Advisors: Don't Run Your Business Like an ATM

Advisor study group and consulting firm warns most RIA firms will decline in value through failure to build scale

By Gil Weinreich NOVEMBER 12, 2012

A large majority of independent advisory firms will see their business value stagnate just as they near the point they want to exit the business, says the Alliance for RIAs(aRIA), a confederation of six RIA firms that brands itself an advisor think tank and offers business growth consulting.
In a just released whitepaper, the second in a series of four on creating value in an independent advisory practice, aRIA warns that most advisors fall into the "annuity trap" of treating their business primarily as a source of current income rather than building "real enterprise value."

Building value in a business requires addressing long-term structural issues, but "advisors are usually not emotionally or philosophically willing to address business structure issues proactively," say the aRIA advisors.

The group's members are Brent Brodeski of Savant Capital, John Burns of Exencial Wealth Management, Ron Carson of Carson Wealth Management Group, Jeff Concepcion of Stratos Wealth Partners, Matt Cooper of Beacon Pointe Wealth Advisors and Neal Simon of Highline Wealth Management.

To avoid the long-term structural problems of a neglected business, hazards including fee compression, erosion of margins, recruitment challenges, low market valuation and limited liquidity, aRIA advisors say advisors must build scale and see their firm as surviving its owner's exit from the business.

As evidence that most firms neglect this, the whitepaper cites Cerulli research that shows the top 742 RIA firms–or just 4.5% of SEC-registered advisor firms–control 60% of all RIA assets. The dominance of just a few firms in this space is a growing trend, they say, adding that 334 or more firms have already reached the billion-dollar asset level, more than three times the number of such firms just five years ago.

Those elite firms that have been able to achieve scale, in the opinion of the aRIA whitepaper, are those who have been willing to invest in people and processes.

The aRIA group cites the example of a firm that contacted their **Advisor Growth Strategies** unit seeking business advice. “The owners of the firm loved managing investment portfolios and had little interest in evolving their client experience and selling,” they write.

The whitepaper says the firm’s choices are to either accept a low-growth status quo; hire a good rainmaker at a cost of at least $200,000 a year–10% of the firm’s revenue; build an alliance with a complimentary firm strong in sales and with a need for a strong investment arm, a strategy they say is hard to execute.

The correct path depends on the “advisor’s unique circumstances,” but the authors note that “many advisors are hesitant to make material investments as it would have an adverse effect on their cash flow and therefore take-home pay.”

Advisors who feel unable to develop their existing firm should look carefully at strategic alliances, roll-up firms (whose deals come with “strings attached”) or joint venture partnerships with other firms.

This last approach can be “an effective route to reducing risk, increasing growth rate, dialing up profit margins and solving … the annuity trap,” the authors write.