

MOVING FORWARD IN UNCERTAIN TIMES

Insights From the 2012 RIA Benchmarking Study From Charles Schwab

Registered investment advisors (RIAs) have shown resilience and strength in a difficult business environment. The 2012 RIA Benchmarking Study from Charles Schwab confirmed that RIAs are experiencing steady client growth and continue to position themselves for success as the RIA channel expands and matures. Firms are evolving to meet today's challenges, gaining productivity through investments in business operations and placing increased emphasis on planning for the future.

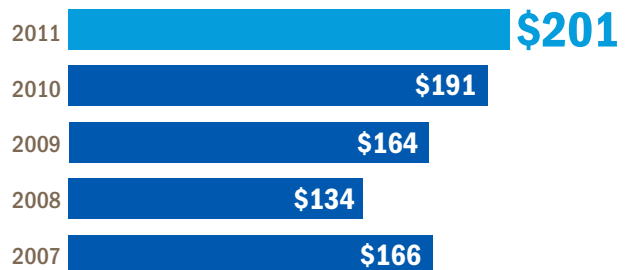
Results of the study show that focus on business rigor and a continued commitment to putting clients first combined to make a big difference for RIAs in 2011. Despite virtually flat markets, RIAs' assets under management (AUM) and revenues rose to new highs because of new client acquisition and stellar client retention. At the same time, perhaps in response to ongoing volatility and the complexity of running a more substantial business, RIAs appear to be more focused than ever on longer-term business planning. These trends may indicate that the resilience, strength, and maturity of the RIA model can foster success even in difficult environments.

Sustained Organic Growth Yields New Highs

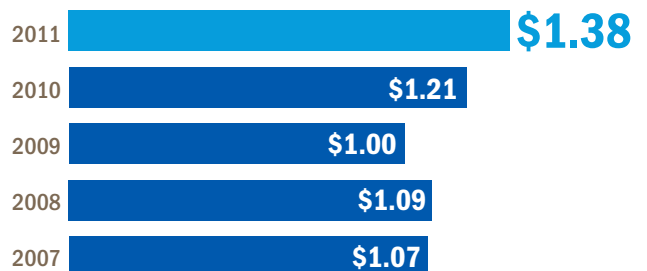
According to Schwab's 2012 RIA Benchmarking Study, RIAs experienced another year of solid growth in 2011. In fact, for the vast majority of firms in the study, 2011 brought the highest levels of AUM and revenues ever, despite ongoing market volatility. The median firm in the study ended the year with \$201 million in AUM, up 3.8% from the prior year, and revenues of \$1.38 million, up 12%.

New clients were a primary source of this growth. Although clients are taking longer to choose an advisor than they did in the past, they continue to find the

ASSETS UNDER MANAGEMENT Median Firm at End of Year, in Millions



REVENUE Median Firm, in Millions



high-touch service approach of the RIA model attractive. According to Schwab's Independent Advisor Outlook Study, almost all advisors reported gaining new clients over the past year. The biggest source of these new clients has been investors leaving full-service brokerage firms (39%).¹

For the median firm, bringing in new clients contributed about 5% to firm assets; the top 20% of firms brought in at least double that amount. In another sign of the strength of the RIA model, client retention remained high. Median client attrition was at 2.8%, down from a recent high of 4.1% in 2009. Looking forward, firms are taking a deliberate approach to growing their business—with growth initiatives at the top of the list of current strategic efforts.

Schwab's annual RIA Benchmarking Study is the largest of its kind focusing exclusively on RIAs. This year's study included 1,025 RIA firms, a 25% increase over last year and, for the first time, more than 100 firms with \$1 billion or more in AUM. Advisors from participating firms completed a detailed survey in early 2012, reflecting on their firm's performance in 2011 and history of growth since 2008. Participating firms represented a total of more than \$425 billion in AUM, approximately 15% of industry assets.

Business Development Requires More Effort

Even as clients continue to join RIAs, it takes more discipline and effort to grow a firm in today's uncertain economic environment. Shaken in recent years, investor confidence has been slow to recover. Business development demands more time and resources than in the past, and—perhaps a sign of an increasingly competitive marketplace—advisors report that prospective clients are interviewing multiple providers and taking longer to make a choice.

