

The 2009 FA Insight Study of Advisory Firms: People and Pay

Sponsored by TD AMERITRADE Institutional

Acknowledgements

The FA Insight team would like to acknowledge the hundreds of firms that responded to *The 2009 FA Insight Study of Advisory Firms: People and Pay*. We appreciate the time and effort that these firms put forth to provide us with their comprehensive information. We hope that as participants you find this report to be a significant return on the investment you made by submitting your data and we look forward to your continued involvement in our work by participating in the 2010 FA Insight Study.

We also want to give thanks to our media partner, Investment Advisor magazine, for promoting the study to its readers. Finally, we want to thank our sponsor, TD AMERITRADE Institutional, for its support on this important research project.



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Executive Summary

People and Pay 2009: Standing Out in Challenging Times

In 2008 about three of every four dollars spent by advisory firms was related to compensating or developing people. People can be an overwhelming cost component for firms, especially in the present, tough business climate. Much more than simply a cost, however, human capital is an asset that must be constantly invested in, nurtured, and allowed to grow in order for firms to enjoy long-term success.

Tough times require firms to pay closer attention to people in order to be properly positioned for market recovery. The quality of people, and how they are deployed and compensated, determines success or failure for a firm on a number of levels. As a leading indicator of success, people are without question the engine that drives client satisfaction, client retention, business efficiency, and financial performance for advisory firms. While managing costs is important, costs can be controlled in ways that avoid compromising the skill and talent that sets a firm apart in an increasingly competitive marketplace.

In this year's study results, we are encouraged to find that so many participating firms are maintaining their commitment to people. In an operating environment that many have all too often shrouded in doom and gloom, participating advisory firms are anticipating an average 3.5% increase in staff for 2009. Many of the best firms in our study, the ones we call Standouts, are taking advantage of a suddenly available talent pool and adding staff instead of cutting back. The 8% of firms intending to let staff go due to financial performance are significantly outnumbered by the 29% of firms who intend to hire. Similarly, firms are more likely to be raising salaries than decreasing salaries as a result of economic conditions.

Growth-minded firms are building capacity within their professional, technical, and support staff ranks. For most, this has undoubtedly meant hiring ahead of the need, a delicate balancing act but a necessary practice for firms aspiring to grow. Building people capacity involves other tough decisions as well. In addition to making appropriate calls on who and when to hire, a firm must also excel in deploying and developing its team members.

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Tough Times, Tough Choices

The inaugural 2009 FA Insight Study of Advisory Firms aims to guide business owners facing serious decisions about their people and pay. Tough times mean tough choices. Without unduly risking the firm's present chances of surviving through the economic downturn, how do executives best position their firms in order to exploit new opportunities when the economy ultimately rebounds?

With a special focus on people and pay, much of the direction provided for firms in this report centers on the most effective ways to organize, motivate, retain, and develop people. The right decisions will build a solid foundation for a firm to achieve its strategic vision as well as its growth aspirations.

We begin with a review of the current market environment, based on the experiences and expectations of the hundreds of firms participating in the study. We analyze financial and operating performance in addition to human capital practices. We pay special attention to trends over time, across firm stages, and among the Standout Firms from whom others in the industry can learn.

Building upon this background, we then present a deeper examination of people and pay, centering on the challenges that firms face and the best means for overcoming them. Next, more tailored lessons are provided in a summary of observations, implications, and key considerations for firms, arranged according to a firm's specific stage of development. As a final aid, we include a wealth of aggregated data in the appendix that will enable firms to benchmark their performance and pay practices as well as gain a better understanding of their competitive environment.

Getting By...

In the face of the worst financial crisis in a generation, advisory firms have displayed remarkable resiliency. In 2008, despite an 18% annual decline in AUM, the typical participating firm ended the year with the number of clients increasing 6% and gross revenues up 5%. As a result, the typical or median firm earned a very respectable pre-tax operating profit margin of 18%.

Despite the uncertain economy, most participating firms have not noticeably cut back on labor. The typical participating firm expects to employ a staff of five in 2009, a level that has held consistently since 2007. Advisory firm owners are committed to retaining experienced staff in order to exploit future growth opportunities.

...But Cause for Concern

There are reasons for concern, however. Growth rates are ratcheting down while firms struggle to contain expenses. Especially if the current recession lingers on and a financial market recovery fails to hold, profit margins firms enjoyed in 2008 will not be sustainable through 2009.

