

Charles Schwab Firm of the Future Study

June 25, 2015

The logo for Charles Schwab, featuring the word "charles" in a lowercase, italicized serif font above the word "SCHWAB" in a bold, uppercase, sans-serif font, all contained within a blue square.

charles
SCHWAB

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About the study

About the study

- The Registered Investment Advisor (RIA) industry continues to advance. As newer generations of clients move to the forefront, and technology evolves at a rapid pace, firms must adapt in order to succeed.
- To understand what RIA firms might look like in the future, Schwab Advisor Services™ initiated the 2015 Charles Schwab RIA Firm of the Future Study. We investigated characteristics shared across high-performing, forward-thinking firms* as a way to identify crucial attributes that future firms might possess.
- These findings correspond to several key areas of focus that current RIA firms can consider as they position themselves for future success: Talent, Technology, Firm Culture, and Business Model.

*We identified firms as “forward thinking” by their responses to questions in the quantitative survey.

Methodology

The study was conducted in a two-phased approach between January and March 2015. Both the quantitative and the qualitative phases were administered by Koski Research:*

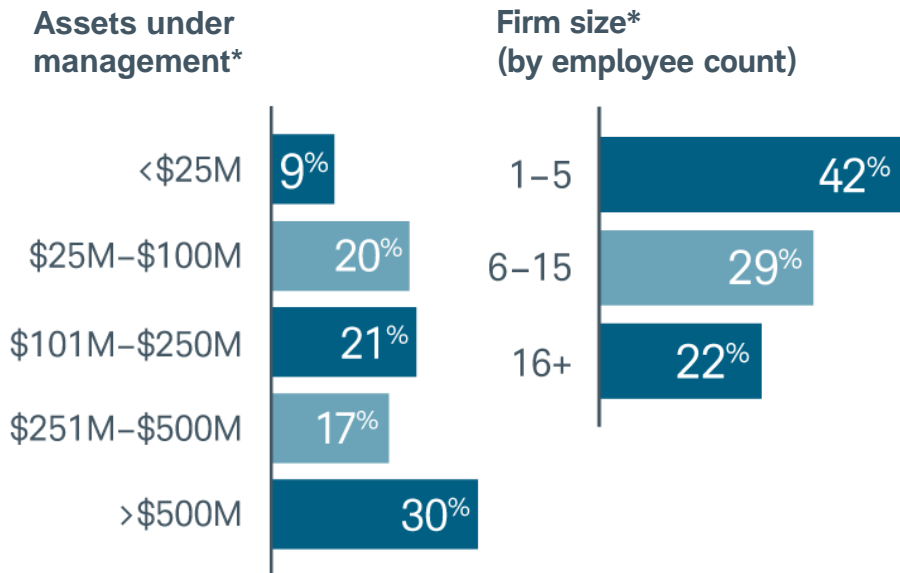
- **Quantitative:** We first surveyed a broad swath of firms to learn more about advisors' attitudes toward change, how they plan to drive growth in the future, and their perceptions around the future of the industry and their firm.
- **Qualitative:** We leveraged the findings from the quantitative phase to identify firms that exhibited forward-thinking attitudes in order to help shine a light on actions and behaviors that may drive a firm of the future.

Methodology

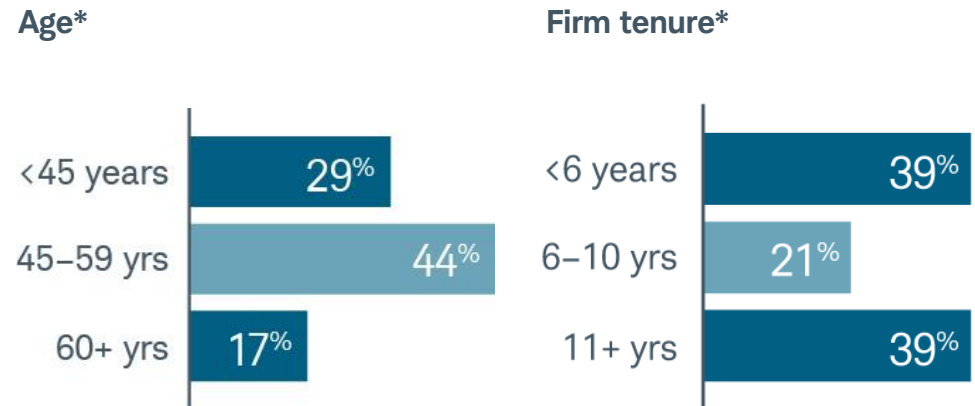
Phase 1: Quantitative

Online survey of 872 RIA firms from across the country that custody with Schwab

Firm information



Respondent demographics



*Where total equals less than 100%, some participants declined to answer.

Methodology

Phase 2: Qualitative

- In-depth interviews of 28 advisors representing 20 RIA firms from 7 cities.
- Firms' assets under management varied, but most held in excess of \$500M.
- Many of those interviewed had participated in the quantitative phase and indicated a forward-thinking mind-set.
- 22 men, 6 women.



Highlights

Highlights

Positive outlook—RIA firms are very optimistic about the future of the industry, though they recognize the need to adapt in order to realize that success.

- Almost all advisors predict organic growth for their firms and are confident that their value proposition will continue to attract market share.
- Advisors agree that change is important to maintain their success, but the quantitative study showed few changes in the business model. This dissonance was not reflected in the qualitative portion where participants demonstrated intentional adaptability.

