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MANY FIRMS ON TRACK TO DOUBLE IN SIZE

Insights From the 2013 RIA Benchmarking Study From Charles Schwab

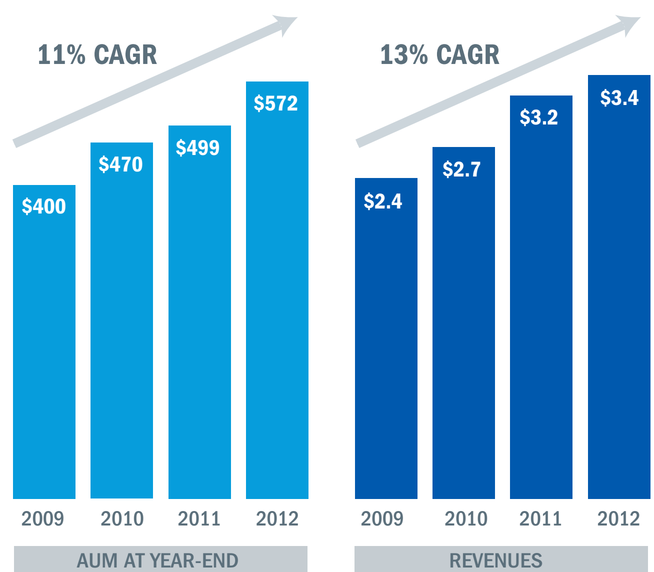
The 2013 RIA Benchmarking Study from Charles Schwab found that during the last three years, registered investment advisors (RIAs) saw a remarkable growth trajectory. The median firm realized an 11% compound annual growth rate (CAGR) in assets under management (AUM) and 13% CAGR in revenues. It is very likely that many more RIAs will join the ranks of firms managing more than $1 billion in AUM in the near future.

In fact, results from the study show that by the end of 2014, roughly one-third of advisors will double in size over the previous 5-year period.[1] Another 25% of RIAs are growing at a rate that puts them on track to double by the end of 2016. This paper examines firms' divergence in growth, the drivers, and the benefits firms can realize—particularly productivity and profitability—as they grow. Such extensive growth has far-reaching implications for RIA firms. Firms will need to think carefully about how to prepare for it, realizing there may also be more RIAs and many more large RIAs in the same community.

Schwab's annual RIA Benchmarking Study is the largest of its kind focusing exclusively on RIAs. This year, 1,025 firms representing nearly half a trillion dollars in AUM completed the survey, reflecting on their experiences in 2012 as well as their annual growth rates from 2010 to 2012. The results that follow, unless otherwise noted, include all firms with at least $250 million in AUM, representing the vast majority of total assets managed by this year's participants.

GROWTH IN AUM AND REVENUES

Median results for all firms $250MM+ AUM (in millions)



1. All firms in the study that manage $250 million or more in assets were examined as a group with regard to their self-reported AUM CAGR over the 3-year period from 2010 through 2012. Firms with a historical 3-year AUM CAGR of 15% or greater—representing both market performance and organic growth—are projected to double in size by the end of 2014 if they continue on the same growth trajectory they experienced from 2010 through 2012. Past performance is no guarantee of future results. From 2010 through 2012, the 3-year asset-allocated CAGR was 6.3% at the median.

The Power of Organic Growth

On the strength of their business model and value proposition, RIAs continue to set the pace in the industry. The median firm ended 2012 with $572 million in AUM and $3.4 million in revenue, increases of 13.3% and 7.1% over the previous year, respectively (as shown on page 1).

What's driving this growth? When all firms are looked at together, steady investment performance across peer groups was the most significant contributor to asset growth, adding 8.5% last year, while the 3-year historical CAGR was 6.3%.[2] Net organic growth—the change in assets from existing clients, new clients, and assets lost to client attrition—was the other driver, adding 4.5%. Net organic growth has been relatively constant over the last four years.

