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TD Ameritrade Institutional Benchmarking

Executive Summary

The 2020 FA Insight Study of Advisory Firms:

Growth by Design

TD Ameritrade Institutional

About the Survey

The objective of this long-running research series is to provide critical context for running a firm, offering owners and managers insight into how their firms are performing and where attention is needed for future improvement. This year's theme, *Growth by Design*, is like past *Growth by Design* study years, focusing on the best practices related to strategic planning, client service, operational efficiency, technology, pricing, marketing and business development.

Data for this year's *Growth by Design* research was collected from February to April 2020 through an online survey with 345 independent advisory firms. All survey respondents have been in business for at least one year, generate a minimum of $100,000 in annual gross revenue and serve individuals or households as primary clients. To draw conclusions about trends and provide context, we further supplement the 2020 data with occasional references to data from previous FA Insight annual studies.

Executive Summary

The business climate took a dramatic turn in the spring of 2020 with the intensification of COVID-19. The sudden shutdown of the U.S. economy and volatile security markets challenged advisory firms in a way not seen since the Great Recession a decade ago. The good news, however, is that firms were on reasonably solid footing going into the pandemic. While the ultimate severity of COVID-19's economic impact is still unknown, firms are poised to weather the storm. Many may emerge even stronger due to the various opportunities that inevitably surface during turbulent times.

Mixed Performance Prior to the Pandemic

While the business fundamentals remain strong, some signs of concern started to show in 2019, including slowing revenue growth, rising expenses and declining profitability. Offsetting these results, however, were several positive developments that should give firm owners reasons for optimism in confronting an increasingly uncertain future. During 2019, the industry reached record levels of productivity and asset growth, in addition to attracting a steady rate of new clients.

9.5%
Median revenue growth in 2019

Down 4 percentage points in comparison to 2018

23%
Median AUM growth in 2019

Increase of 3 percentage points above the previous all-time high in 2009

Wide swings in security markets both hurt and helped firms in 2019. Markets look to continue testing advisors' patience in 2020 as well. A sharp late-2018 falloff depressed firm assets, leading to declining revenue growth in 2019. At 9.5% in 2019, median revenue growth was off nearly four percentage points compared to the year prior. Revenue collection lagged a dramatic recovery in security markets during 2019. The market rebound helped fuel a record 23% AUM growth, three percentage points above the previous all-time high a decade ago.

Appreciation accounted for less than half (45%) of firms' average gross increase in assets, however, with business development efforts making up much of the remainder. The typical firm expanded its client base by 6.6% in 2019, a respectable rate but not quite the record pace achieved in preceding years. Also positive for 2019, productivity in terms of revenue per revenue role was the second highest on record, and revenue per all team members reached a record high.

Market appreciation accounted for less than half (45%) of firms' average gross increase in assets, with business development efforts making up much of the remainder.

Despite the encouraging developments, most firms could not keep costs from outpacing revenues—and chances are strong that this will continue to be a challenge through 2020. Median overhead expenses as a share of revenue, at 41.3% in 2019, hit a high not seen since 2008. Lack of cost control may be only partly to blame—a sudden decline in revenue, which likely occurred in early 2019, will invariably challenge even the most disciplined firm managers to rapidly adjust expenditures. As a result, the operating profit margin for a typical firm dropped to 17.6%, off three percentage points from the year prior.

Expense Management Needs to Rapidly Adjust to Current Conditions

41.3%
Median overhead expenses as a share of revenue

Highest level since 2008

17.6%
Median operating profit margin

Three percentage point decline from 2018

Looking Back to Find the Way Forward

In so many ways, firms' experiences in 2019 seem like a very long time ago. What, if anything, has occurred in the industry's recent past that might still have relevance today? As unlikely as it may seem, some of the best guidance for prepping firms on what might lie ahead may be found by looking much further back than last year. The first FA Insight study launched 11 years ago in the middle of the Great Recession. Data collected during that period offer clues for how current trends might play out in the immediate future and, most importantly, direction for how firms can best navigate the invariably rough waters ahead of them.

While the two are not identical, both the Great Recession and the current pandemic are periods marked by sudden and severe security market fluctuations and extreme economic uncertainty. Advisory firms first felt the recession in 2008, but its full impact did not hit until 2009. That year was likely the worst of any annual FA Insight study, with median revenue falling 9.5 percent and profit margins, at 11.3%, off over six percentage points from the year prior. Just a year later, profitability had bounced back to pre-recession levels, and median revenue growth, at nearly 19%, reached a record that is yet to be topped.