Complacency—Complacency may be the largest threat to future success.

Leadership—Being visionary—even looking ahead 10 to 20 years—emerged as the most important leadership trait. Participants believe that future leadership could be collaborative and forward thinking, and view change as a catalyst for growth.

Purposeful investments—Making investments in technology is vital, but RIAs place even more value on investing in their people—recruiting and developing talent to create a unique firm culture and client experience.

Focus on the future—The next generation of advisors and clients is viewed as an intertwined opportunity for RIAs. Recent revenues have allowed for investment in next-generation talent and permit greater flexibility regarding account minimums.

Detailed findings

Overview

Participants were asked to express their perspective on the future of the RIA industry in one word:



“Optimistic” was expressed most often, followed by “bright,” “exciting,” and “opportunity.”

“I believe we are in a time of economic prosperity. We are in a time of technological advancement that helps us all run our businesses and seek clients and source business. I think there are just so many great things on the horizon.”

—Study participant

Belief in the model

Advisors are overwhelmingly positive about the outlook for the RIA industry

Advisors' confidence not only is a reflection of their current success, but is also driven by their pride in providing independent advice and in being the alternative to other models.

Pride

- These advisors take pride in doing right by their clients, and they work earnestly to help them and address their financial worries at every stage of their lives.

Connection

- In spite of technological advances, advisors believe there will always be a big need for personal service.

Confidence

- The result is confidence. They provide a valued service to their clients, and through caring for their clients, they will succeed.

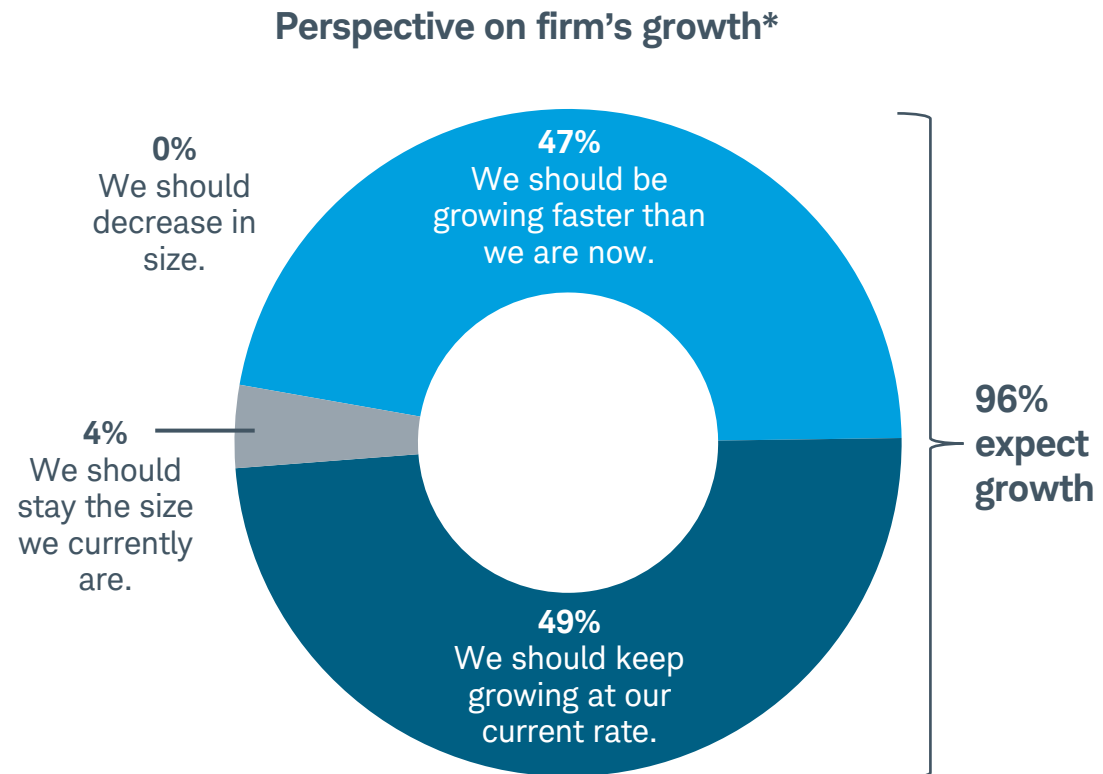
“There is a lot of opportunity to help people. One thing that an advisor offers is the ability to help simplify things, and to focus on what’s important for a client. People really value that.”

–Study participant

Looking toward growth

Advisors are confident about the model's future growth, due in part to their unique RIA value proposition

- 78% of participants said their firm's value proposition will live beyond the current firm leaders.
- Nearly all RIAs surveyed (96%) expect growth for their firms, at either the current or an increased rate.



*Q1: Which of the following best describes your perspective on your firm's growth? (Base: Total respondents = 872)

Anticipating change

RIAs recognize the industry is ever evolving, and as always, they need to be ready to adapt quickly

- Generally, advisors do not see a disconnect between optimism about the future and the necessity of change. They are positive, even as they realize they will need to adapt.
- 66% of quantitative participants agree that “every industry is either changing or dying right now—RIAs need to step into the future.”

“I think you are going to see advisors grow by taking market share from the advisors who stay very traditional.”