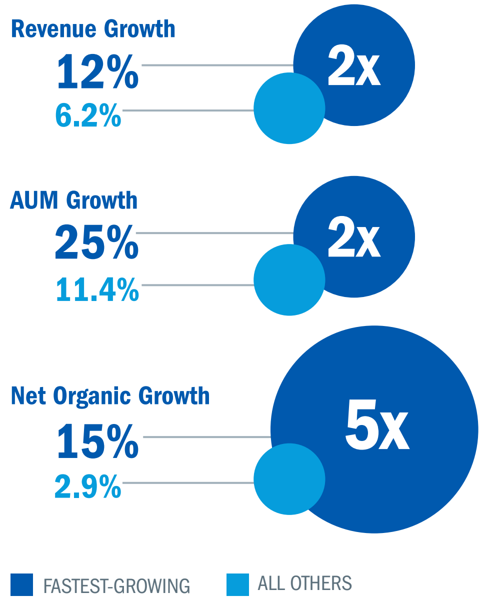
A closer look, however, reveals that RIAs are growing at very different rates. In particular, the fastest-growing firms[3] are enjoying significantly more net organic growth, the area over which they have the most control. Fastest-growing firms had a median net organic growth of 15%—a rate five times that of all other firms at the median, and nearly double the rate of 2012 investment performance. By contrast, firms in the bottom fifth saw substantially less organic growth.

For the fastest-growing firms, net organic growth is five times greater than for all other firms at the median.

The impact of this metric on growth is significant. Consider a hypothetical firm beginning with $400 million in AUM at year-end 2009. Applying the 3-year historical CAGR demonstrated by the fastest-growing firms would result in $691 million in AUM at year-end 2012—representing an additional $1.2 million in revenues, assuming an effective fee of 75 basis points on client assets. The same-size firm from outside that group, however, with a lower 3-year CAGR, would have increased to just $536 million, or 29% less. These implied year-end 2012 AUM values are from net organic growth and investment performance combined. By seeking to

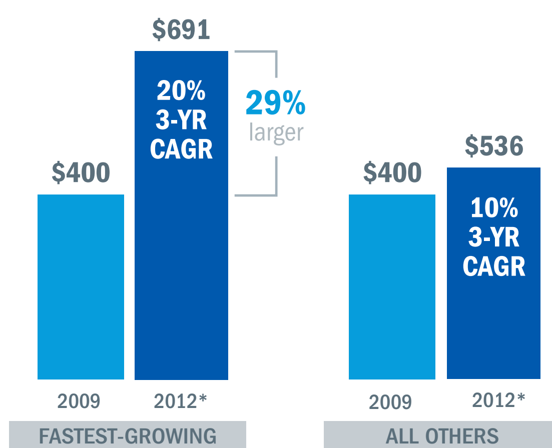
2012 GROWTH RATES

Median results for all firms $250MM+ AUM



THE POWER OF GROWTH

AUM in millions for all firms $250MM+ AUM



Hypothetical situation. For illustrative purposes only.

Median 3-year CAGRs (2010–2012) are calculated for all firms $250 million or more in AUM for fastest-growing firms and all other firms.

* Implied year-end 2012 AUM from net organic growth and investment performance.

2. Past performance is no guarantee of future results.
3. The fastest-growing firms are the top 20% of firms as determined by 2012 net organic growth. This cohort includes 90 firms out of the 451 in the study that have $250 million or more in AUM. Firms with $250 million or more in AUM represent 90% of the total assets of all firms in the study. Net organic growth—the change in assets from existing clients, new clients, and assets lost to client attrition—is the area over which RIAs have most control. Thus, it is the growth metric used for the analysis.

drive organic growth, the fastest-growing firms are better able to determine their destiny. They are taking intentional, strategic actions to achieve their growth objectives.

Pursuing Growth Opportunities

Most RIAs are looking to maximize their financial success, and their outlook is positive: The doubling of AUM projected for one-third of firms by the end of 2014 is in line with historical results seen in this study since the beginning of 2010. Additionally, many advisors are optimistic, with half reporting improved business development results in 2012 over the previous year.