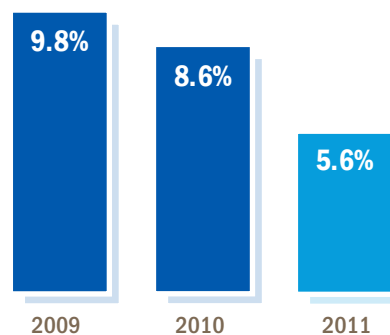
The drop-off in average growth from net asset flows was quite pronounced—declining from 9.8% in 2009 to 5.6% in 2011. Viewed more closely, it was the slowdown in growth at the fastest-growing firms that drove the change. For the median firm in the study, growth from net asset flows edged downward to 4.2% in 2011. At the 80th percentile, however, growth declined more precipitously from 14.7% in 2009 to 10.3% in 2011. This slower growth is more expensive growth, because firms typically expend the same resources with lower results. In other words, the slowdown in business development productivity is increasing the cost of acquiring new clients. The median cost of staff time associated with bringing on \$1 million in new assets was \$4,450 in 2011, up sharply from \$3,730 the year before.



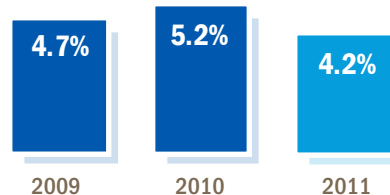
NEW CLIENTS CONTRIBUTED 5% TO GROWTH FOR THE MEDIAN FIRM

GROWTH FROM NET ASSET FLOWS

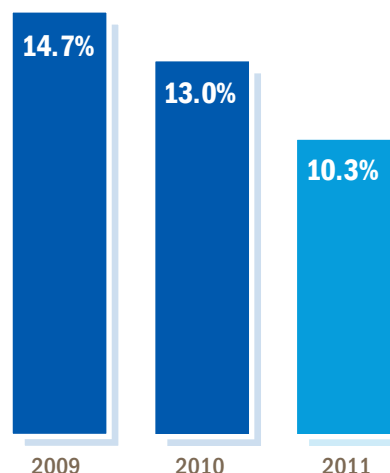
Average Growth



Median Growth



80th Percentile Growth



Although advisors remain confident about growth looking forward, it appears that many are impatient with the gradual pace of economic recovery. Satisfaction with current rates of growth has declined slightly since last year—but fully two-thirds of respondents expressed satisfaction with current rates of growth.

Strategic Initiatives Focus on Growth

As expected, advisors continue to target growth among their top strategic business initiatives. Eighty-four percent of RIAs have a growth-related initiative in their top three priorities. And among the top strategic initiatives advisors said they were planning for 2012, the two highest priorities were related to business development—client referrals and professional referrals.

Firms continue to face familiar obstacles to growth, with more than 4 in 5 firms reporting at least one barrier to overcome. The slow rate of bringing on new clients may explain why 72% of firms cited some aspect of marketing and business development as their top growth barrier. In all, concerns about future growth that are related to marketing and business development dominate the list of what keeps advisors up at night. More than half of firms said they have trouble simply making time for business development.

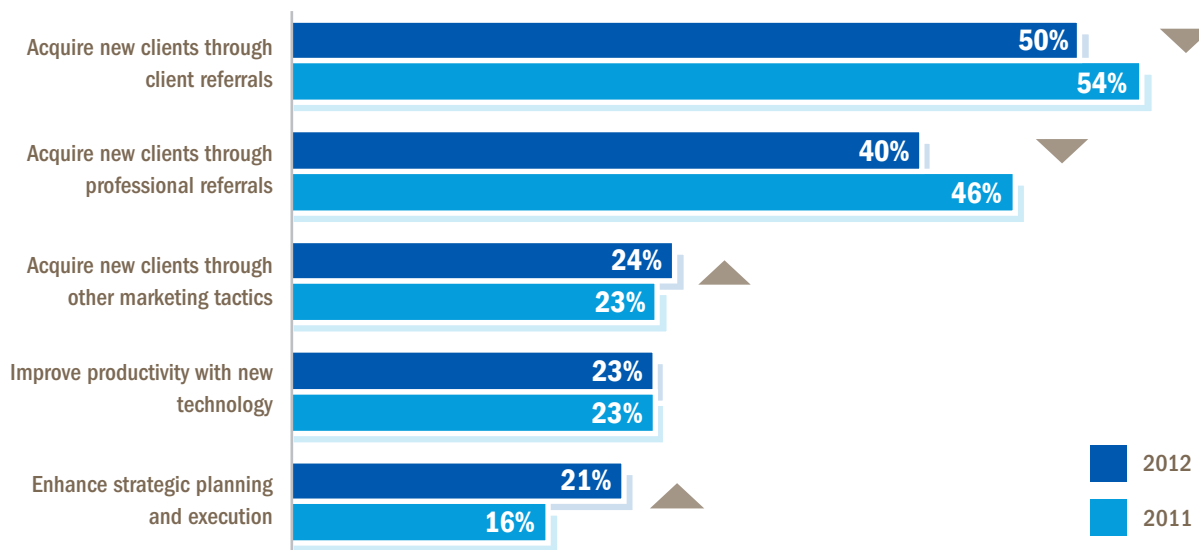
On the other hand, firms see strengths that they can build upon. About three-quarters of advisors cited delivering quality client service as they grow and closing new business as key areas of strength. More than half cited their ability to maintain capacity to add new clients as a key strength, along with the ability to maintain efficient operations as they grow.