—Study participant

Complacency: The largest threat

Getting too comfortable with the status quo and failing to adapt is seen as the main danger threatening continued RIA success

“The biggest threat is being comfortable. I think that there is a real danger to many advisors of having really significant disruptions to their businesses when they realize that they didn’t see the water rising.”

–Study participant

“I think technological advances, pricing pressure, and [attracting and retaining] talent are some of the biggest threats.”

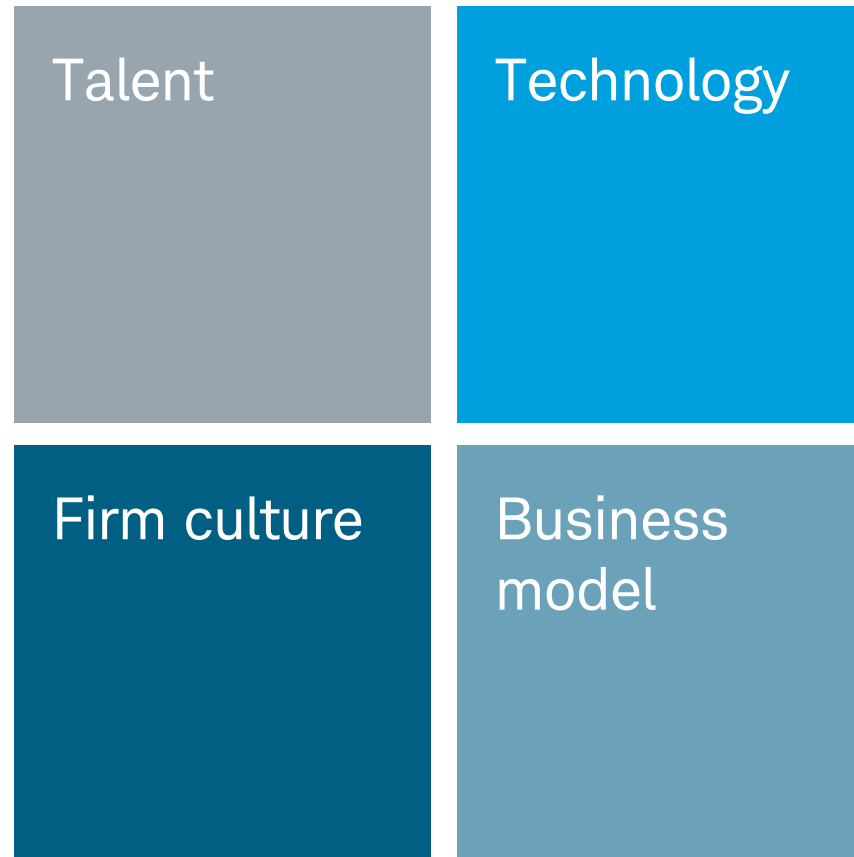
–Study participant

Less potential threats identified by study participants:

- Pricing pressure
- Robo advice
- Finding talent
- Overcrowding in the industry
- Attrition of older clients
- Cybersecurity
- Tax policy changes
- Increased regulation
- Poor overall industry reputation

Building a Firm of the Future

Research shows that forward-looking firms focus on four key areas:



Key areas of focus

Looking at talent, technology, firm culture, and business model

To help ensure that they stay ahead of pressures that will require change, forward-thinking firms emphasize four particular areas of focus:

Talent

- Forward-thinking firms prioritize people as the most important organizational investment. Thriving economies will allow firms to shore up their investments in attracting and developing future talent.

Technology:

- RIAs understand that the industry is at a technological tipping point—with significant leaps in capabilities accelerating. They will need to leverage sophisticated solutions to drive operational efficiencies and meet evolving client needs—or fall behind.

Firm culture

- Visionary leadership and a team-oriented, client-first culture will be crucial. A focus on selective hiring, as well as training and developing talent that demonstrates firm values, will help firms maintain their unique culture and client experience to ensure continued asset growth and future success.

Business model

- Future firms will not be bound by convention; these firms will explore expansion into new client segments, examine alternative pricing structures, and deliver a wider array of new services for a more holistic offering. This focus may drive significant business model changes.

