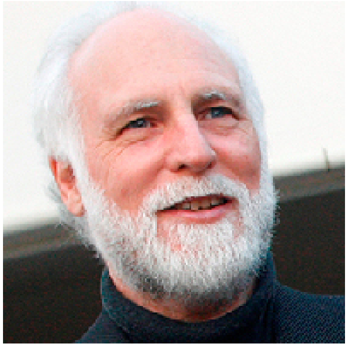
The Post-COVID Challenges Facing the Planning Profession

by Bob Veres, 3/7/22



New data on consumer preferences and behaviors during COVID shows that the advisory firms face daunting challenges with respect to staffing, differentiation and – if they are private-equity backed – financing and maintaining profitability.

There are a lot of opinions about the health of the advisor profession and consumer/advisor relationships floating around, but not everybody is backing their words with actual data. Philip Palaveev, founder and CEO of The Ensemble Practice consulting firm, is a notable exception. He has been the author of the profession's leading benchmarking studies for the last couple of decades (the *Investment News* profitability and compensation benchmarking reports). In his day job as leader of a consulting group, he helps advisory firm founders think through their decisions about how to share equity from founders to staff leaders, how to create compensation structures and partnership agreements, and how to formulate strategic planning initiatives.

With his G2 program, Palaveev gains additional insight, working to develop leadership skills with 100 younger advisor and staff leaders from around the country every year.

Recently, Palaveev authored two additional research reports, one which measured the financial growth of advisory firms during the 2021 COVID-impacted calendar year, and a very different survey that offered some insight into the complicated relationship between upscale consumers and the advisory profession. Both offer real quantitative data around issues on which there has been a great deal of speculation.

Opportunity and disappointment

Let's start with the consumer survey, where 500 randomly selected individuals, all with annual personal pretax income of $100,000 or more, answered questions online. (Readers can download the report here) These are desirable clients for most financial services professionals. Yet one of the most interesting findings was that almost half (43.7%) have no current advisory relationship and have never had one. In all, only 32.4% of this sample of attractive prospects have any kind of relationship with an advisor.

"That tells me that there is still a lot of opportunity in the marketplace," says Palaveev. "A lot of consumers still have not experienced financial planning and financial advice. This data is consistent with the data from our *Investment News* survey," he adds. "When we asked the question: *Where do you get your clients?* Advisory firms told us that at least half of their clients had been self-directed investors before coming to them."

Responding to the same question, 23.9% reported that they had worked with an advisor in the past, but were not working with one now. "Sadly," Palaveev commented in the report, "we have already disappointed many consumers, and it seems that it will not be easy to convince them to come back." Of the disenchanted former clients, 25.7% reported a net worth between $1 million and $5 million, and another 24.2% reported a net worth between $500,000 and $1 million. Disappointment skewed a bit toward wealthier worth between $[illegible] and $1 million. Disappointment skewed a bit toward wealthier individuals.

Independent, fiduciary advisors reading this will smugly conclude that most of this shocking client attrition is coming from customers who were somehow mishandled by the aggressive sales tactics of a wirehouse broker. But the data doesn’t bear that out; the percentage of respondents who left what the survey called “large national brands” was, in fact, slightly lower than the percentage who left what the survey describes as “smaller, privately-owned firms.” The numbers are roughly comparable, but Palaveev notes that, if you look at the attrition for different types of advisors each year, none of the firms, historically, have reported losing more than 1-2% of their clients or customers. “My sense from looking at the data,” he says, “is that none of the channels are losing significant numbers of clients on a year-by-year basis.”

But… 23.9% of the total…? Palaveev’s explanation is that small, incremental attrition over time periods measured in decades tends to add up. “If a firm were to lose 2% of its client base, then after 20 years, there will be a significant number of former clients out there,” he says. The interesting question, to him, is: why aren’t they coming back? “We’re going to be doing more research into this in the fall,” he says.