Reputation is the currency that drives growth at RIA firms, and referrals continue to be their most productive source of new clients, providing 79% of new clients on average. The fastest-growing firms gained, on average, four times the growth from referrals compared with other firms in the study. Interestingly, firms that grew faster—and effectively optimized both growth and productivity—tended to gain that incremental growth from business partners and other professionals. The Best-Managed Firms²—the top 20% of firms surveyed that excelled in growth, productivity, and profits—drove a similar amount of business through client referrals compared with other firms in the study, but saw a 50% higher level of business acquired through referrals from centers of influence, such as attorneys and tax advisors.

Results indicate that firms are interested in taking a more strategic approach to increasing referrals and driving growth. Four in 10 firms expressed a need for developing and following a well-thought-out marketing strategy. This is up significantly up from 28% of firms in 2007, just before the economic downturn.

TOP 5 STRATEGIC INITIATIVES FOR 2012

Percentage of Firms



Taking a Long-Term View

The data suggests an increase in long-term thinking to position the firm for the future. For the first time since the inception of Schwab's RIA Benchmarking Study, strategic planning was identified among the top five initiatives overall. Interest in a more effective approach to strategic planning and executing on the plan grew by nearly one-third over the previous study. Lack of strategic planning was also cited as a barrier to growth, perhaps the reason why more firms are looking to enhance their planning efforts and a possible reflection of the increased costs firms are experiencing with regard to finding new clients. Concern regarding strategic planning and ability to execute on plans increased to 28% of firms, up from 19% in 2007, a trend that we think will continue.

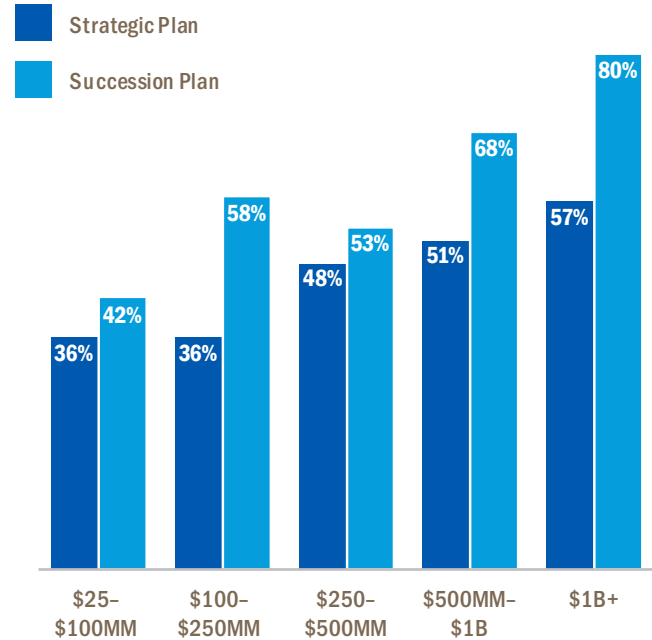
Interestingly, a number of firms have switched their highest-priority initiatives away from marketing and business development, and more firms are prioritizing strategic planning and execution. Overall, 1 in 7 identified strategic planning or succession planning as their top special initiative for 2012, whereas only 1 in 10 did so in the prior year.