Talent

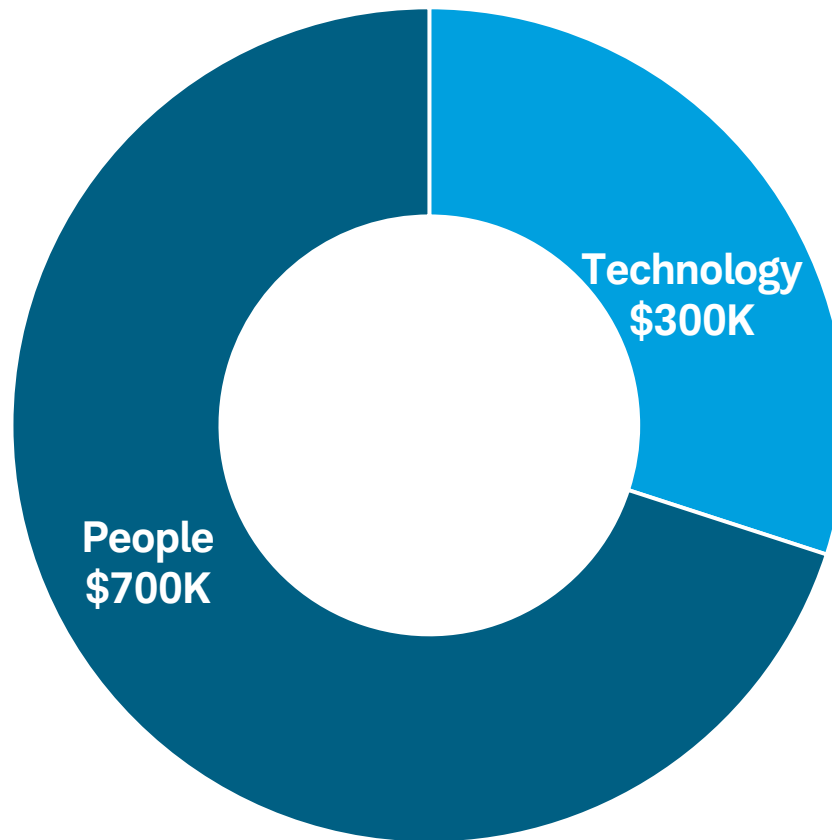
“Assuming that we’re successful in delivering on our 10-year plan—which so far we’ve always done—we’ll have 200 employees 10 years from now, at least. And so for recruiting and training, we have come to the realization that we’re going to be hiring people nonstop.”

—Study participant

Prioritizing people

Advisors expect talent to be their top investment

The million-dollar question: Given the choice between people or technology, where would RIAs invest \$1 million for their firm?

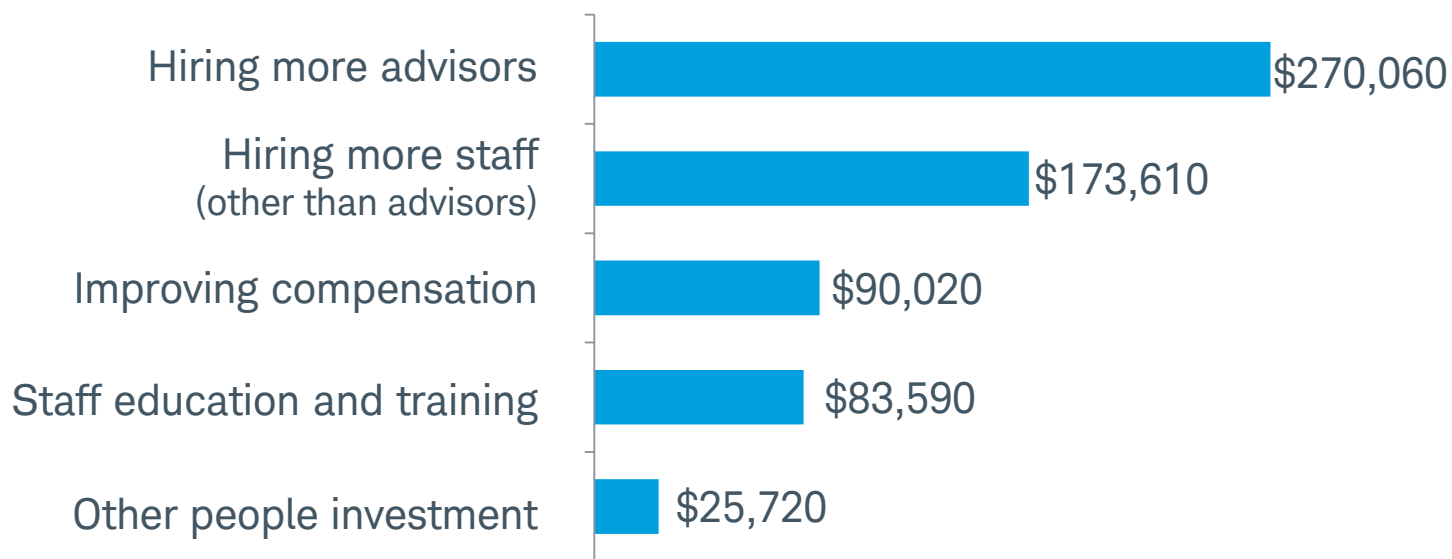


Prioritizing people

Hiring and training are the major investments

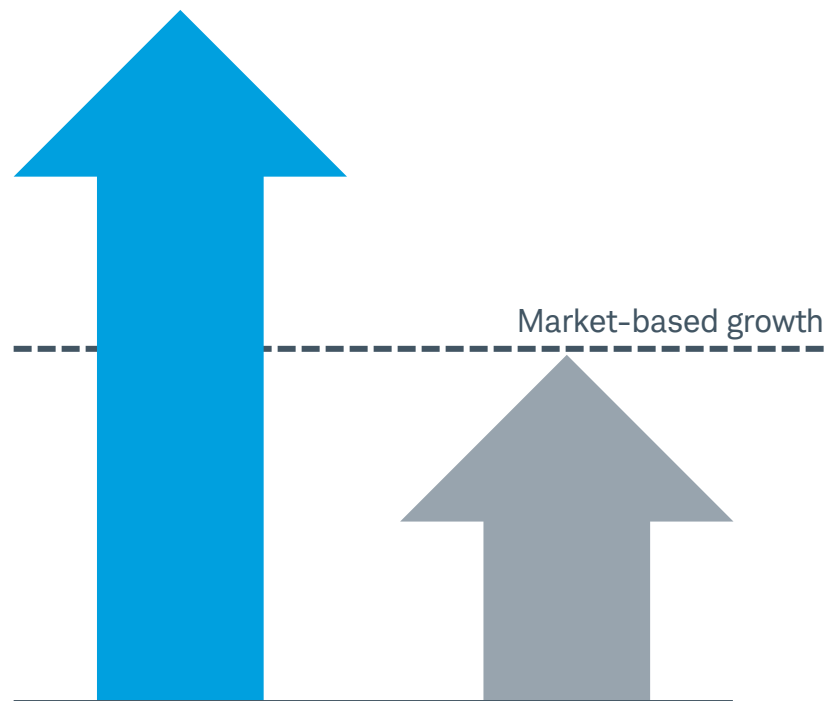
83% of the “people” dollars would be invested in hiring and training.