Some firms in the study are pursuing non-organic means to bolster firm growth, too, such as hiring a new principal with an existing book of business or acquiring another RIA. About one-quarter said they are actively seeking to acquire another RIA, a strategy seen disproportionately among firms with slower rates of organic growth. These firms are recognizing the advantages inherent in scaling up but prefer to look outside their own infrastructure to boost growth.

Some RIAs believe firm size is largely a function of the number of years in operation. The study confirmed, however, that larger RIAs haven't necessarily been in business longer than others. In fact, the median age among firms with $250 million to $500 million in AUM was only five years less than for firms managing $1 billion or more—a fraction of a firm's lifespan. Rather, RIA size is a function of superior CAGRs.

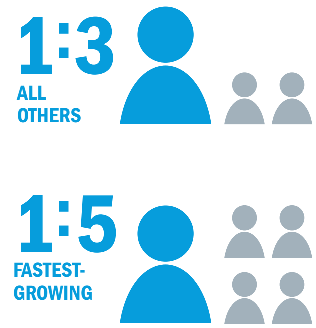
Growth Brings Benefits of Scale

Firm owners think about growth differently, but all of them recognize the benefits that disciplined growth can bring: improved leverage of their business operations and financial results.

PRODUCTIVITY

As firms increase in size, productivity metrics of all kinds improve. For example, at firms with $1 billion or more in AUM, revenue per client and AUM per professional were 51% and 71% higher, respectively, than for firms managing $250 million to $500 million AUM.

FIRMS SEEKING TO ACQUIRE ANOTHER RIA



PRODUCTIVITY METRICS

Median results by peer group (AUM)

Existing Client Productivity	$100MM–$250MM	$250MM–$500MM	$500MM–$1B	$1B+
Revenue per client	$7,449	$9,221	$10,356	$13,923
Revenue per professional (in thousands)	$363	$440	$527	$617
AUM per professional (in millions)	$49	$66	$86	$113
Clients per professional	50	48	48	43

Business Development Productivity	$100MM–$250MM	$250MM–$500MM	$500MM–$1B	$1B+
New AUM per professional (in millions)	$2.6	$3.6	$5.0	$6.7

Client Service Productivity	$100MM–$250MM	$250MM–$500MM	$500MM–$1B	$1B+
Cost of staff time for client service per $1MM AUM	$2,316	$2,030	$1,802	$1,441

NUMBER OF STAFF

Average results by peer group (AUM)

	$100MM–$250MM	$250MM–$500MM	$500MM–$1B	$1B+
Principals (Owners)	1.8	2.2	2.8	5.7
Non-owner professionals	1.6	2.9	5.1	10.0
Relationship managers	0.7	1.3	2.6	5.8
Back-office staff	2.1	3.3	6.5	14.7
Total Staff	**5.5**	**8.4**	**14.4**	**30.4**

