Smaller, Bigger, and Better Trends in the Business of Financial Advice

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When I aligned with the mega-registered investment advisory firm (mega-RIA) Buckingham Wealth Partners, people started asking me for my take on future opportunities for the big-versus-small financial advice business. In this article I share my latest thoughts about the dominant trends I see in today’s financial advice landscape and how they led me to the decision to change firms.

**TREND #1**

*Technology will enable smaller advisors to compete against bigger firms, expanding access to advice in the process.*

About 20 years ago, Mark Hurley of Undiscovered Managers, LLC (and more recently, Fiduciary Network) issued a rather controversial report about his anticipated future of the independent financial advisory industry. Hurley predicted the rise of a handful of mega-RIAs with tens of billions of dollars in assets under management (AUM) that would become nationally dominant players in the mass-affluent marketplace. This would be a coterie of regionally dominant independent firms that also would gain significant market share. Hurley wrote that he expected the size of those firms and their brands, and the associated economies of scale, would largely put the cottage industry of small and especially solo independent advisory businesses out of business (or at least render them uncompetitive and unprofitable).

In practice, though, the past 20 years have unfolded quite differently, driven in large part by the transformational force of the internet, which turned the entire ecosystem of advisor software upside down by allowing independent software solutions to grow and flourish. As a result of this explosion in technology-driven productivity enhancements, solo advisory firms are quietly surviving and even thriving and serving the mass affluent. Tasks that once took a full-time staff member handling a manual spreadsheet are automated largely by software now, and the staff savings from technology efficiencies are boosting the bottom-line profitability of solo advisors and allowing for even more savings (e.g., reduced rent expenses by needing less office space, or the feasibility of operating a location-independent entirely virtual practice). In other words, what used to take an advisor two to three staff members of support to execute for clients now takes at most a part-time assistant and a few thousand dollars of software. Advisors who now staff a team of two to three can support hundreds of thousands of dollars of revenue in a profitable manner.

Accordingly, over the past 10 years top-performing firms with a single owner and $500,000+ of revenue were serving an average of 155 clients with a paraplanner and two administrative staff, generating $870,000 of gross revenue, and a net of more than $500,000 of income to the sole owner (see figure 1).

And many advisors are creating wildly...
profitable practices now with no more than 50 “great” clients. The caveat, though, is that most advisors—and especially small advisors—don’t want to have to (re-)invent the wheel creating everything themselves, and the responsibility to cobble together solutions from an ever-broadening range of options is leading to a form of tech fatigue. Even successful independent solo advisors have long maintained affiliations to some kind of platform that supports their businesses.

From the business perspective, these independent advisor platforms allow those advisors who still want to own and control their businesses to gain some of the benefits of economies of scale from centralized (platform) resources, but without giving up their desired independence.

In turn, the need for advice platforms is leading to the rise of various outsourcing solutions for advisors, along with the new turnkey financial planning platform (TFFP, or what United Capital’s Joe Duran subsequently dubbed as a more phonetically pleasing turnkey advice and planning platform or TAPP). Similar to the turnkey asset management platform (TAMP), the idea of a TAPP is to offer a more centralized and systematized way to deliver financial advice, often with a particular style or planning philosophy, and targeted to a particular type of clientele for whom the approach is best suited.

So in 2014 I co-founded XYPN in this TAPP mold, as one of what I someday anticipate will be hundreds or even thousands of TAPPs. Ours was built around a particular focus of serving Gen X and Gen Y with a monthly subscription and other fee-for-service models of financial planning.

Although the AUM model has been criticized widely and many have predicted its demise as fee compression takes hold, I’ve predicted throughout that the AUM model will continue to hold, due in large part to its especially effective pricing psychology for clients. So, it’s perhaps not surprising that in practice the largest advisory firms are more likely to be AUM-based. Indeed, the average revenue yield on an advisory firm has not substantively moved in the seven years since robo-advisors showed up, i.e., the long-foretold robo-advisor fee compression still is not evident after seven years of robo-advisor competition (see figure 2).