People: Mean investment \$\$ allocated to:



Keeping an eye on the future

Visionary leadership



The Firm of the Future outperforms the market through visionary leadership.

Without visionary leadership, firms grow only with the market.

“Success can be defined in many ways: The leadership has a vision for the firm, has a vision for the future, and articulates that vision down to [employees].”

—Study participant

Forward-looking firms reported looking beyond the typical three- and five-year plans and may increasingly rely on a visionary management team (vs. founding principal) that is looking 10–20 years down the road.

Defining and developing leadership

Equity ownership and clear succession planning are large components

- Forward-thinking firms nurture and encourage those within the organization who demonstrate firm values and an “ownership mind-set” by offering more equity ownership opportunities to future leaders.
- Increasing equity distribution is seen as a key tool for protecting firm culture. It allows firms to incent, develop, and retain the right talent.
- Advisors identified the importance of having clear, comprehensive strategic and succession plans in place as being key to the long-term growth and sustainability of their firms.
- 71% of surveyed firms have more than one equity owner, while 27% of firms have more than five.

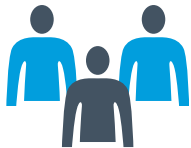
Focus on the next generation

Attracting next-generation advisors is seen as key to attracting the next generation of clients

- 65% of respondents agreed with the statement: “I see great opportunity in the next generation of clients.”
- Firms believe that bringing in younger clients can help ensure the longevity of the firm—and they have found that next-generation advisors can help them attract and retain next-generation clients.
- To attract those younger clients, firms are exploring:



