How Do Registered Investment Advisors Compete for Talent against Big Banks?

By Allan Starkie, PhD

As recruiters of wealth-management talent, the owners of many registered investment advisors (RIAs) come to us, with various degrees of frustration, as they try to compete for client-facing professionals against their larger competitors, who naturally can compensate more generously. The typical solution for this disparity in cash compensation has been the use of equity as an enticement to join a smaller, more-entrepreneurial firm. The problem that has plagued the RIA industry is that, in most cases, equity has been offered in confusing and sometimes suspect configurations that rarely offer liquidity or significant dividend payments. These awkward and sometimes nefarious attempts have undermined the inherent advantage that equity could offer as a recruiting tool, and they have created a creeping cynicism regarding the viability and tangible value of RIA minority ownership.

Roughly 19,500 RIAs are in the United States right now. Their ranks are growing, and their share of assets under management (AUM) is growing as well. Most are quite small, with only 300 that are above the first glass ceiling of $1 billion in AUM. The vast majority suffer from limited cash flow and the burden of growing regulatory costs. In a recent conference hosted by Fiduciary Network, Mark Tibergien of Pershing Advisor Solutions spoke of the future of the RIA market, predicting that we soon will see the evolution of “super-regional RIAs” with revenues of $50 million to $75 million.

These RIAs will be forced to compete within the same limited talent pool as banks and large trust companies. The question arises: With limited resources, what means do RIAs possess to win a talent war against their larger competitors? There clearly is an industry-wide shortage of revenue-bearing, client-facing individuals. The total number of financial advisors declined from 330,909 in 2007 to 302,270 in 2013, with a continued drop to 280,859 projected by 2017 (Cerulli Associates 2013). Cerulli notes that perhaps only 92,000 of these advisors actually focus on high-net-worth (HNW) and ultra-high-net-worth (UHNW) clients. Retail brokers within regional and community banks are obligated to turn over relationships above $1 million to their firms’ wealth management groups. The HNW and UHNW financial advisors are found primarily within the ever-shrinking world of the wirehouse. To make matters worse, 43 percent of these advisors are older than age 55 and approaching retirement.

On other fronts, both the large banks and the large national trust companies have been tactical about managing headcount since the global financial crisis of 2008. Escalating compliance and regulatory costs have been subsidized by cutting front-office costs, resulting in larger books of business and stagnant to lower compensation for client-facing professionals. As a result, advisor headcount has either remained stationary or been reduced within this group.

This might not be so worrisome were it not that during the same period we experienced an explosion in new wealth creation. Capgemini and RBC Wealth Management (2014) reported the largest increase in HNW assets since it began measuring those assets in 1997. U.S. private HNW wealth has grown to $13.9 trillion; 4 million people now have attained HNW status. With a U.S. population of 320 million, the one-percenters have proliferated into the one-and-a-quarter-percenters. To put this in perspective, in 2006 Capgemini reported that 2.7 million U.S. HNW individuals held $9.3 trillion in private wealth. This 50-percent increase in AUM from $9.3 trillion to $13.9 trillion, under normal metrics, should have resulted in an addition of 65,000 to the national labor force; yet, in actuality it has reduced significantly.

The years 2008–2016 have been categorized by massive cost reduction across the industry as large banks and trust companies have tread water on all but essential or targeted recruiting, waiting for an increase in interest rates to again swell revenues. When interest rates finally rise, demand for top-notch client-facing professionals will intensify.

The larger institutions can outbid RIAs on base pay and offer large grants of restricted stock. On the incentive side, virtually no RIAs are capable of competing with a 45-percent brokerage payout or the heady top-tier sales incentives used by national trust companies and most regional banks that crescendo at 75 percent of first-year revenues in some cases. How, then, will RIAs continue to source and win top talent?

First, let us consider the fundamental, general differences between the type of person an RIA would wish to hire and the type of person a big bank would wish to hire, as well as a self-selection mechanism among the candidates themselves (see table 1).

