

POSITIONING FOR THE FUTURE

Insights from the 2009 RIA Benchmarking Study from Charles Schwab

The economic crisis of 2008 and early 2009 has prompted financial advisors to take stock of their businesses and focus on practice management. Despite the slowdown, they are looking to the future, with an emphasis on increasing productivity and positioning their firms for growth.

For advisors, 2008 was the most challenging year in a long time. After three years of watching assets rise steadily, advisors saw assets under management (AUM) plummet. For advisors and their clients, it has clearly been a period of concern.

In early 2009, more than 600 advisors who custody assets with Schwab responded to the opportunity to complete a detailed survey about their practices for the 2009 RIA Benchmarking Study from Charles Schwab. The results paint a picture of how participating firms are responding to today's challenges. The study reflects the cautious optimism of an industry well positioned to adapt to the crisis and stay focused on the long term.

The 2009 RIA Benchmarking Study is the third in the last four years. This paper summarizes key findings from the study across the range of firms participating this year.

Flat Revenue, yet Positive Momentum

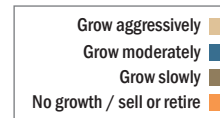
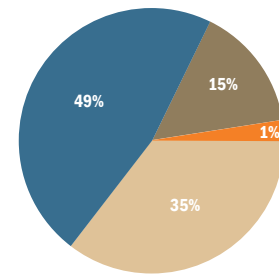
Revenue growth early in 2008 was offset by sharp declines in the fourth quarter, resulting in essentially flat revenue for the year. Because revenues follow assets, participating advisors anticipate a revenue decline of 10% for 2009.

Even so, advisors' long-term optimism about the profession as a whole is apparent in their attitudes toward growth. Advisors who participated in the study are looking ahead and planning to grow. As shown in Exhibit 1, nearly all firms said they plan to grow over the next five years. Of those, 84% plan to grow moderately or aggressively.

In addition, the majority indicated satisfaction with growth to date. Sixty-five percent of RIA firms reported being satisfied or very satisfied with their growth over the past three years, although the percentage of dissatisfied firms went up in that period from 24% to 35%.

EXHIBIT 1: GROWTH PLANS OVER THE NEXT FIVE YEARS

Percentage of Firms



About the Study

The RIA Benchmarking Study from Charles Schwab is designed to capture trends and best practices in the RIA industry, based on the experiences of individual firms. The study provides detailed insights on such topics as assets and revenue growth, sources of new clients, products and pricing, staffing, and firm economics. Participating firms received a customized Peer Benchmarking Report.

The study is part of Schwab's Business Consulting Services, a practice management offering for RIAs. Grounded in the best practices of leading independent advisory firms, Business Consulting Services provides insights, guidance, tools and resources to help advisors strategically manage and grow their firms.

Growth Enablers and Barriers

In assessing whether they have what they need for successful growth, advisors identified several growth enablers—strengths of their firm that will help them attract new clients and new assets. Many of those enablers focus on technology and client service. The top enabler, reported by 75% of firms, was the ability to close the deal after meeting with a prospect. Seventy-three percent of firms cited the ability to maintain quality and consistency in client service as the firm adds more clients. And 67% cited implementing new technologies across the firm to automate processes and build scalability (see Exhibit 2).

Despite their general confidence, 82% of firms saw at least one potential barrier to growth, and 35% saw a major barrier to growth. Seventy-one percent considered some facet of marketing and business development to be a potential barrier. In fact, the top four barriers to growth overall relate to marketing and business development: staff time for business development, developing a marketing strategy, investing enough financial resources to market the firm, and identifying new prospects. Advisors' interest in marketing strategy, investment in marketing and long-term growth planning has increased significantly since the 2007 study, suggesting advisors may be looking for a more methodical approach to building the firm.

