A Giant Step (in the Wrong Direction)

BY PHILIP PALAVEEV

As we try to mold the future of investment consulting, we as practice leaders may be thinking in terms of giant steps that will grow our businesses. Along our paths, however, are land mines that threaten to turn the best-laid plans into giant steps in the wrong direction—for our practices and the profession as a whole. Heed the following five most obvious land mines—and avoid them all.

Land Mine #1. Advisers Forget to Recruit

One of our clients has been looking for experienced professionals for the past five years. The recruitment ad is a perpetual feature on the client’s Web site, and the client always is grousing about not being able to hire experienced people. If the client had recruited a group of inexperienced individuals five years ago, perhaps the firm would have a deep talent pool with five years of experience today.

Many investment consulting firms face this dilemma. On one hand, the firm’s needs are immediate and require experienced individuals who can develop and manage relationships. On the other hand, if the firm does not develop its own talent, it likely will face the same shortage of talent five years hence.

In the 2005 FPA Compensation Survey completed by Moss Adams, more than 50 percent of all participants were looking to recruit experienced professionals. Not surprisingly, as a result, the average compensation to professionals has grown by 23 percent in the past three years.

The problem is particularly severe for smaller, independent firms, which lack the critical mass to easily recruit and grow new professionals. A firm with one or two principals doesn’t have the plentiful resources to coach and support an employee who is not immediately adding to the bottom line. Smaller firms are even less capable of prying away experienced consultants.

Even if the recruits are not contributing to the bottom line right away, their help with existing relationships should result in more capacity for the senior professionals, who then can in turn look to add more clients and revenue.

Land Mine #2. Advisers Leave Operations People Behind

This is one of my favorite quotes from one of my favorite books: "Chaos is found in greatest abundance wherever order is being sought. Chaos will always defeat order because it is so much better organized" (Pratchett 1994). Chaos describes the state of many operations departments. As professionals we tend to be management extroverts. We focus on the clients, on the relationships, and on the referral sources. Even when we discuss our colleagues and employees, we discuss their ability to bring in new clients, develop business, and service clients, not the processes and systems that make this all work smoothly. With that kind of focus, we forget the people who make all of our work possible, credible, and economically viable—the operations people.

The typical investment advisory firm is wasting 8 percent of its revenue on operational inefficiencies (Moss Adams 2005a). The single biggest reason for this performance problem is that firms aren’t giving the people in their back offices necessary leadership, training, and motivation. According to the 2005 FPA Compensation Survey, the aver-
age turnover in operations positions was nearly 25 percent in a single year—indicating that a firm’s entire operations staff changes every four years. Furthermore, people were leaving because they saw no growth opportunities and had lost confidence in management.

As leaders and decision-makers, advisers must recognize that as technology grows more sophisticated, as more new financial products appear more quickly, and as the scope of services provided widens, the people who support the operations of the firm must receive more training, have more skills, and get greater rewards. One of the first challenges for many firms will be to upgrade operations positions and recognize the need to hire operations experts, not generic administrative support. No matter how good the technology, if the people using and supporting it have limited skills, the return on technology investment will be low.

Many firms lack operations leadership. Leadership is an overused term but an underperforming management function. It signifies the ability of the firm to communicate direction to its employees and to translate the firm’s direction into specific paths for individual employees. In other words, operations leaders need to communicate with operations employees about where the firm is headed, how that strategy will succeed, how they will contribute, and how their contributions will make them individually successful and well-rewarded. Unfortunately, the operations department isn’t even invited to strategic planning meetings.

The solution starts strategically by creating a top-level position for an operations manager. That manager must be part of the leadership team and empowered to change processes and staff practices. Even if a firm can’t afford a chief operating officer, one of the existing principals must take a more active role in operations to help the firm create sustainable and efficient processes.

The confusion goes beyond labels. Consistently, we find that advisers themselves are not clear about who they are and what they provide.

Land Mine #3. Advisers Don’t Educate Clients About Advisers

The investment industry uses so many terms to describe its professionals that not even insiders understand who is providing what to whom. If we can’t keep it straight, how can our clients? And if clients don’t understand who advisers are and what they do, they’re at risk of going to the wrong providers for the wrong services and the wrong reasons, ultimately damaging the entire industry’s reputation.

For example, high-net-worth individuals are solicited by wealth managers, investment advisers, investment managers, financial planners, financial advisers, multi-family offices, and life planners—so of course consumers are confused. Indeed, when the SEC held focus groups to see how well consumers can distinguish between terms such as broker and financial planner, the results indicated that consumers can’t tell who is whom and don’t understand the difference between the two (SEC 2005).

The confusion goes beyond labels. Consistently, we find that advisers themselves are not clear about who they are and what they provide. A Moss Adams (2003) survey of independent financial advisers found that 47 percent of all advisers label themselves wealth managers, but only 7 percent provide true wealth management services. Similarly, 25 percent labeled themselves investment consultants.

Educating clients about who advisers (and we use the term generically) are and how you may address their needs is the responsibility of each individual adviser as well as professional organizations such as IMCA. Too often we find confusion within a firm about the scope of offerings for clients. The more clear and honest firms are with clients regarding who they are, the more they collectively will promote the value and role of professional advice, consulting, and management.

To end the addiction to referrals, firms must develop reputations and direct access to clients, which can be costly. Alternatively, cementing existing relationships with referral sources through formal contracts and joint ventures may ensure the continuity of a source.

Land Mine #4. Advisers Let Referral Addiction Grow Deadly

Referrals are the primary business development method for advisers. More than 75 percent of all new business comes either through a referral from another professional (CPA, attorney, etc.) or a referral through an existing client (Moss Adams 2005a). The problem is that over the past five years, many referral sources have become formidable competitors. For example, every single one of the nation’s top 100 CPA firms ranked by Accounting Today now has an internal investment advisory division or plans to develop one. In addition, among CPA firms with more than two partners, many have become licensed as investment advisers.

Law firms also have entered the business, where permitted by law.
While the investment industry has done a good job of marketing to niche clients, it has not spent the same amount of time and effort developing custom solutions for the niches.

Most advisers don’t do planning that considers the future income of the business or its value and liquidity. They simply take the investable portion and treat it generically.

Business owners are just one example. The same could be said for a variety of niche clients, including professionals, executives, families with medical needs, etc. The danger in this generic approach is that it puts these relationships at risk. First, these clients always are going to be susceptible to marketing from competitors who recognize their unique characteristics. Second, these clients are likely to be less satisfied with the services they receive, which are not tailored to their needs, and thus they are more inclined to pursue other options.

To develop and retain more niche relationships, advisers must customize their services to clients’ needs. Customized services for niches will help a firm grow revenues from that niche faster and more profitably.

What Happens Next

I would be alarmed if any of these five land mines took you by surprise. You all see the warnings on a daily basis. You see them when a CPA partner informs you that his firm now requires employees to refer internally. Or when you lose another operations employee due to “family reasons,” which translated means she is leaving because she is underpaid, underappreciated, and her performance evaluation has been delayed for 14 months. Advisers see all these warnings but often underestimate their significance.

A systematic process for evaluating the strategy of a firm and making sure that all perspectives, internal and external, are aligned should be part of the management of your practice. The Chinese have a curse: “May you live in interesting times!” No doubt times are interesting in this industry. The challenge is for business leaders to anticipate and prevent fatal mistakes—so the industry, and the individual businesses, can take a true giant step forward.

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References