RIAs, different as they may be from each other, are surprisingly consistent in terms of their wish-lists for client-facing professionals.

Almost all independents, with whom we deal, are focused on the same type of client-
facing professionals, the most significant traits of which are the following:

- Strong financial planning skills (CFP designation is often a prerequisite)
- Very strong client-service skills
- Track-record of sound business-development success
- A network of centers of influence (ideally accretive to that of the hiring firm)
- Good knowledge of investment management
- Good knowledge of tax and estate planning
- Team-player mentality
- Compatible personality to firm culture
- The holy grail of portable assets

RIAs tend to source these candidates from slightly different places than their larger competitors. Most large banks and trust companies primarily source their candidate pool from each other; RIAs often are skeptical about hiring from big banks. They tend to focus more on the following:

- Other independents
- CPA and law firms
- Home-grown talent, starting with internships
- Big banks and wirehouses come in last place as a source of candidates, although they are sometimes targeted

As a result of the motivational differences that draw particular candidates to RIAs, as well as the fact that the hunting grounds are generally other RIAs (with similar compensation limitations), RIAs should not even try to compete on a cash basis with their larger competitors. Those RIAs with the most-successful recruiting programs are leveraging the appeal of potential wealth creation to draw ambitious, entrepreneurial candidates. And the most significant means of fulfilling such a promise is the sensible and transparent use of ownership.

Since 2008, my firm has placed an equal number of client-facing professionals within the RIA/multi-family-office/single-family-office space as we have among the large banks/trust companies. Although cash compensation generally has been significantly less at RIAs, we have successfully placed professionals of at least comparable talent for lower cost. And another interesting fact: The stick-rate (i.e., three- and five-year candidate retention numbers) is 12-percent higher within the RIAs.

The real differentiator and major advantage that independents have over other wealth-management firms is the ability to create wealth for their key employees. Those wealth advisors drawn to the independents generally want to create personal wealth and become HNW and ultimately UHNW clients themselves. They want to resemble the people they serve, and they recognize that this rarely will happen within a bank.

As clear as this may seem, very few RIAs are using this advantage effectively. Often partnership is guarded too carefully or given in a manner that is incomprehensible and complex. The greatest challenge is creating and articulating a liquidity strategy that will offer new employees a believable roadmap to carry them to the point of monetization.

To use equity as an effective tool for both recruiting and retention, the following characteristics need to exist:

- Simple terms of designation (complex multiple levels and classes of shares become meaningless and even suspect)
- Equity must be offered along with a clear and understandable business plan that projects its potential appreciation
- A liquidity event/monetization strategy needs to be clearly described
- Intermediate forms of liquidity associated with the equity are important (real dividends, ability to borrow against the value, or sell it back)
- Ability to source capital so a potential partner can afford purchasing the equity

Surprisingly, very few firms conform to these important guidelines. As a result, those firms that can use equity effectively have a huge talent pool upon which they can draw on from their less-enlightened peers. “Partner” looks awfully nice engraved below one’s name on a business card. But the word loses its luster when it becomes clear that it is, after all, only a word.

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Table 1: Differences between Big Banks and RIAs

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<thead>
<tr>
<th>Big Banks</th>
<th>RIAs</th>
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<tr>
<td>Referral-based sales expectations</td>
<td>Necessity to be more outward-focused in sourcing AUM</td>
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<td>Reliance on lending products</td>
<td>More focused on planning and holistic wealth management</td>
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<td>Typically risk-averse personalities</td>
<td>More entrepreneurial</td>
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<td>Require large teams/extensive support</td>
<td>“Roll up sleeves” mentality</td>
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<td>Very general level of skills</td>
<td>Deeper level of comprehensive understanding of wealth management tools</td>
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<td>More likely to change firms often</td>
<td>More imbedded in culture and future of firm</td>
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<td>Motivated by cash compensation over restricted stock</td>
<td>Motivated by equity over cash</td>
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References