Finding and choosing advisors

Turning to the respondents who *do* happen to be working with an advisor, the survey asked them to name the primary reason why they selected their firm over others. The leading response, with 18.3%, was that their current advisor had been recommended by a friend or family member. Another 9.4% selected an advisor who was recommended by their CPA or attorney, and 6.3% are working with a professional who was endorsed by their employer. Palaveev sees these aggregate responses as confirmation that referral marketing still ranks somewhere between important and crucial to organic growth.

But advisory firms shouldn’t ignore the other potential attractants. The data, albeit obliquely, suggests that a significant number of clients chose their advisor as the result of a web search. Among respondents, 11.5% said they chose their current advisor because the firm “has an excellent brand reputation” and 9.4% chose their advisor because “they specialize in working with clients like me.” Another 11% said “they offer a service I seek (e.g., financial planning).” The only way they would have found those things out was on the advisory firm’s web page.

Another chart shows that a total of 55.5% of the respondents comparison shopped; that is, their search included at least one other advisory firm. As wealth increased, clients were increasingly likely to include multiple firms in their searches. They may have received a referral, but they also checked other options--probably online.

Interestingly, there doesn’t appear to be a lot of cost shopping in these searches. Only 4.7% of the respondents said that they selected their current advisor because “their cost was low or lower than other advisors.”

The survey asked what prompted the respondents to choose an advisor in the first place and why those who left their advisor broke off the relationship. Palaveev is cautious about interpreting the singular responses he received. The respondents who are working with an advisor offered a lot of “other” responses about the trigger that led them to set up the initial appointment, but also said, “I became worried about my ability to meet my goals” (15.7%); “I faced an important tax decision and needed help” (8.9%); “I received or exercised stock options/deferred comp.” (6.8%); and even “I read a book/article that made me interested in advice" (just 2.6%).

Among those who cited a reason for leaving their advisor relationship: "The cost was too high" (16.3%); "They failed to communicate regularly and clearly" (12.1%); "They did not listen to my point of view" (9.9%); "My values did not match theirs and/or their firm's values (6.4%).

Why be cautious? "In human relationships, at some point in time, we may come to the conclusion that this relationship is broken beyond repair and that we should end it," says Palaveev. "But then somebody asks for the singular reason why you broke up, and they may say something, but it won't be a complete picture. They may say it was because of annoying habits, or they don't listen very well, but that's not giving us the full picture."

He says that a broken relationship with an advisor or advisory firm is probably no different. "At some point, the consumer came to the conclusion that this relationship did not serve their needs anymore, and the advice was not worth paying for," says Palaveev. "They may say they left because the cost was too high, but underlying that is a dissatisfaction with the services. Cost is the rationalization, but behind that, we usually see a much more complex pattern of dissatisfaction, maybe a lack of service, or communication or rapport."

Similarly, advisors should be cautious about building marketing campaigns around the triggers cited in this (or any) survey. "It is probably time for the advisory industry to dispense with the notion that all investors are the same," says Palaveev. Instead, he recommends that advisors focus on segments of the population and identify the triggers that they have in common – the advisor in a tech-firm-heavy market focusing on how to maximize the wealth potential of restricted stock units or targeting the parents of high school kids with college planning seminars.

"To me," Palaveev continues, "this data is telling me that advisors are going to have to narrow their definition of a target client, and know those people. If you focus on business owners," he adds, "suddenly the answers become a little clearer; they will search for an advisor because they are worried about their tax decisions, and they are more likely to listen to a recommendation from their CPA than from a friend or family member."

Referral dysfunctions

By far the most contradictory data in the survey came from the questions about referrals. Specifically, the survey asked those in an advisory relationship whether they had referred anybody to their advisor. An encouraging 52.9% said they had. But later, when they were asked what prompted them to make that referral, 30.4% of that 52.9% responded with "I have not referred anyone in the past."

What gives? Palaveev says that this answer is consistent with the data that Julie Littlechild of Advisor Impact has been gathering, and conforms perfectly to what he hears from the firms he works with. "You hear clients say, *oh, yes, I have been referring my advisor, and I would be happy to refer*," he says. "And advisors are saying: *okay, but where are the referrals?*"

A more realistic number, Palaveev says, is that 7% to 10% of clients make referrals that the advisory firm can trace. The other recommendations that clients think of as referrals are shockingly ineffective.

