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Independent Advisory Firms Invest in the Future Amid Record Client Growth, TD Ameritrade Institutional Study Finds

Latest FA Insight Growth by Design *study shows independent advisory firms increased spending on talent amid high asset and revenue growth*

JERSEY CITY, N.J., Aug. 1, 2018 – A rising tide may lift all boats, but it takes a skilled crew and a charted course to successfully navigate more challenging waters. It follows that independent financial advisors appear to be capitalizing on their recent growth by making investments now that will help sustain their firms for the long term, according to new benchmarking research from TD Ameritrade Institutional[1].

The research is available in a new report, *The 2018 FA Insight Study of Advisory Firms: Growth by Design*, which reveals that median annual client growth -- the growth mechanism most indicative of business expansion -- last year hit a record high of 7.8 percent. Median assets under management (AUM) per client climbed 6.8 percent in 2017 to nearly $1 million.

Firm AUM increased by 20 percent on average, compared to 13 percent in 2016 and nearly on par with 2009's record of 20 percent. Revenue increased by 16 percent in 2017, twice the rate of 2016. TD Ameritrade acquired the the research, benchmarking and consulting capabilities of FA Insight in 2016.

Staffing Up to Meet Demand

Though rising financial markets in 2017 gave registered investment advisors ("RIAs") a boost, the FA Insight study reveals that other factors contributed to firm growth. A record number of clients brought with them new investable assets, which drove revenues and required many firms to staff up to meet demand.

According to the study, firms added team members at a record pace. The typical firm increased headcount from five to six full-time equivalents to support current growth and in anticipation of future needs. Productivity, measured as revenue per team member, rose 12 percent to a record high after a decline in 2016.

The findings also suggest that optimistic firm owners were making reinvestments in their businesses that may have been put on hold during less robust times. Firms spent more last year on office space, technology, marketing and business development — investments that may have been deferred in previous years when growth was more sluggish.

The increase in overhead expenditures, in addition to increased compensation for revenue roles, led to a decline in profit margins, or revenues after overhead and direct expenses. In 2017, the median operating profit margin dropped to 20 percent from 24 percent in 2016.

"Advisors reported spectacular growth in 2017, but I'm especially pleased to see that many firms used some of these gains to improve their operations with an eye to increasing revenue and profitability for the long term," said Vanessa Oligino, director, business performance solutions at TD Ameritrade Institutional.

"Though they may have proceeded cautiously in prior years, many firms saw 2017 as an opportunity to invest in themselves."

Pricing Power Erosion

The 2018 Growth by Design study found that one in six firm owners said pricing pressures were among the top factors that may challenge future growth. Some firms may already be facing this pressure: on average, firms generated 71 basis points of revenue on every dollar in AUM, compared to the recent peak of 78 basis points in 2015.

Despite the dip, most firms are unwilling to adopt alternative pricing approaches other than the AUM-based fee, preferring to wait and see. Two-thirds of firms have not made pricing changes in the past two years and 84 percent have no plans to do so in the next two.

"Changes to the industry landscape are causing many investors to rethink how they define an advisor's value," said Oligino. "The issue of price is not going away, yet we believe independent financial advisors can compete and win by delivering a superior client experience. Firms also need to better articulate all the services they provide and demonstrate how they generate value for their clients."

According to the study, the typical firm indicated that 98 percent of clients are charged exclusively based on AUM, and this fee includes advice for areas outside investment management. The challenge for firms that continue to bundle and charge for their services this way will be to convey their value: clients may not fully comprehend the true value of all that a firm does, giving competitors a potential toehold into discussions around costs.

Forward-Looking Plans

Although the study found a fair number of firms with strategic plans, firm owners can do more to engage staff to implement these plans. Currently, just 60 percent of firms link individual team member goals to strategic plans. Plans should include details on tactics and timelines for completion and should assign accountability in order to be meaningful and yield the desired results.

Advisors can start getting strategic about their growth by concentrating on serving specific targets or niche markets. The study found that it is easier to serve and attract clients – and ultimately easier to achieve sustainable growth – by focusing on a certain type of client.

Serving a particular client type can allow a firm to tailor its messaging and its offering for its desired niche and develop prospects into clients. In fact, firms that truly serve target markets reported client growth that was 35 percent higher than others, with revenue growth that was 25 percent higher, and profit margins that were 17 percent higher.

Forward-looking plans should also address demographic trends that are likely to impact firm growth and profitability over the long term. Right now, 64 percent of firm clients are 55 years of age or older, and for good reason: they typically are more profitable than younger clients.

In firms where at least half of clients were under the age of 55, the typical profit margin was 14 percent, about two-thirds the level of firms serving older clientele. According to FA Insight, the silver lining for advisory firms serving younger clients is that they are growing at double the rate of other firms.

Though many younger clients may be less profitable for firms today, older clients will soon draw down assets. Advisors may better sustain growth down the road with less risk of asset attrition by working with the next generation today.

“It’s critical for advisory firms to have a growth strategy that takes into account the age and stage of their existing client base,” said Oligino. “While younger clientele may be less profitable now, a healthy demographic mix is key to a healthier long-term future.”

To download the executive summary of the report, *2018 FA Insight Study of Advisory Firms: Growth by Design,* go to http://tdai.tdameritrade.com/2018fai-advisory-firms. The summary is free, but registration is required.

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