EXHIBIT 2: TOP GROWTH ENABLERS

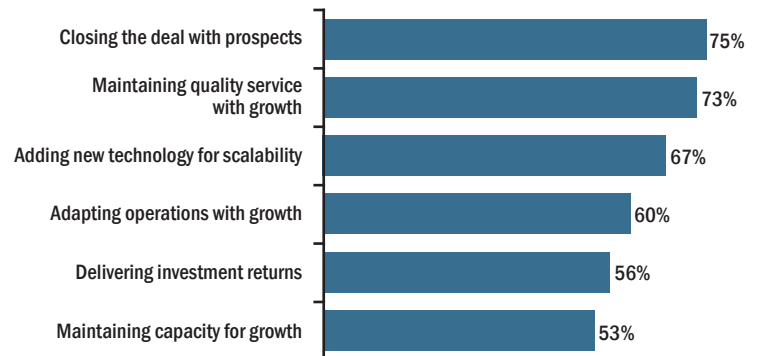
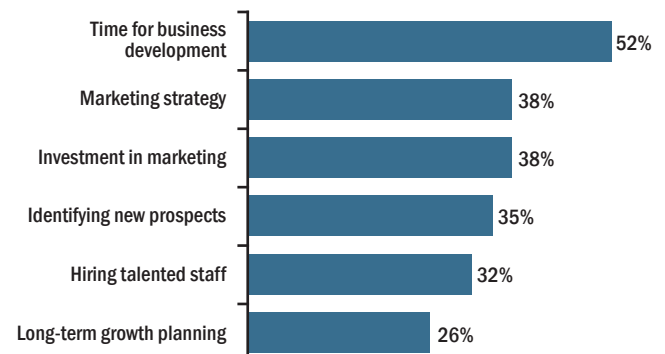


EXHIBIT 3: TOP GROWTH BARRIERS



Client Acquisition

The number of new clients and increased assets under management are two measures of growth. And, although investment performance drove asset levels down, firms continued to gain new clients in 2008. Assets from these new clients helped to offset the overall decline in asset values. The rate of adding new clients slowed compared with recent years, however. For 2008, growth in the number of clients was 5% at the median, compared with 8% and 9% for 2006 and 2007.

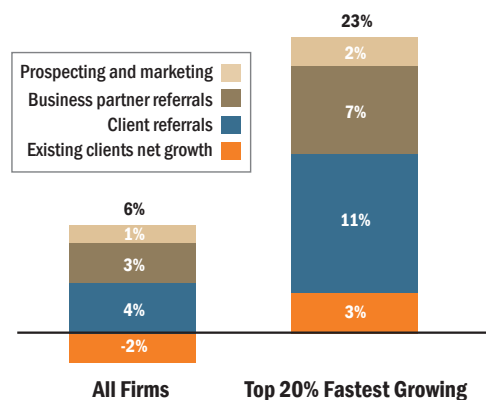
Asset attrition from lost clients rose from 1% in 2007 to just over 2% in 2008. While this remains relatively low, it bears watching. Moreover, new assets from existing clients fell, underscoring both the need for retention strategies and the importance of client acquisition.

Referrals Are Critical

Even as asset values declined, the study revealed that advisors continued to add new assets. Assets under management for the average firm grew 6% in 2008 from net asset flows (see Exhibit 4). But unlike the balanced growth of the last few years, growth in 2008 relied largely on a single source—referrals. Virtually every firm depends on referrals for business development. In 2008, on average, 85% of new clients came through referrals. All other

EXHIBIT 4: 2008 GROWTH IN AUM

Excluding Investment Performance



sources of new clients through prospecting and marketing brought in 15% of new clients.

New assets from referrals accounted for 7% asset growth in 2008 (excluding investment performance). That helped offset the 2% asset attrition from existing clients. Clearly, the study indicated there is great potential for growth in generating referrals. The top 20% fastest growing firms from net asset flows saw 18% growth from referrals.

Implications of Growth: Staffing and Productivity

As firms grow, they face challenges in all aspects of their operations. The right staffing levels and productivity are imperative to manage growth with a high level of client service.

On average, participating firms have 10.1 total staff members, including 5.7 professionals (2.3 principals) and 4.4 administration, operations or dedicated management. As advisory firms grow, they appear to develop more specialized staff roles, such as dedicated management and dedicated business development.

The study shows that scale often leads to economies in business development and client service. Once firms reach a certain inflection point, they can serve each client more profitably. Although they may spend more time per client, those clients tend to have more assets and generate more revenue, driving down the costs relative to AUM.

