THE PURPOSEFUL ADVISORY FIRM

Maximize Your Firm by Design, Not by Default

By John Anderson, Raef Lee, and Bob Veres

It's 2:00 a.m. You're wide awake. You need to decide. Do you want to build an enterprise or preserve a lifestyle business? You're in the driver's seat to run your business—by design or default. Every firm struggles with its unique business challenges.

If you are focused on building enterprise value, you are focused on building your firm. Maybe you worry about retaining your best clients and finding more just like them. You might look at your designated successors and wonder if they'll succeed. You may also agonize over the pace of technological innovation and how to keep up with complex markets and regulatory changes that seem to consume more of your time than ever before.

Or maybe you own a thriving firm that still affords you an ideal work–life balance, but you worry that the income stream you've built may not be sustainable in the future. Outside pressures, such as regulations, competitors, and compression, seem to be working against you. What happens when you decide to call it a day (intentionally or not)?

YOUR FIRM'S NEXT PHASE: TRADE-OFFS AND OPPORTUNITIES

The advisory business landscape supports many different business models. So why is the industry forcing the enterprise model as the "correct" approach?

As defined, an "enterprise firm" will live beyond the original owners, and it has professional management and processes. Our research reveals that no single model is better or worse than another; as long as your model serves your goals and your clients' needs, there is no right or wrong choice. Eventually though, you must decide to either maintain the status quo or lead your business to the next level—a classic dilemma fraught with trade-offs and opportunity costs. If you're not interested in scaling your business or increasing your valuation, investing may not be necessary. This would mean you might be more interested in creating a "lifestyle firm." But if you're looking to expand or optimize your firm's future value, reinvestment is essential. The choice is up to you.

TIME TO MAKE A DECISION

Many advisors habitually focus on the urgent rather than the important. Or they engage in tasks that come easily at the expense of longer-term strategic decision-making. Default occurs when you don't decide—either because the decision is too difficult so you deliberate until time runs out, or because you simply decide not to decide. You've thought about hiring more people, investing in better technology, or even merging with another firm. But you might be thinking, "Why fix something that isn't broken?" Or when you look at the costs you wonder, "Why would I make those changes now?" There is no right or wrong path, but not choosing has consequences, too. The risk is that many key business decisions are neither acknowledged nor evaluated with full intention and awareness of those consequences.

Economics teaches us about making choices about the best possible use of scarce resources. When you choose among various alternatives, you have to forgo other options. We wanted to understand how the trade-offs—what you give up to get what you want—compare to the opportunity costs for evolving advisory businesses. If you want your firm to keep growing, what choices should you make today to build a sustainable enterprise? Conversely, if you're satisfied with what you have, what choices can you make to optimize your firm's future value? Our goal with this article is to help ensure that you make an intentional decision about the path you choose.

WHAT IS A PURPOSEFUL ADVISORY FIRM?

We define a purposeful advisory firm as one that is led and guided by an owner who intentionally develops and executes a strategic plan—either to build an enterprise focused on maximizing the firm's value or to remain the single owner through retirement with no intention of transforming the firm's ownership structure (see figure 1).

DEFINITION OF TERMS

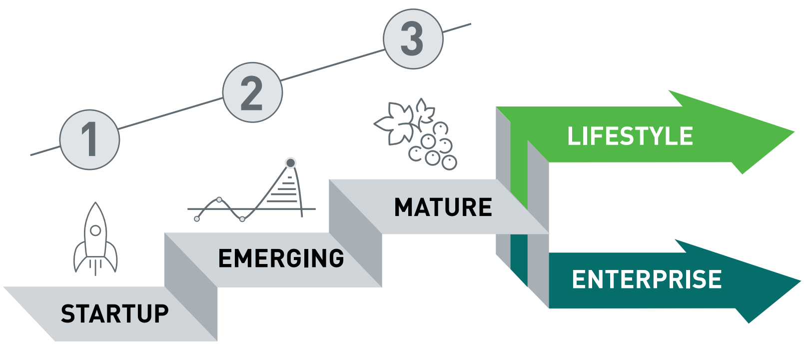
PHASE 1 STARTUP

Startup firms tend to be younger (42 percent of firms are under five years old) and so are their owners, with most age 30 to 60. They have the smallest number of employees (74 percent have one or two total firm employees), and total assets under management are more likely to be less than $25 million.

