A Turkey for One:

Sharing Clients and Compensation

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No single characteristic defines a firm more than the manner in which lead advisors are compensated. Lead advisor compensation profoundly influences the relationship between the firm and its advisors and between the firm and its clients, and it has a decisive impact on interactions between advisors. Therefore, it is no surprise that when the subject of teams comes up, the manner in which revenue from the client will be split is the first topic raised.

Many firms today look to create team-based service, where the client interacts and receives service from a team of professionals, not just one advisor. This approach might focus on specialists—e.g., investment advisor, risk specialist, estate planning specialist—or it may use advisors of different levels—e.g., senior advisor, junior advisor, etc. The advantage of the team is that it adds specialization, creates capacity for senior advisors, and also tends to create a relationship between the client and the firm rather than a relationship between the advisor and the client, thus improving the chance that the firm will retain the client if the advisor leaves.

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Interestingly, most broker-dealer affiliated advisors function in one-on-one relationships with clients, even if they are part of a group practice, whereas most RIAs work in teams in which two or more professionals service each and every relationship. Of course, there are many exceptions, and teams can be found inside broker-dealer branch offices, just like there are many “silos” (production-driven firms) inside the RIA community. Still, most of the time, you can expect that each advisor inside a broker-dealer has his own client base.

Cultural Characteristics and Team Formation

We’ve observed that the ability to form successful teams depends on culture, not whether compensation is shared. If the culture supports team service, then compensation methods are easy to find. If the culture doesn’t support team service, the compensation method may help build a successful team, but the team will be swimming against a mighty current. As long as producers believe that they personally own revenue from the client, they will believe they are better off not sharing, because sharing is costly as well as risky to them, both in terms of overhead and direct income. If the benefits of sharing are unclear to producers, the incentive to share is low to nonexistent.

Ask yourself this: Would you walk into a restaurant, sit down with 10 strangers, and order a large turkey dinner? Would you get a fair share
of the meat? Would the strangers take all the dark meat—the part you like? Would these people agree on side dishes? Besides, you don’t eat much, so why should you pay as much as that guy who looks like he might eat both drumsticks and one of the thighs?

Most people wouldn’t share a restaurant table with strangers, but they do share a turkey dinner, usually with people they know, on Thanksgiving. The difference is the cultural expectation and the relationship among the people involved.

For example, Thanksgiving starts with the expectation that the food will be shared, whereas the branch office expectation is that the revenue is mine. Thanksgiving usually is shared among people who’ve shared a turkey in the past; the branch office may never have shared clients with those other advisors. If your quirky long-lost cousin Ed comes to Thanksgiving, you’ll put up with his idiosyncrasies. But at the branch office, the relationships rarely are strong enough to bear even minor strains.

Obstacles to Revenue Sharing
The more you use the phrases “my client,” “my revenue,” “my income,” and “my practice,” the less likely it is you will be able to create viable teams. In creating compensation plans for investment firms, we have never been able to find the plan that rationalizes without exception why you should share a particular relationship with somebody else rather than doing it on your own. One hundred percent of 45 percent is always greater than 50 percent of 45 percent. Of course, we always have tried to explain that 50 percent of $1 million is always greater than 100 percent of $200,000. But we don’t think that advisors are convinced that a) they can’t build $1 million on their own or b) that the other guy will stick with them all the way to $1 million.

The management of the firm often is the biggest obstacle to sharing—ironically so, because management usually is driving the effort to create teams. We learn to share the turkey by watching mom and dad do it. In the branch office, we frequently see the branch manager get an override on the book of business of producer Ed, who grumbles about it every Friday at happy hour. If we see bosses sharing, it is easier to follow their examples rather than do the opposite. Not-sharing basically is condoned in many firms and many branch managers don’t understand why advisors need to do it. This makes it difficult to create a culture of teamwork.

