How RIAs are becoming as complacent as wirehouses -- and what it'll take to snap out of it

by Guest Columnist **John Furey**

Brooke's Note: Not since Mark Hurley wrote his discomfiting report about the fact that most RIAs have no enterprise value has an authoritative voice issued a warning quite as stern as this one for RIAs. See: What to make of Mark Hurley's latest prophesy that most RIA firms will go out with a whimper. John Furey is that rare person at the confluence of many RIA rivers who is unhampered by corporate considerations in blowing a whistle on disturbing, RIA-focused politically incorrect trends that he observes. There have been warnings like this one for a decade, but Furey makes the case that so much has occurred in the past five years that the playing field — and its disturbing tilt — need be observed in a new light.

Independent advisors have experienced a great run but they may be running out of time to make the changes needed to be part of tomorrow's success story.

Since Cerulli Associates started publishing the growth metrics for the space in 2004, RIAs and IBDs have grown at a significantly faster pace relative to the rest of the industry. Perhaps this explains why many independent advisors now act like their wirehouse counterparts — complacent, entitled, and satisfied with their position in the financial advisory world.

Up until now the noise foretelling doom, stagnation and the end of the golden age has been just that — noise. Advisors have heard it all in the past — about how the advisory industry will be turned on its head. There are many bold predictions that remain unfulfilled, for now. Perhaps the hypotheses were wrong or maybe the concepts were too bleeding-edge/ahead of their time. Here are a few:

• There will be a wave of consolidation between advisors as smaller entities struggle to compete.

• Virtually all independent advisory firms have very little to no firm value (the economic value of an advisory firm if sold to a third party) and owners have to come to grips with the fact that a savvy buyer will pay little to nothing to buy their firm. See:The top 10 deepest fears — and highest hopes — of RIA practitioners.

• The mom-and-pop advisory shop will not be able to compete against emerging regional RIA and IBD entities. See: Brian Hamburger answers the questions about an SRO future that has RIA stomachs in turmoil.

• Advisors are not prepared for the wave of succession planning that will hit once baby boomer advisors seek to retire. See:Favorite succession plan of RIAs remains the same: none at all.

Most independent advisory firm owners shrug off theories such as these because the RIA and IBD ecosystems have never had it so good. The independent channels are the fastest-growing segment in the industry, and a rush of market participants have provided owner/operators with technology, investment solutions and platforms that many feel are superior to those at wirehouses and banks.

The prevailing thinking of advisors is usually “those future concepts are interesting, but they do not have impact on me today or anytime in the immediate future.” See: IBD reps are new wave of breakaways to the RIA channel, say some recruiters and custodians.

Are these advisors right? Are industry observers and experts crying wolf? Or is the day of industrywide transforming change swiftly approaching? See: Wall Street thriller 'Margin Call’ is a cautionary tale — even for RIAs.

The BlackBerry trap

What we do know about our industry is this — if you are not advancing, innovating and constantly improving, you are moving backward. Advisors may be falling into a cozy trap if they think in too linear a way. Could any one of us envision the capabilities of an iPhone 10 years ago? I, personally, could only think about the newest cool feature coming out on the next iteration of my Schwab-issued BlackBerry. Back then those with BlackBerrys scoffed at owners of the lesser communications devices. If you told me that I would be able to consolidate disparate personal and business applications in one single handheld device, I wouldn’t have believed you. See: Fidelity, Schwab and TD Ameritrade prep for arms race in mobile technology for advisors.

Advisors run the same risk of looking back one day and marveling at how they couldn’t have imagined the way things turned out. Sometimes change comes slowly — but not in this industry. Here, when change arrives, it arrives via monumental shifts. If it isn’t technology, it is a new model. If not a new model, a new mindset — yours or your clients’. Change is constant and it is usually unforgiving.

Massive scale

For example, five years ago firms like Focus Financial Partners LLC and United Capital Financial Advisers LLC were considered outliers with unproven business models. Fast forward to today. These firms are the leaders of an entire segment of firms seeking to provide massive scale, value, and financial liquidity to our industry. See: What exactly the CEOs of HighTower, Focus Financial and Dynasty Financial revealed when they shared a stage in Las Vegas.