LEVERAGING CORE COMPETENCIES

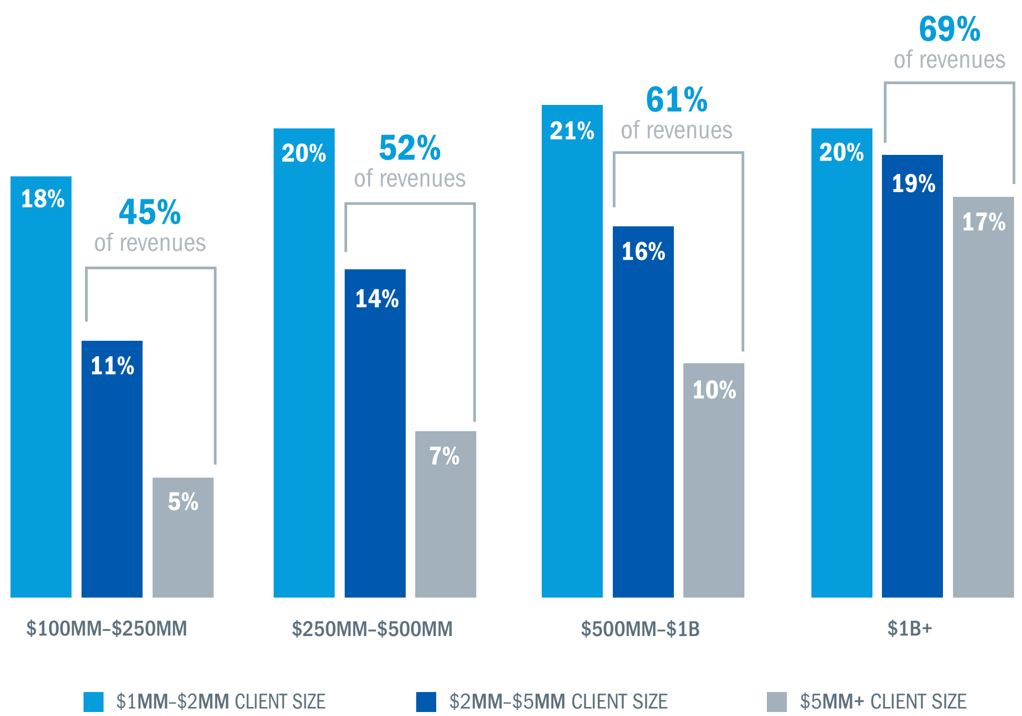
Larger firms are often able to use a team approach, allowing for multiple client touchpoints. Firms managing assets of $1 billion or more reported having an average of 30 staff members, while those managing $100 million to $250 million had 6. Also, non-principal staff, including relationship managers, comprised a greater portion of the staff at larger firms. This structure better leverages the time of firm principals, who are able to spend more time generating new business and then spend more time working *on* the business.

ATTRACTING LARGER CLIENTS

Larger firms tend to attract larger clients, and more of them. And the bulk of the revenues at these firms can typically be attributed to this segment: Clients with assets over $5 million accounted for half of revenues at RIAs with $1 billion or more in AUM, but only one-fifth of revenues

PERCENTAGE OF CLIENTS BY ASSETS PER RELATIONSHIP

Median results by peer group (AUM)



at firms with $100 million to $250 million in AUM. These clients are often excellent conduits to their peers, too, and play an effective role connecting individuals with similar asset levels to their advisory team.

Conversely, larger firms have fewer small relationships. At firms managing $100 million to $250 million in assets, clients with less than $500,000 in assets accounted for close to half of the clientele but just 17% of the revenue, whereas at firms managing $1 billion or more, only about one-quarter of clients were at that level, generating 7.4% of the firm's revenues. As firms grow, they are more likely to focus their efforts on larger relationships.

PRICING

Pricing is also a point of strength for larger firms. Compared with smaller firms, they generally have higher fees for larger clients. Also, as firms grow, they are more disciplined about applying minimum fees.

FINANCIAL RESULTS

Larger firms typically demonstrate superior financial results. With a higher revenue base and disciplined spending, results show that larger firms have better margins and higher principal compensation. For firms with $1 billion or more in assets, the standardized operating income margin[4] was 25% greater than that of firms managing $250 million to $500 million in assets.

Developing a Culture of Referrals

An impressive difference in growth often results when a firm focuses on excelling at relationship marketing, a necessity for professional services firms that wish to outperform the industry averages. Almost all RIAs deliver an exceptional client experience. What seems to drive the difference in growth is that some firms are able to amplify the message about the client experience they create into the communities they serve. When the firm can get more people—whether clients or other business professionals—to talk about what their firm does well and the value it can deliver to the right individuals, referrals and new business often follow.

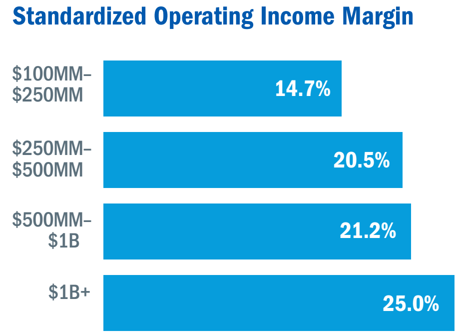
PRICING

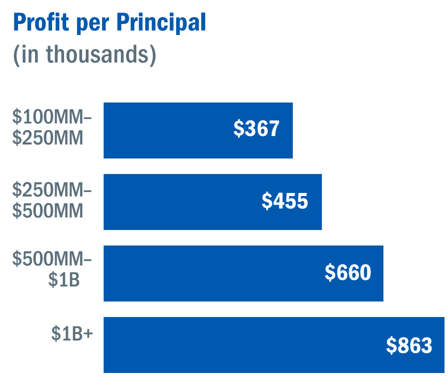
Median results by peer group (AUM); basis points charged on assets