Client growth among participating firms in 2007 was an estimated 8%, with firms expecting 5% growth for 2009. Annual revenue growth, as a result of shrunken portfolios, is off more dramatically. Median firm revenue growth, dropping from 21% in 2007 to 5% in 2008, is expected by firms to dip to -2% in 2009.

While revenues are trending down, the opposite is true of firm workloads. As clients demand increased attention to restore their damaged portfolios and lost sense of confidence, costs have been a struggle to contain. In 2008 about 45% of revenue was related to overhead, defined as those expenses not directly associated with generating revenue. Normally this ratio should be in the range of 35 to 40%.

Further, counter to enjoying any scale economies, bigger firms are experiencing especially high overhead expenses. Large firm clients tend to require a higher level of service, and large firms tend to provide this service internally, as opposed to relying on outsourcing. This equation has made it much tougher for the large firm to adjust its cost structure in an environment characterized by slowing revenue growth and increased demand for service.

Standout Firms Really Stand Out

For answers on how to best weather the current business climate and position for future growth, we looked to the industry's best-performing firms. For the purposes of analysis, we have defined a group of Standout Firms at every stage of firm development. By definition, Standout Firms best demonstrated the ability to grow and generate income, key factors that build sustainable value for firm shareholders.

The performance of these firms was exemplary. Depending on the firm stage, Standouts:

- Experienced revenue growth at rates five to eight times higher relative to their peers
- Generated 40 to 90% more owner income
- Held a 13- to 17-percentage-point edge in terms of lower overhead expense as a share of revenue
- Achieved profit margins that were typically double that of their peers

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People and pay practices play a key role in the success of these firms. Standouts are clearly putting people first and getting the most from their people as a result. Coupling thoughtful organizational design with dedicated management and formal training programs allows professionals at Standout Firms to delegate non-essential work and stay focused on revenue generation. While Standout Firms tend to employ a greater share of non-professionals, more effective deployment of these staff members allows Standouts to devote a smaller proportion of revenue to compensating them.

To assure they have the best people and sufficient capacity, Standouts are more apt to hire and more apt to give raises, despite an uncertain economy.

Training is a key distinction between Standout Firms and other participating firms. At every firm stage, Standouts are more likely to make formal training programs available to their staff, and they are more likely to offer them across every position group. Standouts use training to gain a performance edge over peers as well as to better position their firms for the future, grooming people to progress in alignment with firm growth goals.

Standout Firms also demonstrate forward thinking in terms of salary adjustment and hiring. To assure they have the best people and sufficient capacity, Standouts are more apt to hire and more apt to give raises, despite an uncertain economy.

Thriving, Not Just Surviving

With the right management practices, any firm can move beyond simply surviving to truly thriving. As for where to focus, some of the most important lessons from our research include the following:

- A firm's organizational structure and human capital plan must be in solid alignment with its business strategy. This includes structuring a compensation plan that aligns staff behavior with firm strategy and client service objectives.
- Firms cannot grow without growing their people. This means actively managing the organizational structure, building a training capability, and adhering to a hiring strategy that anticipates growth as well as the need to move people into increasingly specialized positions with more concentrated expertise.
- People are best motivated when they stand to gain personally from improved performance. Incentive pay linked to achieving specific objectives is a powerful tool for motivating team members to contribute additional effort in order to achieve firm goals. The opportunity for key individuals to earn equity shares is an effective motivator as well.

- Proactive performance management will drive positive performance outcomes. Meaningful performance measures, consistently monitored and managed, can reduce subjectivity regarding the measurement of individual contributions and more clearly tie compensation to performance.
- No matter how dire the revenue picture, a firm's top priority must be to protect its investment in people. Before cutting salaries or laying off staff, exhaust all ideas for how people can be made more productive and used more efficiently.

How a firm prioritizes these lessons is up to each individual advisory firm owner. Executives are encouraged to apply the findings of this analysis to their own specific situations in order to identify where they are most vulnerable. Much is to be gained by implementing a plan to shore up people and pay practices. People are a firm's most valuable asset and core to its competitive advantage. Disciplined people practices, particularly those related to organizational structure, compensation planning, and staff development practices, will assure a firm's success and longevity through the good times as well as the bad.

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