Lowered asset minimums



Bringing in younger advisors



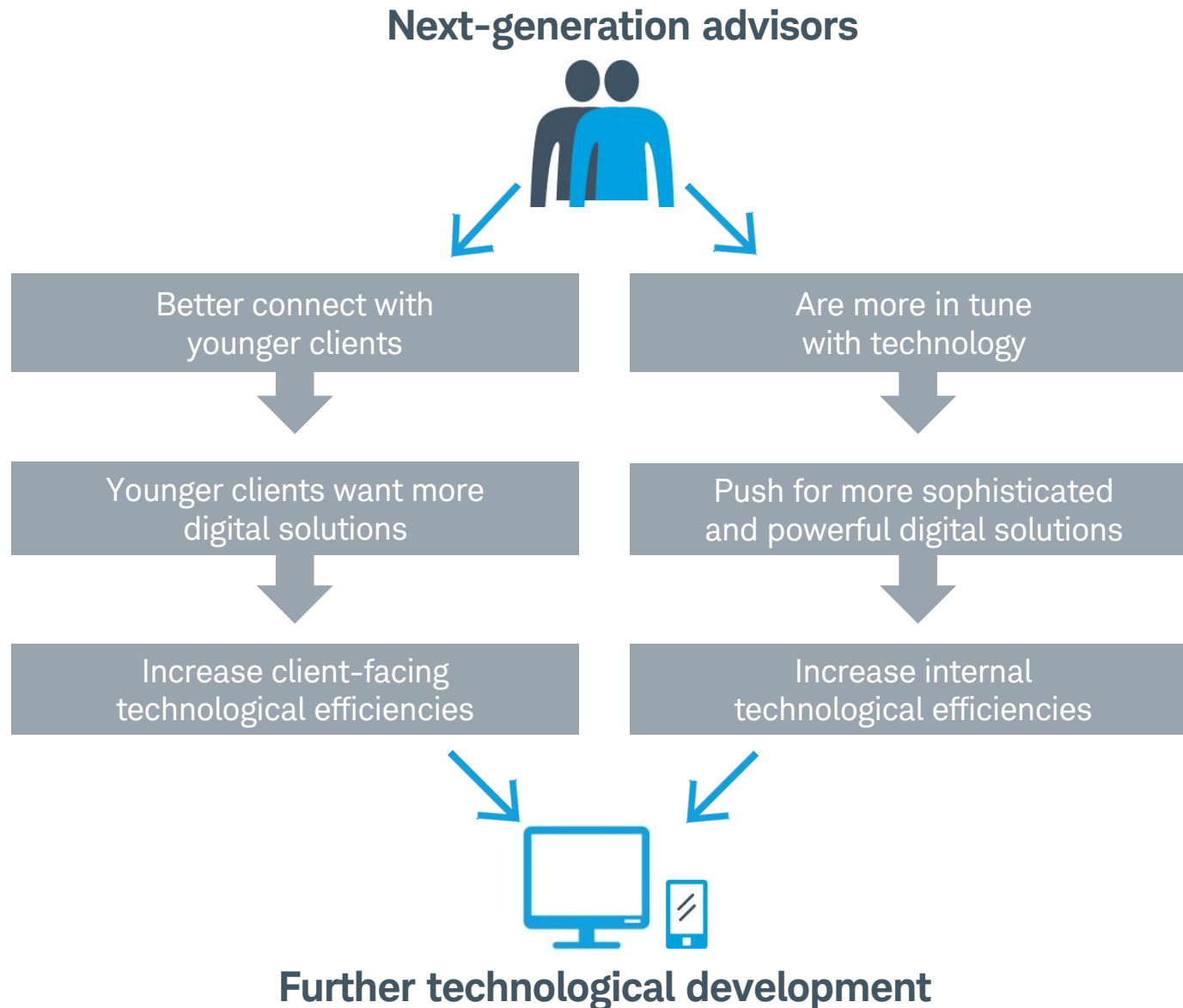
Integrating technology

“We can offer our clients the opportunity to have their children come in, and they’ll be able to interact with our younger advisors, because they can relate better.”

—Study participant

Next-generation talent and technology

Younger advisors may be key to implementing important technology transitions





“Generation Y and Generation X [advisors] are amazing at leveraging technology for their clients. They are amazing at taking an application and saying, ‘Here is how we can help, and here is how it creates a better client experience.’”

—Study participant

Technology

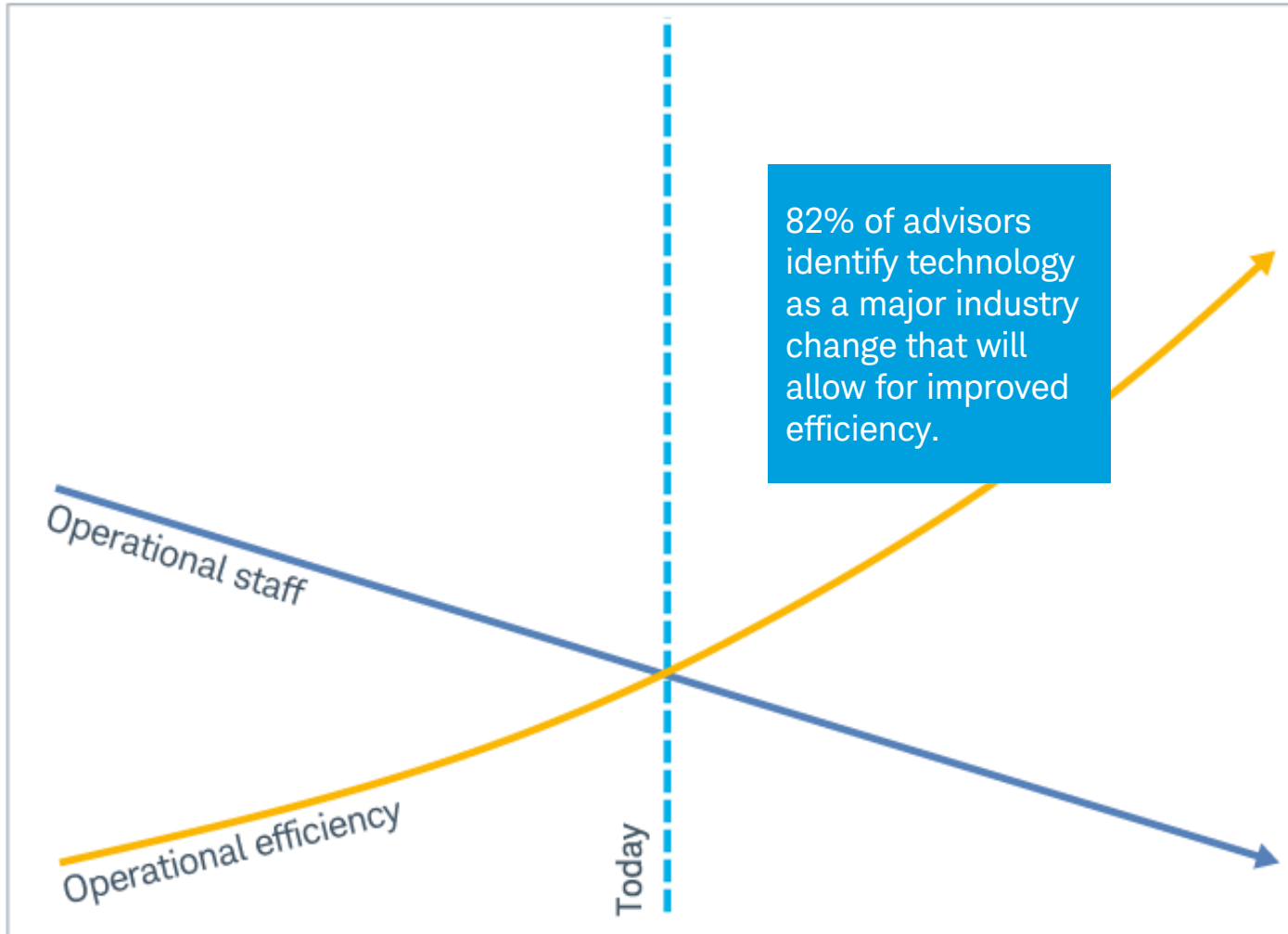
“I’m a big believer in the relationship with a client, and it’s still a really important piece. So the threat of technology—as long as we harness it appropriately—it can really be an opportunity to serve clients better and more effectively.”