Lessons from Standout Firms of the Great Recession

The first and most obvious lesson from a decade back is that no matter how challenging times may seem, advisory firms are resilient, with a demonstrated capability to quickly rebound. The second and more important lesson learned is that crises frequently offer unique opportunities. This was clearly demonstrated by a select group of Standout firms tracked in the years leading up to and just following the Great Recession.[1]

Standout Firm Key Areas of Focus Through the Great Recession

New client development | Team expansion | Productivity | Expense management

[1] Out of all firms who consistently participated in the annual FA Insight studies over the 2009–2012 period, we distinguished a group of Standout firms. In a slightly modified version of our typical annual methodology, Standouts demonstrated both above-average revenue growth from 2008 to 2011 and above-average profitability in 2011 following economic recovery.

In comparison to their peers, these firms were not satisfied with simply hunkering down to "weather the storm." Instead, Standouts demonstrated confidence and assertiveness that allowed them to prosper in a turbulent time. Four key areas of focus allowed Standouts to excel in relation to their peers:

- **Emphasis on new client development.** While growth at peer firms stalled, Standouts consistently added clients. In 2009, their weakest year, the typical Standout firm still managed 5% client growth compared to virtually no growth for peer firms.
- **Team expansion.** Along with steady client growth, median total team members for Standouts increased from seven in 2007 to 10 by 2010 compared to peer firms contracting slightly over the same time frame.
- **Rising productivity.** With extra capacity and revenue growth stalling at the onset of the recession, Standout productivity initially weakened. By 2011, however, revenue per revenue generator at Standout firms was 22% greater than in 2008. Concurrently, productivity at other firms fell by 10%. Ultimately, the added capacity allowed Standouts to take better advantage of new business opportunities as the recession transitioned to recovery.
- **Managing expenses.** More so than their peers, Standouts were quick to adjust costs to maintain profitability. Short-term sacrifices were made to ensure the long-term sustainability and growth trajectory of the firm. Overhead expenses as a share of revenue, for example, dropped from 45% to 31% during the 2008-2011 period. Standout owners cut back on their own salaries as well, which helped to defray the expense of additional staff.

Playing the Long Game

As the Standouts of the Great Recession demonstrated, it pays to maintain a focus on growth even in the most trying times. This includes, perhaps most importantly, a proactive approach toward business development. A related consideration given the current pandemic: Success will also require firms to rethink their traditional ways of communicating and engaging with prospects.

While firms have successfully added clients in recent years, there is plenty of potential for more effective business development. Second only to concerns about the economic climate, firms rated developing new business as the greatest challenge to their ability to grow. Improving client referral processes as well as prospect conversion rates are two key ways firms can address business development challenges.

For most firms, growth is client-led, with 56% of firms citing additional business from current clients as a top driver for growth. Related, referrals from clients accounted for nearly half of firms' new business. Most firms are not actively priming the pump on this steady pipeline of new opportunities, however. When prospects are identified, the typical firm converts 65% of them to clients. Based on median operating metrics, a firm realizes an additional $2,000 in new annual revenue with each percentage point improvement in its conversion rate. More firms (45%) cite client and prospect events among their top three marketing expenditures, but just 15% rank referral programs this high. Whether it's a long-overdue update to the "tried and true" or in direct response to COVID-19, firms urgently need to develop new methods of engaging.

Experimenting with New Ways of Driving Engagement

Advisors have been hesitantly moving to more online and social media communications for the last several years; in the age of the coronavirus, this is now a necessity. Webinars, podcasts and virtual classrooms are just a few examples of mediums that advisors can consider adapting for fostering engagement remotely. Especially given growing constraints on in-person interactions, social media has tremendous potential for cost-effectively driving client engagement, promoting and reinforcing the firm's brand and directly generating new clients.

In 2019, marketing through social media accounted for 8% of new client activity, behind only client referrals and centers of influence as a leading source of new business. There is broad interest across the industry for making greater use of social media—just 13% of firms thought social media was not an effective fit with their business approach. The most commonly reported obstacle to expanding social media use was simply a lack of time or resources to commit to developing and deploying a social strategy.