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“Let’s say you and I are friends,” Palaveev proposes, “and you say, *hey, Philip, do you know a good advisor?* I say, *oh, yeah, you should work with my advisor named Joe. Look him up. You’ll find him online.* I never send an email to Joe, I never send you the contact information, and chances are you forget the name ten minutes after we talked.”

That dysfunctional referral dynamic, Palaveev says, is not the client's fault; it’s the advisor’s.

How so? Most clients are never told how to provide an effective referral, and many advisors still think their best approach is to simply ask clients to refer them. In the survey, only 12% of the clients who said they made referrals (if, in fact they did) said they did so because their advisor had asked them to.

Palaveev recommends that advisors help their clients understand how to follow a functional referral process. “In the course of a conversation,” he says, “you could say to a client, *hey, if you’re looking to connect somebody with us, please give them my name and contact information, and then send me a quick email so I will know to follow up with them and make sure that they get taken care of*.”

In addition, he recommends that advisors help clients better communicate their services. “I occasionally talk to my personal friends, and out of curiosity, I will ask them, *what does your advisor do for you?*” says Palaveev. “Their answers tend to be very singular, something like: *oh, my advisor talks to me about when I can finally retire and quit this job.* Which probably means that they will recognize opportunities to refer someone only if that other person has the exact same goal. But the data clearly indicates that consumers all have different needs, triggers and criteria that they look for.” He recommends that advisors find time during client interactions to tell their story, why they’re passionate about what they do and the kind of people they want to help. The story will be more easily remembered (and repeated) than a list of services the firm might be providing.

Pulse of the profession

Meanwhile, one might wonder why Palaveev would bother with the Pulse survey of advisory firms when he’s the author of a much more comprehensive report that comes out each fall. “The idea was to get a set of data very quickly,” he says. “The problem with the bigger surveys is that they take a lot of time to collect the data and publish the reports, so they reflect on what happened a year or more in the past. This current environment is so dynamic that I didn’t want to wait until September to find out how 2021 was.”

The Pulse survey was limited to people The Ensemble Practice has (or has had) relationships with – in this case, 84 firms that are skewed large; the average participating firm was managing $1.45 billion in client assets at the start of 2022, and only 14% of the sample had less than $500 million in AUM.

The good news is that the median growth of all the participating firms (measured by AUM) was 21.7%, some of the fastest one-year growth that Palaveev has measured in his long career.

But the S&P 500 was up 26.9% last year. Does that mean that advisory firms were experiencing negative growth after you parse out the market effect? “Keep in mind that the typical advisory firm has portfolios, in aggregate, closer to 60/40 than 100% in the S&P or Nasdaq,” says Palaveev. “The diversified portfolios held by most clients were returning something closer to 15-17%.”

The report showed net growth in the number of clients (new clients minus attrition) of 8.6%, which Palaveev says represents a very strong year. But when he looked more closely at the data, he found an interesting pattern.

"2021 was a tale of two halves," he says. "The first six months of the year, it appeared that this was going to be a record year for business development: we saw an overall 7% increase in the number of clients. And then the second half of the year seems to have flattened out a bit. A 1,000-client firm had about 70 new clients by July, but then ended the year with 85."

Moreover, the aggregate number of client losses last year was higher than normal: a reduction of 2.5% of the participants' overall client base – double historical numbers for this cohort.

To help interpret the attrition figure, Palaveev turns to a later data point in the survey, where he found that only 47% of the surveyed firms increased their staff numbers, 50% experienced resignations and only 47% hired staff to replace the departures. Overall, the report suggests that staffing was relatively static last year, even though advisory firms were serving more clients.