—Study participant

The technological tipping point

Advisors see technology as a means to drive operational efficiency and fulfill client expectations

Evolution of technology over time



- Technology will be an important driver of growth by providing scale, but it is no longer a differentiator.
- Greater operational efficiency will allow firms to staff more client-facing roles.
- Advisors described their “holy grail” as a single integrated portal for clients to connect and collaborate with their advisors and information, all in one place.

Navigating the roadblocks

Lack of resources can be a barrier for implementing technology to improve operational efficiency

Biggest pain points:

- Systems integration and compatibility
- Manual rebalancing
- Quarterly reporting
- Performance reporting
- Document management
- Face-to-face meeting preparations
- Paper signatures

“[Many advisors] are struggling with the myriad of solutions; the problem we have is integration. You know, bidirectional information going among our various [platforms].”

Roadblocks to technological advances for firms:

- Dependency on legacy systems
- Lack of funds
- No desire for growth
- No demand among clients
- No resources for implementation

“A lot of firms are just kind of stagnant. They’re five years behind the times in terms of technology because they haven’t decided to pull the trigger, or they didn’t want to spend the money.”

–Study participants

Improving the client experience

Clients may prefer a convenient, transparent experience through technology

- Advisors' expected ongoing investment in technology reflects a desire to improve the client experience.
- Advisors believe clients increasingly expect to engage with firms, their advisors, and their financial information using digital, mobile technology.
- 69% of advisor respondents said they believe their custodian needs to help them navigate change—including bringing them new technology and supporting that technology.

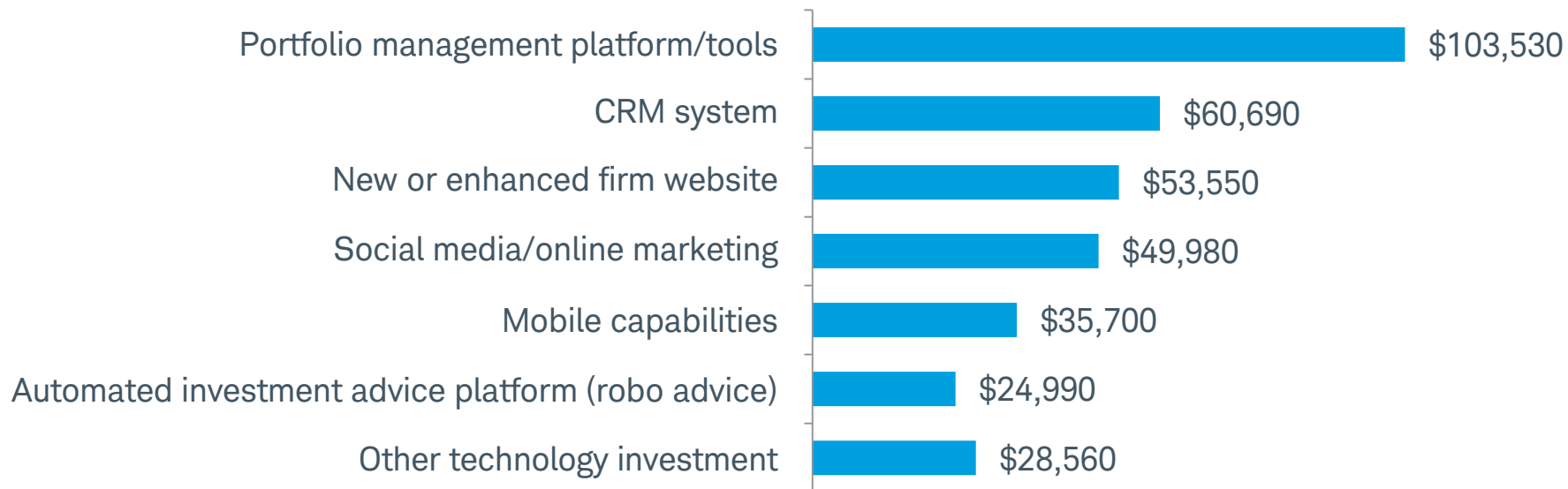
“Everything we do goes back to that interaction with clients and wanting to make sure that they are at the forefront of everything that we do.”

—Study participant

Focus areas

Investments in technology are expected to span multiple areas

Technology: Mean investment dollars allocated to:



Q5. Of the amount you would invest in technology, what percentage would you allocate towards each of the following?
(Base: Those Who Would Invest in Technology = 857)

The outlook on automated investing

Advisors report they are cautious but consider automated investment solutions to be a potential growth opportunity

*“I think the ‘robo-advisor’ is going to be what [tax software] is to the CPA world. You hire a great CPA, you invest your money in that CPA, and they will help you with your taxes, because your taxes are complicated. **If you have simple taxes, do the software.** And I think the same thing happens on the ‘robo-advisor.’”*

*“By the end of the year, I will have picked which racehorse I want in the ‘robo’ camp. We will white label it. It will be part of our **service offering for smaller clients**, and I mean we’re going to build the whole service model around it.”*

*“Will we lose clients to ‘robo-advisors’? Will we lose assets and market share to them? That remains to be seen. Some people will say we will. My sense of it is we won’t. Not anything material. I think that is simply going to **make the pie bigger.**”*

Firm culture

“The one reason why we have such great growth is because we have phenomenal people, which leads to an amazing culture.”