	$100MM–$250MM	$250MM–$500MM	$500MM–$1B	$1B+
$2MM client	88	87	95	91
$5MM client	74	70	75	79
$10MM client	60	53	60	65
% of firms applying minimum fee	55%	58%	65%	71%

FINANCIAL RESULTS

Median results by peer group (AUM)





4. Standardized operating income margin is calculated using standardized principal compensation, which is set at approximately the peer group median.

With nearly 80% of new client acquisitions coming from referrals, advisors understand their critical importance. But the firms that outpace their peers in terms of growth are particularly successful at generating referrals from one of the most important groups within their community: other trusted business partners, also known as COIs (centers of influence)—a particularly powerful engine for growth.

Generating more—and more substantial—referrals of all kinds requires a disciplined approach that is evident in the culture of fastest-growing firms. Found across all peer groups, these top performers acquired referrals from COIs at a higher rate than all other firms do from COIs and existing clients combined. They also saw 12.7% net organic growth from new clients at the median in 2012, compared with 4.4% among all other firms. That's fueling three times more overall organic growth for the fastest-growing firms—a dramatic difference that over time can explain why one RIA is growing moderately while another is achieving superior growth in the same period.

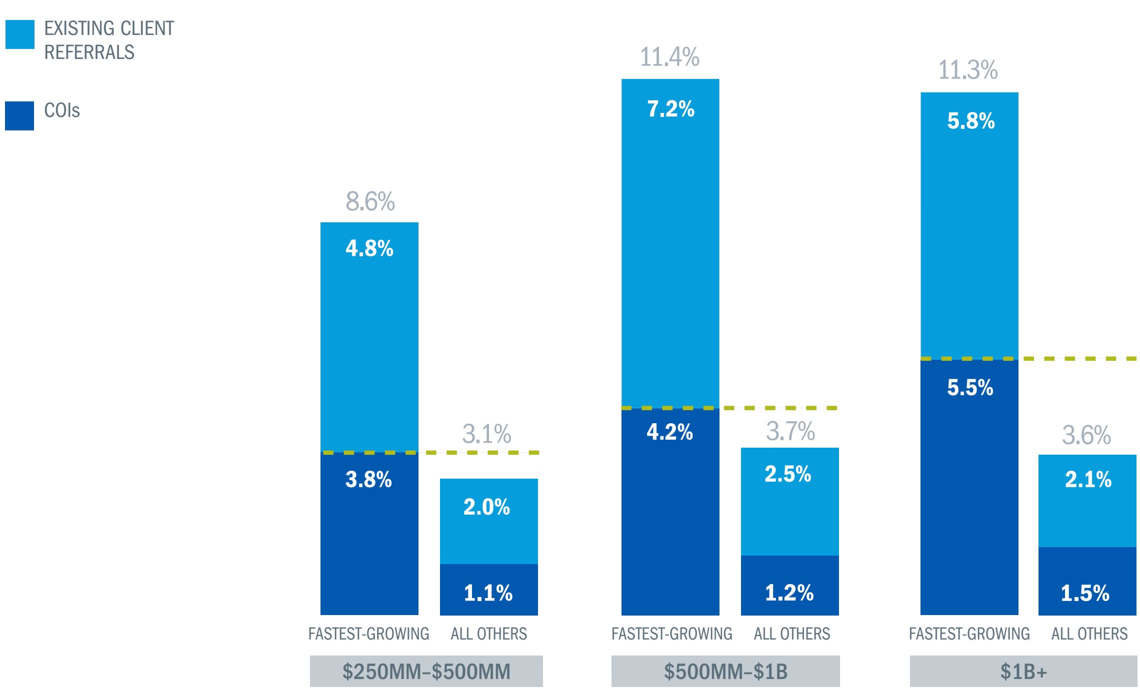
The success of a referral program is not dependent on the age or size of the RIA. Fastest-growing firms have simply developed a strategic and disciplined approach in which referrals are maximized, to drive overall growth and to capitalize on benefits of scale—and had 36% more new clients to show for it last year. The fastest-growing firms often create a culture of referrals that brings in more and larger clients. And with client attrition at 3.1% in 2012, RIA firms did very well at keeping the clients they bring in.