Firms that take a long view in looking to the future tend to do better than those that don't. In fact, Best-Managed Firms, those that are growing quickly and realizing higher profitability, take strategic planning more seriously than other firms. Our 2011 study of Best-Managed Firms' strategic planning practices shows these firms use twice as many resources in developing their plan, are twice as likely to plan on a 5-year or longer time horizon, and are twice as likely to validate business results on a monthly basis.³ Larger firms are also more likely to plan. Of firms that engaged in planning efforts in 2011, 57% of larger firms—those with \$1 billion or more in AUM—reported having a written strategic plan in place, compared with 36% of smaller firms—those with less than \$250 million in assets.

The benefits of planning for the future are widely acknowledged. "To take advantage of long-term business opportunities and overcome hurdles to growth, advisors can develop a strategic plan that allows them to maximize their resources by prioritizing efforts across client service, operations, and business development," said Jon Beatty, senior vice president of sales and relationship management for Schwab Advisor Services™. "A written strategic plan acts as a roadmap that helps advisors gain alignment, stay on track, make critical business decisions, and build long-term value for the firm."

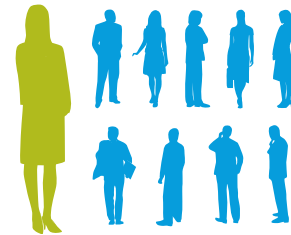
PLANNING BY FIRM SIZE

Percentage of Firms With a Written Plan



FIRMS IDENTIFYING STRATEGIC OR SUCCESSION PLANNING AS TOP OBJECTIVE

2011
1:10



2012
1:7



Productivity Drives Profits

Focusing on productivity is another sound business strategy in uncertain times. One reason firms continue to see success despite flat markets is their increasing attention to streamlining operations workflow—an area of business they may feel they can better control.

As the industry grows, RIAs are finding more providers with technology and outsourcing solutions that can help streamline business operations. An increasing use of such productivity tools not only makes sense for many of the firms in the study but also reflects a maturing industry with greater attention to creating sustainable business enterprises.

For firms in this year's study, the fourth overall on the list of top initiatives—and the first that doesn't involve marketing—was investing in technology to support firm productivity. This indicates that firms see technology as much more than a cost of doing business. It's a key strategic investment they believe enables them to increase productivity and scale efficiently.

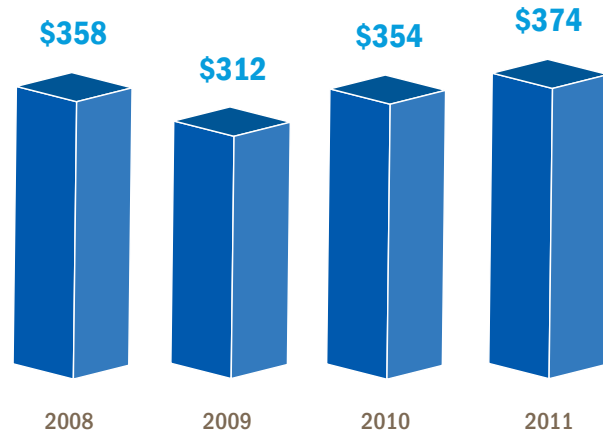
RIAs are using technologies to improve and streamline client services, and also becoming more adept at integrating these technologies throughout their office—even though more than half still cite technology integration as one of their challenges. The average firm uses 5.4 of the 8 technologies included in the study, up from 4.4 three years ago. The biggest increase in technology use was the adoption of trade order management and rebalancing software, now used by more than half of all firms, compared with only one-third of firms three years ago. Firms indicated that rebalancing software can produce the greatest time savings, and reported an average saving of 33%—the highest of any technology system. The next largest area of growth was the use of a client website, now used by nearly half of firms, also up from about one-third three years ago.

Outsourcing can help firms improve efficiency and client service by redirecting tasks that could otherwise burden staff, allowing employees to focus more on the firm's core competencies like working directly with clients.

More firms are outsourcing back-office operations such as data management, perhaps because there are many more high-quality outsourcing solutions. The percentage of firms outsourcing at least one of the back-office functions of data management, reporting, and invoicing rose from 22% to 33% in the last three years—a 50% increase in the use of these solutions during that period. The most commonly outsourced functions are IT support and compliance. Increased reliance on outside experts for compliance has been a strong trend (35% of firms reported outsourcing compliance, up from 23%

REVENUE PER PROFESSIONAL

Median Firm, in Thousands



three years ago), not only reducing expenses but potentially lowering the risks of overlooking or misinterpreting evolving requirements.