—Study participant

Fostering a client-centric culture

Creating a team focused on exceptional client experience

- Advisors believe that forward-looking firms will cultivate an atmosphere where it's understood that delivering an exceptional client experience helps ensure continued asset growth and future success.
- Many surveyed advisors believe that building a firm of the future starts with visionary leaders who inspire a culture of change, where adapting to client needs and market demands is not only expected but also wholly embraced.
- A client-centric focus and a firm wide appreciation for caring about clients' financial goals and needs are at the core of the culture—cultivated and protected by firm leaders.

“I can teach, I can mentor, I can develop people. But I can't teach heart. Heart goes back to the values. It is a service orientation, for both internal and external clients. It is a sincere desire to help people.”

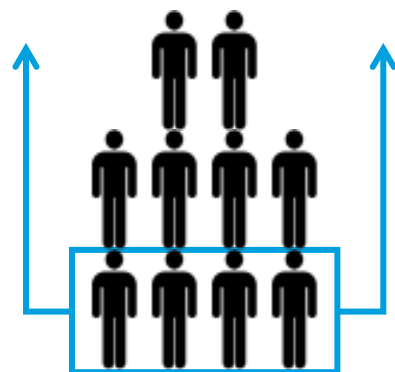
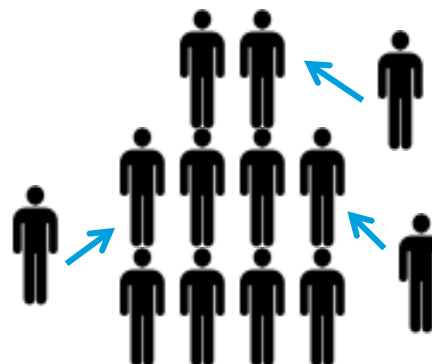
—Study participant

Maintaining cultural consistency

Firms will focus more on training leaders from within the organization rather than on “folding in” outside talent

Advisors believe that building leaders from the bottom up can allow their firms to create and maintain cultural consistency throughout the organization—and carry it through to the future.

Less common—bringing on older advisors or “folding in” other firms—rare due to the vetting process and finding the right fit (exceptions may include hiring for specialized expertise)



More common—building firms from within and developing talent from the bottom level up to leadership, creating a consistent firm culture

Business model

A man in a dark suit, white shirt, and dark tie is sitting at a dark table outdoors. He is looking down at a smartphone in his hands. A silver laptop is open on the table in front of him. The background is blurred, showing trees and a building.

“I think you are going to see advisors grow by taking market share from the advisors who stay very traditional.”

–Study participant

Not bound by convention

Driving business growth through adaptability, expanded offerings

- Advisors predict that the Firm of the Future will continue the current trend of RIA firms offering more comprehensive services behind investment management—such as tax planning, estate planning, retirement services, and more.
- These firms will likely leverage relationships with centers of influence as a foothold to expand their services.
- Offering greater opportunities for equity ownership can empower future principals and help ensure consistency in firm culture, vision, and client experience while developing and retaining top staff.

“That is the challenge to our industry: Who is going to be willing to change? Who is going to be adaptive? Who is going to be agile?”

—Study participant

Keeping an eye on pricing models

Advisors are watching pricing models closely, and they may need to adapt to fit evolving investor needs

- While just 20% of surveyed advisors predicted that a majority of firms will change pricing models in the next five years, many said they were willing to consider adapting their pricing to meet market demands.
- 55% of surveyed advisors say they would change pricing to fit evolving investor needs. Only 10% said they would change their pricing because of technology.

	Pricing today	Pricing 5 years from now
Asset-based fee	95%	89%
Flat rate	23%	32%
Service-level pricing	8%	32%
A la carte	3%	13%

Source: Quantitative survey data. For illustrative purposes only.

- Interviews revealed some advisors are considering unbundling fees from investment management to better represent the value of their service (wealth management, planning, and additional financial services).

Summary

Defining their firms for the future

Change is an opportunity

- RIAs can help foster sustainable success by building strong, client-centric firm cultures that revolve around visionary leadership, employee empowerment, and the drive to evolve with change.
- RIAs are embracing new technology (such as mobile platforms, automated investment solutions, and integrated systems) to help them drive scale and enhance service, while looking to future growth in new segments with new service offerings.
- As the industry continues to mature, firms could adapt existing value propositions to further differentiate themselves and reinforce the unique value of the independent model.
- RIAs are looking to their custodians to help provide the tools, resources, and insights that will help firms succeed, now and in the future.



Disclosures

This presentation was produced by Charles Schwab & Co. Inc. (Schwab) and is for general informational purposes only.

Charles Schwab RIA Firm of the Future Study was conducted for Schwab Advisor Services™ by Koski Research (Koski) and was released in June 2015. The report relies on information provided to Koski by 872 advisors in a quantitative survey and 28 advisors by interview. All participants custody with Schwab. All data was self-reported by participants and not validated or verified. This report is not a recommendation or endorsement of any investment advisor, whether or not quoted or described in the report. Experiences expressed are no guarantee of future performance or success and may not be representative of your experience.

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