Figure 1

THE PHASES OF A PURPOSEFUL ADVISORY FIRM

A purposeful advisory firm can be led and guided by an owner who intentionally develops and executes a strategic plan—either to build an enterprise focused on maximizing the firm's value or to remain the single owner through retirement with no intention of transforming the firm's ownership structure.



PHASE 2 EMERGING

Although still relatively small, emerging firms are well-established (most have been in business between six and 20 years) and manage $25 million to $75 million in assets. They occupy a sweet spot in the sense that many future options may be available; 40 percent of owners are under age 50. Intentional decision-making at this stage in their evolution could prove highly rewarding. Firms at this stage often partner with others to share resources and expenses but still run separate practices. Most are in a growth mode, adding clients, technology, and even new advisors to lower expenses and reduce overhead, but on average they have five or fewer employees.

PHASE 3 MATURE

Mature firms have more assets under management and most have been in business longer than 20 years (58 percent). They are further characterized as what we call "mature lifestyle" or "mature enterprise" firms.

Although the term "lifestyle advisor" historically has had negative undertones, we have come to appreciate the model that has evolved intentionally and is associated with strong cash flows, high quality standards, and loyal clients.

We use the term "lifestyle" to describe firms that typically are owned and managed by the founder and often bear that individual's name. Lifestyle firm owners tend to enjoy the sales and client relationship aspects of the business, and are less interested in managing teams or hiring a full-time chief operating officer to run the business. On average, they employ fewer than 10 individuals and 57 percent have been operating for more than 20 years. Fifty-five percent of firms have assets under management between $150 million and $500 million, with 8 percent exceeding $500 million.[1]

"Enterprise" firms are slightly larger; one-fifth of these firms have more than $500 million in assets under management and 28 percent have more than 11 employees. About half serve 250 to 500 clients, but 30 percent have more than 500 clients. The majority (59 percent) have been operating for more than 20 years.[2]

CHANGE IS EVERYWHERE

The forces of change—consumer, industry, regulatory, and market—are everywhere. Their impact on the advisory profession is staggering and the pace of change is unlikely to abate. With this added pressure, some advisors are leaving the profession, which is contributing to an increasing number of mergers and acquisitions (M&A). M&A activity hit an all-time high of 142 transactions in 2016. The fourth quarter was the ninth successive quarter of 30 or more transactions, demonstrating a sustained and robust M&A market.[3] You cannot ignore these factors of change or use them as an excuse to avoid critical decision-making.

We observe that the most-successful advisors are investing conscientiously to varying degrees in their talent, technology, and value proposition to drive growth, sustainability, and the potential to sell. For your business to thrive in the future, you'll want to establish a serious and deliberate vision of the kind of firm you want.

VALUE ENGINEERING FOR TODAY'S ADVISORY FIRMS

Popular in the manufacturing industry, value engineering determines which changes in design or process can be made to reduce costs without reducing utility. It's more complicated for service businesses because many factors influence customers' purchase decisions and the motivation of the business owner factors more meaningfully into the equation.

Every advisory firm consists of four essential components—people, value proposition or brand, investment philosophy, and technology. These are the levers you control through your decisions. Analyzing these component parts helps advisors assess what's essential, what can be eliminated, and what changes could be made to greatly enhance the overall service. Purposeful planning and decision-making depend largely on the owner's goal to either maximize cash flow or enhance the value of the firm.

FIRM CHARACTERISTICS: A CLOSER LOOK AT THE PHASES OF EVOLUTION

Figures 2–5 offer a realistic picture of today's firms at each stage of their evolution, based on our survey results. The results reflect only those responses from owners and managing partners. Which phase most closely matches your firm?

Figure 2

THE PHASES OF EVOLUTION—STARTUP[4]

BUSINESS PROFILE: THE STRUGGLE

- Sales, sales, sales
- Only 18% have AUM-only income
- Adaptable to any sales opportunity

Clients	Fee Structure	AUM	Net Profit	Age	Years in the Business	Firm Employees
51-250	AUM + COMMISSION	< $25M	< 30%	30s-60s	< 10	2

PEOPLE	VALUE PROP	INVESTMENTS	TECHNOLOGY
• One advisor	• Historically broad • Overstated • Fine-tuning required	• Putting together custom solutions for every client	• High initial expense—spending ranges between 5% and 10% of revenue
• Reactive hiring • Staff added gradually to support founder	• Paperwork and redundant tasks	• Using wholesaler support	• Affordable and easy to use • Not well-integrated
• Long hours—doing everything themselves	• Brand is nonexistent	• Lure of commissions	• Broker-dealer clearing through institutional custodian
• Growth constrained by individual limitations	• Exploring client niches	• Lack of clarity about investment process	• Website is an online brochure