8%

of new clients sourced through social media marketing

- **Third-ranking source of new clients** behind only referrals from clients and COIs
- **just 13% of firms** thought social media was not an effective fit with their business approach
- **The most commonly reported obstacle to greater social media use**—a lack of time or resources

The Power of the Minimum Fee

Pricing, dominated by the AUM-linked fee, is another frequently overlooked measure for supporting firm growth and profitability. Every market downturn invariably calls into question the efficacy of AUM fees. Then security markets recover, revenue growth revives, and any consideration to move beyond the AUM-linked fee gets put on the back burner again. In 2019, the typical firm generated 96% of all revenue from an AUM-linked fee, with 41% of firms reporting that they are completely satisfied with the current pricing structure and have no desire to change. “Easy to administer” and “industry standard” were other leading reasons for staying with AUM fees.

Despite firms’ comfort with charging according to AUM, the fact remains that revenues will be vulnerable in market downturns when fees correlate to AUM. Making a change has a very real potential to drive revenue growth. Further, AUM-linked pricing can confuse clients in terms of where the firm provides value. The typical firm offers 19 services—with 13 of the 15 most common services provided unrelated to asset management.

Just 6% of 2019 study firms collected half or more of their revenue from fees not tied to AUM. Based on their performance characteristics, these pioneering firms appear to be still fine-tuning their pricing approach. A less radical shift away from AUM pricing is to simply implement a minimum client fee, which is effectively a pricing floor with clear performance advantages, including 42% greater profitability.

Firms with disciplined adherence to minimum fees demonstrate clear performance advantages, including **42% greater profitability.**

Maximize Return on Investment

Directly boosting revenues is one way to minimize vulnerability in a pandemic. Enhancing efficiency and productivity further strengthens immunity by stretching investment dollars and improving profitability. Growth alone doesn't instill value in a firm regardless of the business climate. Building value requires sustainable growth, where a firm is not only growing but growing profitably.

While efficiency is not often credited as a growth driver, it is clearly top of mind when firms look ahead to sustain growth. Efficiency or productivity improvements figured prominently in strategic plans, for example, with about three-quarters of firms setting their focus on these objectives.

Client service, marketing and operations all are business areas where firms are realizing new efficiencies today and showing promise to continue improvements into the near future. Not only are firms generating more revenue per team member, but a sea change may be underway regarding the number of team members needed. For several years running, the typical firm employed 1.3 non-revenue roles per revenue role. In 2020, this dropped sharply to an even 1:1 ratio, which suggests firm efficiency gains are reducing the amount of support personnel advisors require.

Growing Use of Technology and Automation Result in FTE Savings

1.3
Non-revenue roles per revenue role in 2018

vs.

1.0
Non-revenue role per revenue role in 2020

More tightly integrated technology is among the more encouraging operations-related developments in recent years and a critical driver behind improved productivity. The share of firms with the capability for data to flow automatically as needed across software applications is now at 81%, compared to just 61% in 2016. To facilitate integration, 70% of firms are now relying on one central application, either a single-purpose application serving as a "hub" for other applications or an "all in one" multi-purpose application.

The share of firms with data flowing automatically as needed across applications is **up 20 percentage points from 2016.**

Uncertainty Impacts Optimistic Outlook

The global pandemic instantly impacted firms' outlook for the future. Firms providing data for this year's FA Insight study prior to the pandemic-influenced national declaration of emergency on March 13 had a much different outlook for the future than those completing the survey in the weeks that followed. While both groups experienced nearly identical revenue growth in 2019, expectations for 2020 growth were nearly four percentage points less for those reporting post-declaration than firms reporting prior.

Even amid a pandemic, however, firms have many viable options for generating growth. Business development played a prominent role in sustaining growth for the last recession's Standouts. The same can be true for today's firms. As an effective means for ensuring more profitable growth, firms would also be well-served to focus on efficiency improvements and pricing enhancements.

Important, too, is maintaining enough capacity in terms of people, another practice demonstrated by recession-era Standouts. Nearly one-fifth of today's firms cited adding new team members as a major contributor toward recent growth. Another 28% of firms credited the expertise of existing team members as a key growth driver.

On top of representing a direct addition of new clients, a transaction can also spur growth through the introduction of new capabilities and scale economies. While activity tends to be more prevalent with larger firms, 33% of all firms were involved in a recent merger or acquisition.

Prioritize Your Growth Agenda

Given the many options, how should a firm prioritize its own agenda for growth? As distracted as firm owners may be during these extraordinary times, long-term planning can be the difference between success or failure. Extraordinary circumstances aren't a pass, however, for failing to look forward and prepare for a brighter future. Decisions made today can have long-term consequences—this is especially true in an environment of such fast-paced change. With the right plan in place, including detail for managing costs, promoting efficiencies and developing business, firms have a foundation for sustaining growth even through the most challenging conditions.

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