Instead, it appears that the real limitation of the AUM model is that it serves only a limited subset of households—those with sufficiently large amounts of assets to manage, or, more generally, those with enough net worth on their balance sheets to pay a small slice for advice on the rest. These are the households with significant assets that are not tied up in a 401(k) or other employer retirement plans that are inclined to delegate those assets in the first place.

By contrast, new fee-for-service models—e.g., charging fees that amount to 1–2 percent of income instead of charging based upon (and requiring clients willing to delegate) assets—are better for those who have income but not necessarily assets, or are not inclined to...
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The key point, though, is that the rise of technology is enabling a new generation of independent small and solo financial advisors, operating never-before-possible business models to serve never-before-reached new markets of clients in need of financial advice, who will be supported by a broad range of outsourcing solutions and a new form of platform (the TAPP) to facilitate that growth (see figure 4).

As long as technology continues its inexorable march forward and facilitates an ever-growing system of support structures and platforms for advisors, I continue to bet on the ongoing trend of technology enhancing the capabilities and business success of the solo and small-firm independent advisor.

TREND #2
As the industry shifts from products to advice, a new cadre of national-scale employee-based advice firms will emerge.

Even though technology has boosted the competitive viability of small and solo independent advisors, Hurley’s prediction about the rise of mega-RIAs built on a wave of industry consolidation has held true as well. A subset of breakout firms is trying to reach national size and scale, and multiple $10-billion+ AUM advisory firms have emerged in just the past few years.

All the emerging mega-RIAs are seeking economies of scale in order to expand both the reach and profitability of delivering financial planning advice, which notably may not come in the scalability of financial advice itself. Industry benchmarking studies actually show remarkably little economy of scale or cost efficiency in scaling financial advisors themselves. Efficiencies do appear to come, however, in the scalability of almost everything else in the firm, including the investments and operations, and especially the marketing and the branding of the advisory firm. (With intangible services like financial advice, it’s difficult to evaluate who is a good advisor or not, so consumers often fall back to relying on brand and social proof indicators such as size to decide who is best to work with.) Regardless, the largest independent advisory firms are disproportionately able to attract a far higher percentage of the most affluent clientele in the first place and appear to be increasingly focusing on this clientele segment. Or stated more simply: The larger the advisory firm, the larger the average client household it serves, and the more revenue each advisor at the firm is capable of servicing (see figure 5).

A key distinction of the national-scale mega-RIAs is that, unlike their solo-firm brethren, they may be independent firms themselves but generally are not an independent model for their advisors. Instead, the mega-RIAs increasingly operate like traditional employee enterprises, and in fact are growing so quickly that the number of employee advisors in the RIA channel may now exceed the number of independent RIA business owners.

The appeal of this employee model is driven largely by the fact that, at scale, mega-RIAs are capable of centralizing marketing, shifting business development responsibilities away from the firm’s individual advisors and generating clients for them. By splitting business development and client advice and servicing, advisory firm jobs become
more salary-based, which lowers the average compensation to advisors (saving cost for the firm and improving profit margins), but also reducing the failure rate of advisors, who are no longer at risk of being forced out of the business if they can’t bring in enough of their own clients. This model makes it feasible for mega-RIAs to expand the number of job opportunities for the subset of advisors who prefer to eschew building their own practices and favor simply working for a firm that lets them spend as much time as possible being financial advisors and serving clients.

The key point, though, is that unlike Hurley’s vision of a big-versus-small firm future, it’s not a question of whether big or small firms will succeed. It’s about recognizing that both will have opportunities to succeed, albeit in different domains (see figure 6). A subset of small firms always will have a nimbleness to pivot faster than big firms and explore new business models, new markets, new niches, and new specializations, even as large firms bring to bear their economies of scale and brand to pursue the most affluent clients. Over the past 20 years, the big have gotten bigger and the small have gotten more profitable, too.8

Similarly, a subset of advisors always will prefer to be independent business owners—with all the freedom and control (and responsibility and burden) of making all their own choices—and others will prefer an employee model where they can focus on serving clients and let someone else worry about all the infrastructure stuff. In fact, “tuck-ins”—advisors who were once independent and merge themselves into a larger firm to get away from business management work so they can get back to focusing on clients—are a growing trend.