Figure 3

THE PHASES OF EVOLUTION—EMERGING[5]

BUSINESS PROFILE: BREAKING OUT

- View as advisor, not business owner
- Business growth happens fast, multiple technologies, unclear roles of staff, no niche
- High level of profitability due to small staffs and investment variety
- 54% have fee structure combining commission + AUM/planning
- 57% believe fiduciary is important to clients
- 73% expect practice to survive their career

Clients	Fee Structure	AUM	Net Profit	Age	Years in the Business	Firm Employees
100-250	AUM + COMMISSION	$25M–$75M	30% to 50%	40s-60s	6–20	1–5

PEOPLE	VALUE PROP	INVESTMENTS	TECHNOLOGY
• Founder uses support staff and possibly junior advisor	• A service model with many exceptions	• No CIO or defined investment process	• Multiple technologies collected over time, not well-integrated
• Staff is brought on as pain is felt	• Personality-driven marketing	• Most portfolios are custom, without the scale of models	• Basic CRM tracks client data but not workflows
• Advisor in a steady state of execution rather than a management role	• Brand is not clear. The lead advisor is the brand.	• Many small accounts/clients who didn't grow. Some clients were sold investments and expect advice for life	• Sending out performance statements rather than facilitating client access to account data via client portal
• Need to solve continuity and succession issues		• Evolving investment process leaves orphan accounts and old investments in client portfolios adding risk of oversight/monitoring	• Half (50%) spend 6% to 10% of revenue on technology

SUMMARY: KEY RESEARCH FINDINGS[6]

- The most profitable firms are the emerging businesses, with an average of one to five employees; enterprise firms vary in their profitability—depending upon their infrastructure and costs.
- Most lifestyle practice owners think of themselves as advisors first, not business owners. These same respondents identified themselves as mature, lifestyle businesses with no intention of looking for the second generation of advisors.

Figure 4

THE PHASES OF EVOLUTION—MATURE LIFESTYLE[7]

BUSINESS PROFILE: THE PERSONALITY

- Lead advisor is the image of the firm
- 57% are SEC/State-registered RIAs
- Lead advisor focuses on clients

Clients	Fee Structure	AUM	Net Profit	Age	Years in the Business	Firm Employees
100-150	AUM + COMMISSION	$75M–$500M	> 30%	50s-70s	> 20	Founder + 2–5

PEOPLE	VALUE PROP	INVESTMENTS	TECHNOLOGY
• Founding advisor with junior advisors who have defined client-facing responsibilities	• Founder is the brand • Reputation is well established in niche area • Sixty-nine percent believe being a fiduciary is important to clients	• Evolution toward model portfolios for greater efficiency	• Spend on average 6% to 10% of revenue on technology • Internal IT support—only 17% of advisors outsource the function
• Back-office specialists with legacy staff members who evolved into key roles	• Haven't visited brand in two years or more • Increasingly rely on fee revenue and de-emphasize commissions	• Do we hire a CIO and a team of investment analysts, or delegate to a third party?	• CRM used to help founding advisor keep track of who's doing what
• No clear successor, but hopes that one or more junior advisors will "step up" to the challenge	• Personality-based—junior advisors are trained in the founding advisor's client service methodology	• Customized performance statements posted quarterly in client vaults	• Website emphasizes client fears, planning process, and credentials of the founder
• Less likely to change or adapt to new market challenges	• Founding advisor works with the clients who pay the most • Junior advisors work with less complicated clients	• Many "one-off" demands from larger investment-focused clients • No defined investment process	• Support staff manually re-enters data into a suite of legacy tools

Figure 5

THE PHASES OF EVOLUTION—MATURE ENTERPRISE[8]

BUSINESS PROFILE: TEAM

- Management team running the firm
- Transformation—takes a multi-year plan
- 86% confidence that firm will survive founders
- Focus on efficiency (expense cutting)
- Expansion by acquisition now an option (or to be acquired)

Clients	Fee Structure	AUM	Net Profit	Age	Years in the Business	Firm Employees
200–500+	AUM + PLANNING	$150M–$500M	> 30%	40s-60s	> 20	Up to 35 +