New firms with unique views of the market are now gaining a foothold and starting to redefine the market, including super-RIAs that have regional or national growth aspirations. Advisory firms cannot continue to plow along and ignore massive shifts occurring in the industry. Ignoring changes to the market could be dangerous and outright irresponsible for advisors if they are seeking to ensure that their primary constituencies (clients, employees and their families) will be able to survive and thrive in the future. See: How a swath of billion-dollar-plus RIAs are posing a threat to indie advisors.

Four pillars of a paradigm shift

Fast forward to today. In speaking to thousands of advisors over my career at Charles Schwab and now principal at Advisor Growth Strategies LLC and as the managing director of an RIA, I have the privilege of helping advisors solve for key challenges in their business or help them achieve their next level of growth. I hear firsthand from them how competitive forces are impacting their businesses. What is different today is that the market is evolving at a more exponential rate than in the past. Here are a few key industry landscape changes that will force advisors to move from passive into fully engaged mode.

1. RIAs with roots in the wirehouse or IBD model tend to have superior sales acumen. As the trend to independence continues, existing independents will likely see increase competition from other independent advisors in their market. See:Nine things I learned as an RIA infiltrator in an IBD world.

2. Pricing pressure will increase and independents will be forced to expand their value proposition or risk revenue being derogated. This, along with increased costs, will put pressure on margin. The importance of scale will increase.

3. New and potentially disruptive market entrants could change the current market paradigm for value-added independent advice delivery. Don't believe it? Explore Betterment's website. See: After outcry, Betterment 86's (but not on purpose) a blog post inflaming advisors.

4. The market is innovating faster than participants can keep up. New providers such as Dynasty Financial Partners LLC and inStream are trying to redefine traditional capabilities, yet many advisors choose to ignore the implications in favor of their current solution set. See: Dynasty Financial hires a heavy-hitting lawyer to oversee a sea of contracts.

The implication of these forces is that while things on the surface level seem calm and smooth, advisory-business owners run the risk of being marginalized in the future and could watch helplessly as the value of their businesses erodes due to lack of scale, a decreasing value proposition, degrading revenue and profits, and the inability to recruit and retain top talent. The options for advisors to realize the value of their life's work through a succession plan that they control will be few.

Dare to change

And yet dangers on the horizon aside, advisors are still in the driver's seat and should take the opportunity to evaluate strategic options to running and operating their businesses and build a strategic plan to drive future growth, scale and certainty.

You can:

1. Develop your existing firm by moving from "harvest" mode to "reinvestment" mode and taking steps to build scale.

2. Form strategic alliances (i.e. my firm, aRIA, or Zero Alpha Group — entities with complimentary capabilities) and outsource to expand value proposition and gain scale. See: John Furey is creating a think-tank out of six big RIAs that want to grow like roll-ups without the pressures of an IPO.

3. Sell or merge with an acquirer that can provide liquidity and a superior platform for growth.

4. Combine with or join an existing independent advisory firm to gain scale and improve the value proposition.

5. Stop thinking you've done all you can, that your practice will continue in perpetuity as is, or things are "good enough." If you aren't interested in improvement, merely a paycheck, realize you're running an annuity-type business akin to wirehouse advisors. Advisors cannot be so naïve as to think that all of the warnings about our segment of this industry are wrong. They are certainly avoidable if steps are taken to protect ourselves now.

Nobody can predict the future with certainty, but advisors should engage in a dialog about model options available to them or take the opportunity to reinvest in their businesses to create sustainable firms that will be able to compete over the long haul. At the end of the day, isn't that the reason advisors found the independent space to begin with? Making changes can be fun and energizing, as we approach the new year, I encourage advisors to embark on the journey.

The most recent aRIA report analyzing the future opportunities and risk that our industry faces can be found onwww.allianceforrias.com

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