"That might suggest that these firms were more efficient," says Palaveev, but the efficiency might not be coming from better processes or new software. "Some of that capacity was created by the fact that client interactions went online," he says. "The online meeting is inherently more efficient than the in-person client meeting. They jump more quickly to the point, without a lot of chit chat, without that *'Do you want some coffee? Can I use the restroom?'* kind of things. The unscripted social interactions are more limited."

In the new Zoom meeting environment, advisors who once struggled to handle three in-person client meetings a day are now able to handle twice that number of on-screen conversations. But, Palaveev adds, the depth of the client interactions might not be the same. "We expect to see more attrition, particularly with clients who are in the first year or two of the relationship," he says, "because it is much harder to create deep and strong relationships when we are not meeting person to person."

In that vein, one can look back into the consumer research and note that most of the clients who say they broke up with their advisor did so within the first two years of their relationship, and pair that with the Pulse survey's findings that there was a pickup in clients in the first part of the year, but more than normal attrition for the year as a whole.

Staffing issues

Reading deeply between the lines, Palaveev worries that many advisory firms are understaffed to provide the level of service that would keep clients satisfied – and the higher level that would drive referrals – and they don't realize it. "We are in a period of relatively low maintenance in client relationships overall," he says. "The markets have been good, there is no crisis, things have been relatively stable from a portfolio standpoint, and the pandemic made the client meetings less labor-intensive."

His recommendation? If I'm an advisory firm, I'd be looking at this and saying, *are we being complacent in our growth?* And also: *We have to hire more aggressively. We have grown revenues a lot because of the markets and new clients, and we haven't added people at all."*

Palaveev notes how the airline industry cut back its aggregate headcount when demand was low, and then, when people started booking flights again, they found themselves was low, and then, when people started booking flights again, they found themselves unable to handle the influx of passengers.

“Advisory firms have to staff not for today’s low demand; they should be staffing for normal or perhaps even high demand,” he says. “At the moment, they’re staffed for low-maintenance clients and shorter, less-deep client meetings. Sooner or later, they’re going to have to reach out to those clients and provide additional touches, have more contacts and more complex conversations, and if they aren’t staffed for it, we could see more client attrition at some point in the future.”

The staff attrition number – where 50% of firms experienced resignations – fits well with the "great resignation” narrative that is going on throughout the American economy, and anecdotal reports suggest that it has become darned difficult to hire good, experienced advisors and support staff lately. Will advisory firms be able to take Palaveev’s advice to start staffing up for more normal demand?

“It’s very easy to hire people,” says Palaveev. “The answer is very simple. My real estate broker told me, when I was buying a house, that the very simple solution is called ‘price.’ It is easy,” he says, “to hire people when you offer competitive compensation. It is difficult to hire people when you don’t.”

Does that mean that advisory firms have been stingy in their salary offers? Looking back at his most recent compensation and staffing reports, Palaveev says the answer seems to be yes. “It always surprises me that, despite the industry being very prosperous, compensation across most positions in advisory firms is about the same as it was five years ago. I think it’s time,” he says, “to increase compensation across the board for all positions. If you’re trying to recruit somebody with a $35,000-$40,000 salary, you’re going to face a lot of challenges.”

In his own consulting experience, Palaveev has found that the firms that are hiring aggressively are paying higher salaries than the averages you are seeing in the survey reports. Advisory firms that are embracing the remote workplace are able to compete for experienced advisors with firms all over the country – and the great resignation, as it impacts the planning profession, has a lot of advisors thinking hard about their current employment situation.

The back office hiring challenge is even more serious. “If you’re hiring operations or support people,” says Palaveev, “you find yourself competing with a lot of different firms and industries that need that kind of worker. Some of those employers have been very aggressive and have been paying very well.”

Consumer and professional ambiguity

When Palaveev looks back at the data from his two surveys and combines them with his experience in the profession, he sees some interesting dynamics that most of us haven’t heard or read about. One is the ambiguity built into any data set that comes from consumers who report that they’re working with ”an advisor.” It is especially complicated when someone asks them what *kind* of advisor, or what channel the advisor works in.