Productivity per professional tends to increase as firms grow, although there are productive firms of every size. While professionals at the median firm manage 47 clients and \$47 million in assets, generating \$360,000 in revenues per professional, those at top-performing firms—in the 80th percentile for all firms—produce at nearly double the median, managing 88 clients with \$83 million in assets and generating \$560,000 in revenues per professional.

As shown in Exhibit 5, the cost of client service per \$1 million AUM decreased steadily as firms grew. Client service cost per \$1 million AUM was \$3,000 for the smallest firms and \$1,500 for the largest. Business development costs per \$1 million in AUM increased initially as firms grew from small to mid-size, but dropped dramatically for firms above \$500 million in assets under management (see Exhibit 6).

EXHIBIT 5: CLIENT SERVICE TIME COST PER \$1MM AUM

Average Cost by Firm AUM

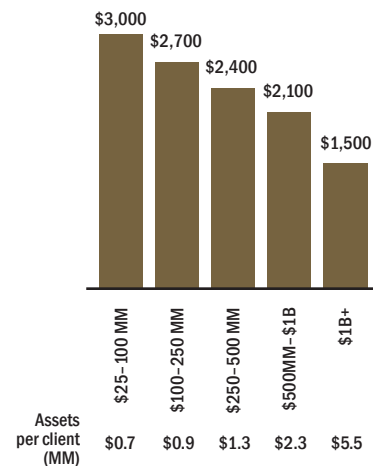


EXHIBIT 6: BUSINESS DEVELOPMENT TIME COST PER \$1MM NEW AUM

Average Cost by Firm AUM

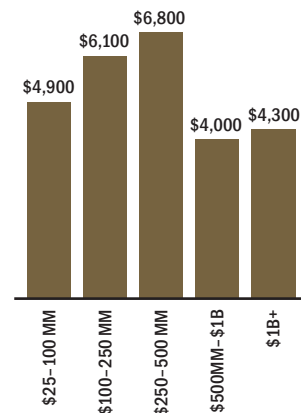
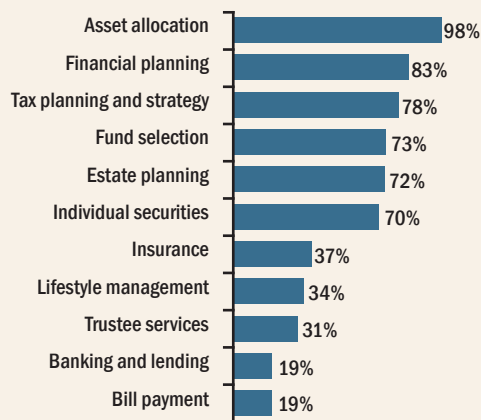


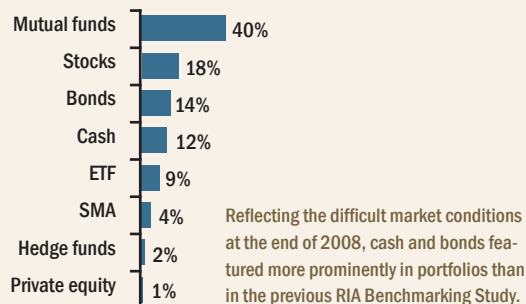
EXHIBIT 7: SERVICE AND INVESTMENT OFFERINGS

The study also obtained information about the services advisors offer and the investment types they use.

Advisors Offering Service



Investment Products as Percentage of Assets



Technology as Strategy

Technology can offer significant productivity benefits and cost savings. Because some time-saving applications are not widely adopted, more efficient use of technology represents an opportunity for many firms to streamline their operations.

Overall, firms view investing in technology as a key strategic decision that can help them increase accuracy and efficiency while delivering better client service. Ninety-five percent said they purchase technology to increase efficiency and 90% to increase client service. Seventy-six percent of firms described their approach to technology investment as moderate or aggressive.

Yet some critical and time-saving applications are not widely adopted. For example, only half of firms in the study use their client relationship management (CRM) system to create standard tasks, and only 42% integrate their CRM with document management and 32% with portfolio management. Similarly, fewer than half of firms use the paperless fax feature of their document management system, and only a quarter use advanced search capabilities.