PEOPLE	VALUE PROP	INVESTMENTS	TECHNOLOGY
• Multiple advisors with shared client responsibilities • Shared ownership or shared equity in the firm	• Clearly defined and repeatable service models • Brand is differentiated • Comprehensive wealth management • Used to determine pricing	• High cost structure to support investment-related services • Risk that value proposition may change to investment management	• Technology is customized/optimized for the firm • 28% outsource the technology function
• Lead advisor/founder moves into senior management role	• Client segmentation (both niche and small accounts)	• Monthly reviews of investment climate and individual investments	• CRM used to design workflows • Consistent operational processes
• Stakeholders help shape a shared vision • Collaboration and scale	• Clear branding has evolved for the firm's target market(s)	• Investment returns available after market close on client portals	• Software is tightly integrated through single sign-on
• COO function handled as a full-time position (or managing partner)	• Firm plans a role in the niche market, generating business through visibility	• More complex use of strategies for higher-net-worth clients	• Technology suite is evaluated against new opportunities
• Clear career path for advisors and teams	• Average age of clients stays constant as new, younger clients are onboarded		• Integration of systems is high priority

- The lifestyle business goal is to maximize current cash flow—not future value or equity.
- We specifically asked advisors who had self-identified as lifestyle businesses whether they thought that their practices would live past them; 74 percent said yes. Of special note: In actual practice this may be very difficult.

DETERMINE YOUR FIRM'S FINANCIAL FUTURE

Remember, purposeful planning and decision-making depend largely on your goal to either maximize current cash flow or long-term value. When you make your decision, regardless of choosing the lifestyle or enterprise model, you should be able to direct your firm's financial future to match your goals and your clients' needs.

FIRMING UP YOUR FIRM

DECIDE WHAT KIND OF FIRM YOU ARE

Now that you've identified with one of the phases, you should focus on firming up your firm. Start by asking what kind of firm you see in your future (see figure 6). Because personal goals typically drive business goals, you'll need to start with a clear vision of your personal future. If you haven't already, you may soon reach a crossroads and will need to decide whether to become a lifestyle or an enterprise business. Either path is acceptable, but you must decide. As we've suggested throughout, if you don't purposefully make the decision, then your firm will, by default, become a limited lifestyle firm with limited value beyond your retirement. Therefore, it is important to make the decision and then proactively create the optimized lifestyle or enterprise firm you imagine.

WHEN SHOULD YOU MAKE THE DECISION?

It's rare that any firm can be an enterprise firm from the onset. Why? Because when you're in the startup phase, your focus is on sales and gathering assets. You expect to be successful, but you won't succeed if you start building an enterprise structure too early. So although this decision can be made at any time, in our experience, it most likely happens when the firm has reached the following milestones:

- $100 million or more in assets under management. The sweet spot to actively decide to change your firm is between $100 million and $200 million. In our experience, most don't make the decision until they reach $250 million in assets under management.
- More than one top advisor.
- An infrastructure with seven or more employees.

PURPOSEFUL QUESTIONS TO ASK YOURSELF AS YOU MAKE YOUR DECISION.

- Do you want to maintain your role as a great advisor, or do you want to try a new, more managerial role? Do you have the appetite for the significant work to transform the firm away from the individual into a team business?
- Do you have a clear idea of who the next generation of leadership for your firm is?
- Do you have family members in your firm who have a passion for the business?
- Do you want your clients to be advised by you or by a new or different team advice model?
- If there is more than one lead advisor: Have you ever discussed the future of your firm? Do you have a common vision?

Note that we didn't pose the question directly: "Do you want to be a lifestyle or enterprise firm?" Most advisors will say they are building or want to own an enterprise firm—because they may believe it's the "right" thing to say. Our survey results clearly demonstrate this tendency.

- Almost three-quarters (74 percent) of our survey respondents indicate that they expect their practices will survive beyond their careers[9]
- Nearly the same amount (73 percent) believe their brands differentiate their firms from others[10]

Actively acquiring new clients and operating efficiently rank among all respondents as the two most important business success factors. In our view, these are strong indicators that imply a desire to grow and reflect the owners' belief that they are building enterprise firms. The responses, though, are instinctive and do not necessarily consider the true commitment or capability of the key players or the amount of effort required.