Another key way firms are boosting productivity is by matching clients with the level of service they need. Forty-two percent of firms report that they are using client segmentation practices, up from 36% since we first fielded the question two years ago. Key strategies include adding services for top clients, reassigning smaller relationships to junior staff to ensure all clients receive the best service, and appropriately pricing relationships. In our work with clients, we have found that when senior firm members refocus their time on the tasks and clients that matter most, firms experience increased productivity as well as accelerated growth.

Revenue per professional, a key measure of productivity, has continued to increase since reaching a low in 2009. In 2011, firms reported a median \$374,000 in revenue per professional, up nearly 20% from the level reported for 2009, and even exceeding the level reported in 2008. Revenue per professional is driven by revenue per client and the number of clients a professional can serve. While larger firms in the study tend to exhibit higher productivity, the Best-Managed Firms show that high productivity can be achieved at any stage of growth. The Best-Managed Firms had median productivity of \$606,000 versus \$419,000 for all other firms in the study.

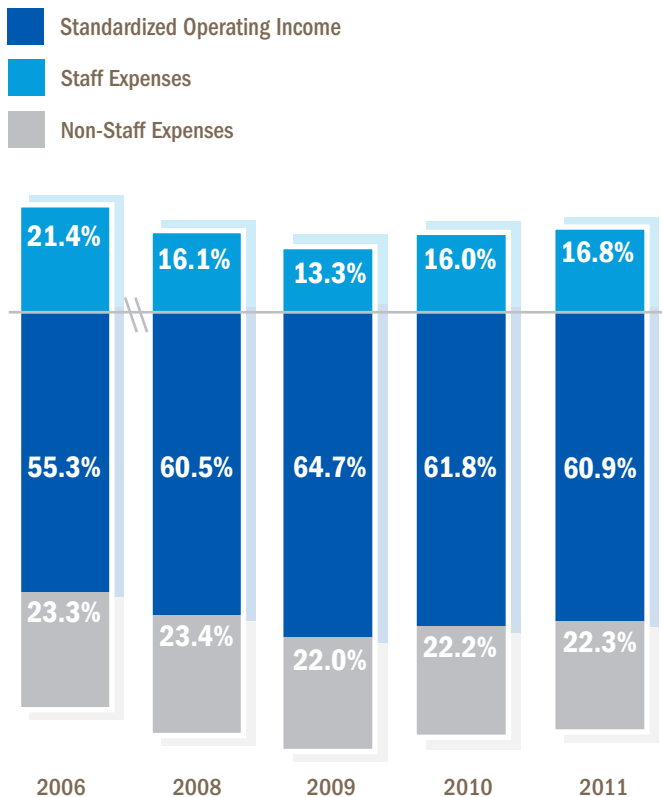
Productivity has a clear and direct link to profitability. Overall, managerial rigor has helped produce a 14% growth in profits and increased principal compensation in 2011 at the median firm.

Firms Are Building for the Future

Maintaining a well-planned and efficiently run business pays off not only today—but perhaps even more so in the future. Principals who invest in strengthening their businesses are adding long-term value to their firms. This may be one reason why succession planning is also becoming a higher priority for RIAs—in 2012, 1 in 20 firms reported making succession planning their top strategic initiative, compared with 1 in 33 a year ago. And 1 in 7 placed it in their top three. In working with advisors to develop a succession plan, we have found that a key step is to lay out the ways a firm leader can create value—putting increased structure around the great service they deliver every day—with the idea of building a more scalable and valuable enterprise.

Participation in Schwab's 2012 RIA Benchmarking Study itself is a strong indicator of the shift in advisor attitudes. The rise in participation suggests that increasing numbers of RIAs are interested in running their businesses in a more strategic, thoughtful, and disciplined manner. The customized Peer Benchmarking Report that firms in the study received helped them to execute on that vision in record numbers.