Taking advantage of workflow functionality may increase both satisfaction with the application and productivity. For example, CRM users who use workflow functionality are satisfied with their CRM 65% of the time and report time savings of 16% over their prior approach. Of those who do not use workflow features, only 11% are satisfied with their CRM and report only 7% time savings.¹

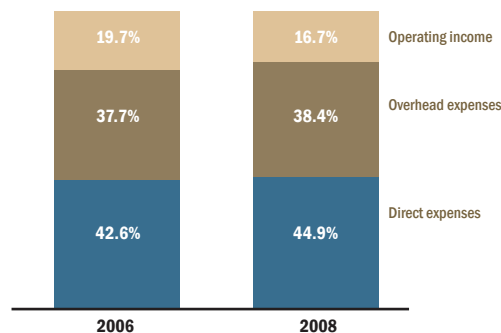
Productivity Needed as Profits Decline

According to study participants, firm profitability was under pressure in 2008 as revenues stayed flat and expenses grew. Overall profitability declined for average firms as well as the most profitable ones. (See Exhibit 8).

Average operating income for all firms dropped to 16.7% in 2008, down from 19.7% in 2006 (see Exhibit 8). Direct expenses rose slightly, to 44.9% on average, up from 42.6% in 2006. Professional salaries and bonuses accounted for most of the increase, rising from 40.7% to 42.5%. Overhead costs grew slightly, to 38.4% of total revenues, up from 37.7%, with the increase coming largely from operations and administration staff. IT spending rose from 1.7% to 3% of total revenues, demonstrating an increased commitment to investing in productivity, especially in lean times.

EXHIBIT 8: AVERAGE OPERATING INCOME

Percentage of Revenues



Conclusion

Despite the challenging financial environment, the study results show that more independent advisors appear to be laying the foundation for long-term growth by recognizing the value of investing strategically in their businesses. When the economy regains momentum, firms that have improved their processes and put the right people in place should be ready to take advantage of new opportunities.

Overview of Participating Firms

¹All results reported in this paper are for participating firms with more than \$25 million in AUM, except for the findings on CRM users, which are for firms with more than \$100 million in AUM.

- 610 registered investment advisors, collectively managing more than \$175 billion, completed the survey.
- 370 participating firms have more than \$100 million in AUM.
- 110 firms have \$500 million or more.
- 53 firms have \$1 billion or more.
- Firms described themselves as: wealth managers, 57%; money managers, 30%; financial planners, 9%; institutional investment consultants, 3%; family offices, 1%.
- On average, participants have 325 clients, \$380 million in AUM and \$2.5 million in revenue.

Market Knowledge Tools®

Schwab's MKT Reports are a collection of white papers and how-to guides designed to help advisors grow, compete and succeed. The reports highlight best practices, case studies and insights from growth leaders and best-managed firms across the industry. They are distributed as part of Schwab's Business Consulting Services platform, Schwab's practice management program for registered investment advisors, providing thought leadership, resources and support in key areas of an advisor's business, such as Human Capital, Marketing & Business Development, Business Strategy & Planning, Technology & Operations, Transition Planning, and Compliance Resources.

The following reports, available to advisors who custody for Schwab electronically or in hard copies, may help you leverage insights from the RIA Benchmarking Study.

- ***Getting the Most Out of Your CRM Investment: Customer Relationship Management Best Practices, 2009***
- ***Best-Managed Firms: The Business of Serving Clients, 2009***
- ***Best-Managed Firms: It's About Time, 2007***
- ***Maximizing Referrals from Clients: How to Develop and Implement a Strategic Referral Process, 2007***
- ***Technology Best Practices: Making the Most of Your Technology Investment, 2007***

For more information

To learn more about how Schwab works with advisors, visit www.schwabinstitutional.com/public.

If you are a Schwab client and would like to participate in the next RIA Benchmarking Study, please call your relationship manager.

Methodology & Disclosures

- All information contained in this report is provided for general informational purposes only. Schwab makes no representation or warranty as to the accuracy, completeness or appropriateness of the information in the report.
- This report is not a recommendation of any business enterprise or investment advisory practice management technique, strategy or practice reported on or described.
- Responses were collected during February and March of 2009.
- All data is self-reported by study participants and is not verified or validated. Each participating advisory firm submitted only one set of responses.
- Data for 2006 comes from Schwab's 2007 RIA Benchmarking Study.

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