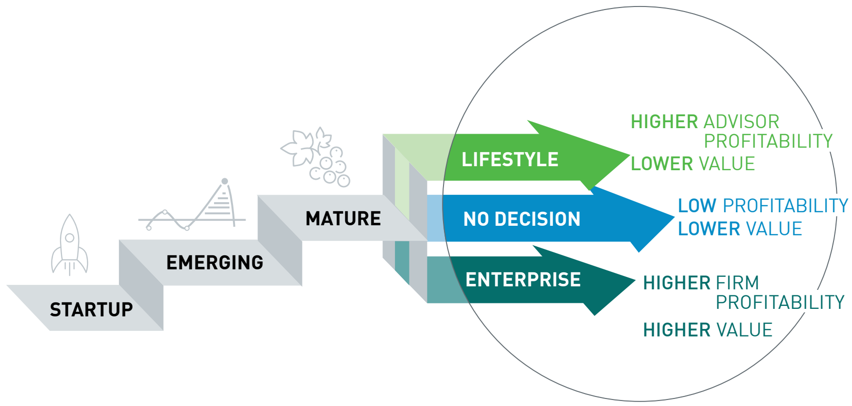
FURTHER CONSIDERATIONS

This is not a moral or ethical decision. The advisory ecosystem probably will

Figure 6

DECIDE WHAT KIND OF FIRM YOU WANT TO HAVE

NOT MAKING A DECISION COULD LEAD TO LOW PROFITABILITY AND LOWER VALUE



achieve the same steady-state equilibrium that you see in the law and accounting professions: a very small number of national firms, a somewhat larger number of regional firms, a still larger number of firms with a significant presence in individual cities—and a majority of the total number of firms functioning as solo practices or smaller firms. If this is true for the advisory profession, then most of the founders and successors reading this will opt for the lifestyle model, and the lifestyle model may continue to be the center of gravity in the profession.

However, in the future, the lifestyle practices almost certainly will become stronger, more intentional, and managed more professionally than they are today. We designed this article to help you make an intentional decision about how you want your firm to look in the future, and then, once you've made that decision, to achieve greater success on your chosen path.

Choose the lifestyle model if: You are uncomfortable managing teams and/or unwilling to devote the revenue to hiring C-level people such as a chief operating officer. This model applies if you believe that taking on the challenge would affect your personal time and personal revenues in unacceptable ways—and, importantly, you've saved at a rate where you don't need to monetize your practice to afford retirement.

Choose the enterprise model if: Your goal is for the firm to continue to serve clients after your departure from the profession, and you would like to confine your personal contribution to a particular area of interest or expertise.

The advisory business prides itself on helping clients prepare for the future. Yet, paradoxically, most advisors don't heed their own advice. Most advisors don't purposefully plot a path for their businesses. As you tell your clients, without a plan, you can't get to your destination. The same is true for your firm.

We've talked about the need to make a decision and to be purposeful. Once you've identified your business model, it is imperative to take action. And the ways you firm up your firm are very

Table 1

DECISIONS FOR MATURE LIFESTYLE FIRMS

People	Value Proposition/Brand	Investment Philosophy	Technology
• Provide your people with profit sharing and bonuses. • You want to provide instant recognition rather than long-term gratification. • Ensure there is a robust business continuity plan in place, with a clear destination for clients.	• Double down on the personality of the brand. • Focus on referrals and client/prospect events. • Segment your client base and pass the less profitable clients to a junior advisor.	• Unless you are a pure investment advisor, outsource to create efficiencies and systems that enable you to focus on solving client needs. • Spend as much time with prospects and clients as possible, with a focus on goals-based planning/investing. • Pursue a disciplined model portfolio process for scale. • Focus on the best income distribution strategies as the client base ages.	• Focus on client-facing technology such as client portals, financial planning tools, and performance reporting. • Hone the client review reports/documents that are provided to the clients; you want to keep your clients as sticky as possible. • Update website with focus on the trustworthiness and qualities of the founder.