RIA FIRM PROFIT AND LOSS Average Percentage of Revenue



Findings from Schwab's 2012 RIA Benchmarking Study are echoed in other research. According to Schwab's 2012 High Net Worth Investor Study, investors have confidence in their advisors' ability to meet their investment goals in the current market—and more than one-third say their desire for investment advice has increased in the last few years.⁴

"It's clear RIAs continue to win in the financial services industry," Beatty said. "By skillfully maneuvering the complexities of an ever-changing marketplace, RIAs can continue to grow at a steady pace while pursuing superior client service and firm profitability."

Moving to the Next Level

There are many ways to streamline operations and grow your firm. For example:

- Benchmark Against Peers.** Participate in Schwab's 2013 RIA Benchmarking Study, to be fielded in February 2013. It's a complimentary benefit to Schwab clients that can help you gain focus on your top opportunities.
- Set Goals That Matter.** Whether you have a formal strategic business plan or a set of annual objectives, focus your firm's energy around well-articulated goals that can truly make a difference for the success of your firm.
- Measure Success.** If you haven't already, determine a set of key benchmarks to track and regularly review with firm leadership and staff.
- Leverage the Relationship.** As a Schwab client, you can access a range of practice management resources through your relationship manager. Ask about our Insight to Action Programs to move forward on key topics such as centers of influence marketing, strategic planning, succession planning, and client segmentation. Regional teams of technology and business operations consultants and business consultants are available to provide one-on-one guidance for more complex business and strategy issues.

About the 2012 RIA Benchmarking Study From Charles Schwab

Schwab designed this study to capture trends and best practices in the RIA industry, based on survey responses from individual firms. The 2012 study provides detailed insights on topics such as asset and revenue growth, sources of new clients, products and pricing, staffing, marketing, technology, and financial performance.

Since the inception of the study in 2006, more than 2,400 firms have participated, with many repeat participants. A total of 1,025 advisory firms that custody their assets with Schwab participated this year, making this the leading study in the RIA industry and an important source of information for RIAs about trends and developments in the marketplace.

Topics covered in this year's study include top strategic initiatives, strategic and succession planning, staff productivity, technology and operations, and the breakout of the cost of client service into direct service and meetings, financial planning, and investment management. With well over \$425 billion in AUM, this year's participant firms represent various sizes and business models.

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 insight, guidance, tools, and resources to help you strategically manage and grow your firm.

About Schwab Market Knowledge Tools® (MKT)

Based on the leadership position of Charles Schwab & Co., Inc. (Schwab) in the RIA marketplace (nearly 7,000 advisors and over 25 years as of this printing), we are in a position to observe what works in successful advisory firms. Through Schwab's proprietary benchmarking and in-depth qualitative research with successful firms, we are able to discover and share best practices.

This white paper is part of the Schwab MKT series, an ongoing program of industry research reports, white papers, and guides from Schwab designed to keep investment advisors on the forefront of trends and competitive challenges facing the industry today. The MKT program delivers the kind of relevant and timely information needed for future business planning. The following MKT reports, available in electronic or hard copies, provide strategic insights about leveraging the opportunities noted in Schwab's 2012 RIA Benchmarking Study.

- Best-Managed Firms: Mastering Strategic Planning
- Internal Succession Planning: Transitioning Employees to Ownership
- Transition Planning: A Guide to Understanding Valuation and Deal Structure
- Best-Managed Firms: Client Segmentation Strategies
- Integrating Technology into Your Practice

For More Information

To learn more about these and other resources, visit the Practice Management section of News & Resources at schwabadvisorcenter.com. To learn more about how Schwab works with advisors, visit schwabadvisorcenter.com/public. If you are a Schwab client and would like to participate in the next RIA Benchmarking Study, please call your relationship manager.

Endnotes

1. Independent Advisor Outlook Study, Charles Schwab & Co., April 2012.
2. Best-Managed Firms are the top 20% of qualifying firms ranked by profitability, revenue growth, and productivity in annual RIA Benchmarking Studies from Charles Schwab. The top 20% is calculated after removing those with less than \$1 million in revenue.
3. Schwab Market Knowledge Tools® (MKT) Best-Managed Firms: Mastering Strategic Planning—A Practical Guide to Charting Your Firm's Future.
4. High Net Worth Investor Study, Charles Schwab & Co., April 2012.

Sources for graphics: For all graphics, data comes from the 2012 RIA Benchmarking Study from Charles Schwab. The 2012 study was fielded in February and March 2012. The study contains self-reported data from 1,025 firms.

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