In other words, clients have myriad complex needs and wants, and that’s why the advisor landscape is so fractured, with more than 300,000 financial advisors total, but the largest platforms have barely 5-percent market share. So, I’m not betting on small independents over large enterprises or vice versa. I’m betting on both—through my involvement in both XY Planning Network (a TAPP to support independent advisors) and mega-RIA Buckingham—each of which I expect to thrive in its respective domain (see figure 7).

**TREND #3**

*Increasing demand for more sophisticated advice will require more education of advisors and spawn evidence-based financial planning approaches.*

I think it’s rather ironic that when it comes to the subject of fiduciary duty, the industry and regulators focus on whether advisors have undue conflicts of interest and not on determining which or whether advisors have enough training, education, and experience. In other words, delivering fiduciary advice in the best interests of a client isn’t just about the duty of loyalty (to mitigate or eliminate any conflicts of interest that could impair the quality of advice). It’s also about the duty of care to give advice only in the areas in which the advisor is competent. But obtaining a license to give financial advice requires only a high school diploma and a basic 2–3-hour regulatory exam that tests almost nothing about the actual delivery of financial advice itself (and technically, the diploma is optional).

As technology advances, software will handle even more of the basic tasks of financial advice, forcing advisors to move up the value chain and provide increasingly complex financial advice, above and beyond what the technology will automate. To some extent, this challenge is playing out already, leading...
to rapid growth in the number of CFP®
certificants even as the total number of
financial advisors is projected to
decline. Post- CFP designations also are
growing as more advisors seek to further
differentiate beyond the increasingly
common CFP certification.

Yet when it comes to financial advice in
complex situations, there is still remark-
ably little consistency and agreement
on what constitutes the best. Instead,
financial advice is still largely a domain
of beliefs and opinions of individual
advisors about what may be best for any
particular client. The evidence-based
approach still has not taken hold in
financial planning advice.

In part this is because client goals are
varied and nuanced. How should one
weigh the tax—benefits of 529 college
savings plans against costs compared
with a Coverdell Education Savings
Account, saving in a Roth Individual
Retirement Account to withdraw for
college, or using whole life insurance
loans, gifting appreciated stock to sell at
long-term benefits—term?

In other words, how do you decide what
type of retirement account to use and
which one to make the decisions based not just on opin-
ions and beliefs as well as hard data and
rigorous analysis of what really works
(or doesn’t work, or when it does and
when it doesn’t). Evidence-based invest-
ing provides an opportunity for advisory
firms to differentiate, and it’s conducive
to the use of centralized resources and scale to formulate and implement such
advice practices.

The bottom line is that I take a more
abundance—minded approach. There is
room for both large and small firms,
independent and employee models,
AUM and fee—for-service models,
because they serve different types of
clientele and appeal to different types
of advisors based on career preferences,
motivations, and personality styles.

At the same time, technology has and
will continue to reshape the landscape of
financial advice and the industry partici-
pants. It is making small firms more
profitable and capable of expanding into
new markets and new business models,
but it’s also facilitating the scalability of
mega—RIAs developing national brands
and national reach. It is improving the
quality of advice by providing increas-
ingly sophisticated tools to support the
analysis of complex client situations, but
it’s also pressuring advisors to invest
more into their own careers, training,
and education, to stay one step ahead
of what technology provides.

So it isn’t about which type of advisor
firm or model or approach will win or
lose. It’s about the ability of any particu-
lar firm to be clear about what it aims to
pursue and the types of clients it wishes
to serve, then get and have the right
people on board and successfully
execute on that vision.

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