Table 2

DECISIONS FOR MATURE ENTERPRISE FIRMS

People	Value Proposition/Brand	Investment Philosophy	Technology
• Define roles and job descriptions, and provide career path for team members. • Create employee manual and performance reviews; you'll be bringing on new employees and you will want a good process. • Create a team client model, where more than one person interacts with the client. • Create succession plan with clear ways for the new generation of advisors to be partners. • Start to create the C-level staff members with a management, not an advisor role. The COO is typically first. • Create partnerships or processes to find and bring on new employees.	• Create a new value proposition from scratch. It will be different. Find help to do so. • Create new branding that supports the new value proposition. • Look to broaden the client segments and services; you'll want a fuller range of services. • Create a multi-generational client program. • Create new lead generation models (such as COI partnerships, digital marketing, radio).	• Determine if investments are a key part of your value proposition, and if so, engage a CIO for non-core assets. • Expand your investment solutions (e.g., alternatives and tax management) to fit with your broader value proposition. • Ensure that your client reporting is especially good so that the client sees the value of your investment processes.	• Review and upgrade your technology and workflows to enhance efficiency with your new team structures. • Deepen the integration between the core technologies (especially CRM, financial planning, and portfolio management). • Outsource your IT (including IT strategy, computer support, and cyber-security).

Table 3

CONSEQUENCES FOR NO DECISION FIRMS

People	Value Proposition/Brand	Investment Philosophy	Technology
• Low morale • Key employee retention issues • No continuity or next-gen ownership in place • Inefficient business operations can reduce revenue	• No brand identity can limit growth • No value proposition can limit scope of services • Hard-to-justify fees	• Inefficient investment process can diminish client experience • One-off investment approach (no models) could add inefficiency, risk, and expense • Overcomplicate by hiring investment specialists for non-differentiated assets	• No clarity on how to spend technology budget can lead to expensive mistakes • Technology budget is not given priority, limiting future profitability and efficiencies • In-house technology detracts from core business functions • Little appetite for technology efficiency

different. Tables 1 and 2 provide guides for making the most of your purposeful firm.

WHAT HAPPENS WHEN YOU DON'T MAKE A DECISION?

If you don't make a decision, your firm will make it for you. Fall down the middle path and there could be consequences as shown in table 3.

The move to an enterprise firm requires significant change management and should be done with a road map that identifies the various initiatives, implemented over time in a way that your budget will support.

The move to a purposeful lifestyle business, although not as traumatic as the move to an enterprise firm, is more work than most people envision. You also should approach it with a road map and complete it over time.

Our assumption is that the enterprise firm will create more value for the owners upon transfer or sale, and the lifestyle firm can generate more current income for the owners. Each has its own benefits and trade-offs, and both can be done on purpose—by design, not default.

The move to an enterprise firm requires significant change management and should be done with a road map that identifies the various initiatives, implemented over time in a way that your budget will support.

CONCLUSION

In our combined decades of working with advisors, our research and thought-leadership efforts have uncovered and analyzed best practices to shed light on the experiences of the nation's leading advisory firms. Time and again, we find that firms that have experienced the greatest success are those that are willing to move beyond their comfort zones, constantly evolving their businesses to adapt to new market realities. We believe that future success will be short-lived and increasingly difficult for firms that rely solely on old thinking or gut instincts. Becoming a purposeful advisory firm requires intention, prioritization, and planning.

To read the white paper in its entirety, visit seic.com/purposeful.

John Anderson is managing director and head of SEI Practice Management Solutions at SEI Advisor Network. He is responsible for all programs focused on helping financial advisors grow their businesses, create efficiencies in their operations, and differentiate their practices. Contact him at janderson@seic.com.

Raef Lee is managing director and head of new services and strategic partnerships at SEI Advisor Network. He defines new product offerings for advisors either by partnering with best-in-class companies or shepherding the requirements into SEI's development teams. Contact him at rlee@seic.com.

Bob Veres is editor and publisher of Inside Information *and author of* The New Profession *(2016), a book about the financial planning profession. Contact him at bob@bobveres.com.*

ENDNOTES

1. Primary research included survey on Advisory Business Models; March 2017, n=400 Owners/Managing Partners.
2. Ibid.
3. First Quarter 2016 | *DeVoe & Company RIA Deal Book*, http://www.devoeandcompany.com/ria-ma-deal-books/.
4. Primary research included survey on Advisory Business Models; March 2017, n=400 Owners/Managing Partners.
5. Ibid.
6. Ibid.
7. Ibid.
8. Ibid.
9. Ibid.
10. Ibid.

Information provided by SEI Advisor Network, a strategic business unit of SEI. Services provided by SEI Investments Management Corporation (SIMC), a wholly owned subsidiary of SEI.

The types of advisors and firms have been categorized by SEI based on shared demographics we found meaningful to distinguish between from our study responses and are for illustration only.