“I don’t think most consumers understand terms like ‘wirehouse’ and ‘independent,’” Palaveev says. “If you were to ask them, *are you working with a wirehouse?* – I think most consumers would ask *What? What’s a wirehouse?*” That, of course, makes it hard to determine, with any precision, where the client attrition is coming from – or even whether those who self-report working with, or having worked with an advisor, have experienced the service levels we associate with the various professional sectors.

"I suspect that somebody at Google who is getting answers on their 401(k) from someone on the HR team thinks they're working with an advisor," Palaveev says. "Somebody may have talked about their investments with somebody at a Fidelity branch and thought that was an advisory relationship. They may have thought that the Edward Jones guy who sold them an annuity was providing an advisory relationship. Or that the insurance broker was an advisor."

In other words, it's possible that many disappointed advisory consumers never actually experienced financial planning – and in this environment, consumers don't have an easy way to know that.

But the confusion extends beyond consumers. "Traditionally you and I have defined the community that we work with as firms that are independent," says Palaveev. "But I'm not 100% sure what *independent* means any more. Is the firm *independent* if it's 50% owned by a bank or private equity? Is a firm *independent* if it's national and the office the consumer is working with was bought into a larger entity that provides standardized services across many offices? Is a firm *independent* if it's growing as large as a wirehouse, even if it's owned by the people who operate it?

"I'm not saying they are *not* independent," Palaveev says. "But the definition of who are independent advisory firms is a little fuzzier these days than it was, say, 10 years ago."

There's a certain subset of the profession that seems to be growing less independent: planning firms that are accepting substantial private equity investments. Palaveev wonders whether their advice will suddenly become less (that word again) *independent* if the market conditions change.

"I think the catalyst for that is what happens when interest rates go up," he says. "Private equity is fueled by borrowing an enormous amount of capital, just the way the housing boom was fueled by cheap mortgages. If interest rates go up, and the private equity firms' cost of capital goes up dramatically, their ability to service these loans may decline. The relationship between them and the firms they have acquired may get strained, because now they really need to see the cash come out."

Higher interest rates could trigger a market downturn, creating a perfect storm. The private equity firms will be demanding more return on their investments, meaning a bigger drain on the cash flow of those advisory firms, at a time when the profession is having to provide more service to anxious clients, and taking in fewer AUM revenues. This goes back to Palaveev's earlier concern that firms, in aggregate, may discover that they have staffed for a balmy environment that isn't likely to last forever.

If you put everything from the two studies together, they paint an interesting picture of the state of the profession. There is still a lot of room to grow, in a marketplace where almost half of consumers still haven't experienced an advisory relationship. And many others who say they have may have only tasted a perfunctory one.

Almost a quarter of the prospect universe has left an unsatisfactory advisory relationship, and the data is muddled as to why or exactly who they left. At the same time, advisory firms experienced near-record growth during the COVID-impacted year just past but are experiencing staff and client attrition at levels the profession hasn't seen before. Advisory firms have been adding clients without, in aggregate, adding staff, and seem to be relying on the added efficiency of face-to-screen client meetings and a balmy investment climate on the added efficiency of face-to-screen client meetings and a balmy investment climate to make it work.

A substantial number of existing clients found their advisor through a referral, but the existing referral dynamic is extremely dysfunctional and in need of a fix – which can only happen on an advisor-by-advisor basis.

Overall, this data – and pretty much all data about advisor/client relationships – is muddled by investor confusion about who is an advisor and the fine distinctions between them. But there is also growing fuzziness about how the profession itself defines some of those distinctions in this age of national brand advisory firms, hot M&A activity and an influx of private equity investments.

The profession faces ominous signs. The data doesn't explicitly say that; you have to look closely at the underlying details. Having data is great, and there's some value in the opinions of thought leaders. Put the two together, as Palaveev has done, and you get some real insight into where we are, where we might be going, and what to prepare for.

Bob Veres' ***Inside Information*** *service is the best practice management, marketing, client service resource for financial services professionals. Check out his blog at: www.bobveres.com.*