RIA firms are better able to share because they start with the cultural expectation of sharing. The firm is formed by two or three partners who already share revenue and clients, and newly hired advisors find it easy to join. If a sharing environment exists, others will participate in kind; the difficulty is getting started. Where we have seen firms successfully switch to teams, it usually has been because the most successful advisors have declared that they want to work this way and will support the plan. If they set the example, others tend to follow. If instead they are the ones asking, “Well, what if I bring in the client, and Joe services the portfolio, but the client wants me in all the meetings?” the plan is doomed.

Factors That Complicate Team Formation
Team type. The “vertical team” has a senior advisor and one or more junior advisors. In the vertical team, the idea really is to create capacity for the senior advisor and better economics, because the junior advisor has lower compensation. The “horizontal team” has two or more senior advisors who practice together to enhance client service through specialization (e.g., a CPA paired with a CFP). Note that a team can be both vertical and horizontal (e.g., two principals and three juniors).

Materiality. Materiality effect is the significance of the team arrangement in the professional’s practice. If the advisor shares some relationships but for the most part works solo, the nonshared clients and activities likely will overwhelm the advisor’s decision-making capacity. Similarly, relationship size will influence whether it can be shared; the larger the relationship, the more room it leaves for cooperation. If, say, a $5,000 fee is shared among four advisors, none of the four has enough “skin in the game” to expend much effort on the relationship. But if the fee were split between just two advisors, each would have more of a performance incentive.

Relationship size. Relationship size has a materiality effect and it influences the complexity of the work. The more complex the work, the more likely the formation of horizontal teams. It should be no surprise that wealth management firms are most likely to have horizontal teams and that multifamily offices pretty much have no choice but to form horizontal teams, because the complexity of client needs and services delivered requires the expertise of multiple advisors.

Communication. Sharing requires communication overhead. After all, every delegated task needs to be explained and usually requires follow-up. Communication overhead is a fixed cost of teaming up, and it explains why firms with higher average revenue per client are more likely to form teams. For example, family offices that are at the extreme high end of client size deliver team-based service as a rule, and the same is true for multifamily office firms that service several families.

Sales. A firm that places a very high value on business development (sales) can have only one type of team: vertical. If the firm values the sale most, then it is only logical that the sales role will receive the majority of compensation. This makes it difficult for two senior advisors to share in the sale, because the revenue must be high for the relationship to be material for two.
Factors That Support Team Formation

Our discussion so far may seem rather gloomy; we only have listed factors that complicate team formation and none that facilitate it. Two factors greatly support the formation of teams and facilitate finding a team compensation model. These are clients and equity.

Clients. When clients clearly express an expectation that they will be serviced by a team rather than an individual, professionals find a way to cooperate. This happens often in the multifamily-office environment or when a firm takes on an extraordinarily large relationship. Similarly, in the world of institutional investment, consulting teams are the norm, though they are just starting to form in the retail world. Whether teams become the norm in retail or not also depends on client expectations, and those still are evolving. But client satisfaction surveys show that many clients—and not only the largest—want to see depth and breadth in their advisor team.

Equity. Equity (ownership in the business) also encourages cooperation and collaboration—think of the difference between a condo building and a rental. Firms that have career paths leading to equity opportunity have an advantage in creating teams because, ultimately, every owner shares in the same bottom-line and can see that collaboration is the path to economic benefit. Owners also see shared reputation at stake, and that often is as important as income.

Conclusion

Can your firm ever change? Can you create a team inside a broker-dealer or branch that does not necessarily support teams? The answer is yes, but the process will be difficult. The first thing you have to change is culture, and culture is difficult to change. The change has to start from the top, and not just in words but in action. It also will require persistence through inevitable frustrations, especially in the early stages. Philosophically it also may require losing your biggest stars, the top producers who have excelled as individuals. Unfortunately they often are the biggest obstacles to change. They are influential, they are successful, and if they hate working with others, the team concept probably won’t work for anyone.

It may seem counterintuitive, but changes in behavior have to precede changes in compensation. If your organization has to pay for any change in behavior to occur, you probably don’t have the underlying ability to create teams. It comes down to this: Commit to teaming up first and everything that implies, and then sort out the compensation.

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