains Strong 4

Figure 4: Costs Fall While Profits Rise 5

Figure 5: Steady Expansion in Team Members per Firm 7

Figure 6: Investment in People Remains Constant 7

Figure 7: Productivity Growth Continues 8

Figure 8: Pay Growth Slowest for Advisor Positions 9

Figure 9: Lead Advisor Aging Slows 10

Figure 10: Insufficient Pipeline for Developing Next Generation of Lead Advisors 11

Figure 11: The Four Stages of Development 14

Figure 12: Growth and Income Medians for Standout Firms vs. Others, 2014 15

Figure 13: Cost Control Is a Standout Standard 16

Figure 14: Staffing Expenditures Contribute to Standout Cost Savings 16

Figure 15: Standouts Tilt Toward Premium Pay 17

Figure 16: All but Smallest Standout Firms Achieve Greater Productivity 18

Figure 17: Service Structure Options Evolve with Growth 20

Figure 18: Organizational Practices Improve Some, but Weaknesses Remain 21

Figure 19: Documented Structures Support Large Standout Growth 22

Figure 20: Total FTEs Grow Faster Than Professionals As Revenue Expands 22

Figure 21: Non-professionals Account for Nearly 60% of Advisory Firm Positions 23

Figure 22: Advisory Firms Shift Focus Away from Traditional Hiring Sources 24

Figure 23: Pay Variability Increases with Level of Responsibility 26
Figure 24: Similar Positions Within Bigger Firms Pay More 27
Figure 25: Greater Variable Pay for More Influential Positions 27
Figure 26: Performance-Based Pay Aligns Behaviors with Firm Success 28
Figure 27: Biggest and Best Firms Embrace Performance-Based Incentive Pay 29
Figure 28: Trend Toward Performance-Based Pay Weak at Best 29
Figure 29: Implementation Reservations Are the Greatest Obstacle 30
Figure 30: Firm Performance Typically Dictates Incentive Pay Award 30
Figure 31: Revenue and Profits Are Most Typical Firm-Wide Performance Drivers 31
Figure 32: Performance Ratings Lead Individual Incentive Drivers for Non-professionals 32
Figure 33: Succession Readiness Better, but More Improvement Needed 34
Figure 34: Firms Slow to Broaden Ownership As Owners Grow Older 35
Figure 35: Share of Owners Nearing Retirement Increases 35
Figure 36: Organizational Structure Provides Succession Foundation 37
Figure 37: Progressing People Is Important Factor for Succession Preparedness 37
Figure 38: Succession Preparedness Correlates with Training and Evaluation Programs 38
Figure 39: Long-Term Financing Is Most Typical Method of Paying for Shares 39

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