Technology as a Business Imperative

To remain competitive in today's market, RIAs are embracing technology as a central, strategic part of doing business—already the case for 8 in 10 firms. Technology providers have responded to the growth in the RIA channel by developing a range of new solutions that support business objectives and streamline operations, to the benefit of firms in all peer groups.

2012 NET ASSET FLOWS FROM NEW CLIENTS SOURCED BY REFERRALS ONLY

Fastest-growing firms vs. all others (AUM)



Nearly all study participants reported making investments to integrate their technology systems, and the effort seems to be paying off: The number of firms ranking integration as a top challenge decreased by 38% from the previous year. In addition, two-thirds of firms have already moved or plan to move major systems to the cloud, an important tool for improving business efficiency and access to data. At most firms, defined processes and workflows are already helping further business goals, growth, and business development initiatives, and still more respondents expect to add such workflows within the next couple of years.

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Engaging the Next Generation

Preparing for the next generation of clients is a key part of any growth strategy. More than half of firms in the study said they now commonly offer family education—a service that can help establish a relationship with the family members of existing clients. An additional 40% said they plan to add family education—a higher rate of potential adoption than any other service. Statistics suggest that more than 90% of inheritors change advisors when wealth is transferred.[5] By helping prepare families for wealth transfers, RIAs are not only serving their clients but also improving the likelihood of retaining these assets.

Younger generations use social media in their daily lives and expect the instant access and convenience digital technologies provide, making them a key selling point for prospective next-generation clients. Not surprisingly, almost half of firms in the study have adopted or plan to adopt mobile device solutions that offer access to client accounts. And about 8 in 10 said they will upgrade the websites on which their clients access accounts.

Advisors are also exploring new marketing channels. While traditional approaches to business development remain dominant, many firms are looking strategically to new technologies, the web, and mobile for help in cultivating prospects, while also expanding their reach with current clients. Most of the 60% to 70% of firms currently using such channels—including Facebook, Twitter, and LinkedIn, as well as sites specializing in the financial services community—said these avenues are not yet producing significant new business. But social media remains a crucial tool in both future business generation and client service.

Looking Ahead

Growth plans cannot be built purely on high expectations from the markets, and numerous challenges to growth could cloud the horizon, such as market fluctuations, regulatory changes, and increased competition. Nevertheless, RIA firms are optimistic about the future. Focusing on growth initiatives is critical for advisors to attain benefits of scale and maximize financial success.

The RIA model is a bright spot, with the number of RIAs increasing steadily and projected to continue growing in 2013 and 2014.[6] "Clients are demanding the objectivity and high-touch approach to client service for which RIA firms are known," says Jon Beatty, senior vice president of Schwab Advisor Services™. "That gives RIA firms an edge in the marketplace."

5. Institute for Preparing Heirs, November 2012.
6. Cerulli Quantitative Update, Advisor Metrics, 2012.

About the 2013 RIA Benchmarking Study from Charles Schwab

Schwab designed this study to capture insights in the RIA industry, based on survey responses from individual firms. The 2013 study provides information 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 2,500 firms have participated, with many repeat participants. A total of 1,025 advisory firms representing nearly half a trillion dollars in AUM that custody their assets with Schwab participated this year, making this the leading study in the RIA industry.

The RIA Benchmarking Study comprises self-reported data from advisory firms that custody their assets with Schwab. Participant firms represent various sizes and business models. They are categorized into 12 peer groups—6 wealth manager groups and 6 money manager groups, by AUM size.

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.

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