



# Virtual Office News

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## Guest Columnist: Stuart DePina, CEO and Matt Springer, President & Founder, Tamarac Inc.

### Embracing process change to drive profitability

Over the course of the last year, as a result of the significant market decline, the typical fee based RIA firm has experienced erosion in top-line revenue as asset values of their

client base have decreased in some cases by as much as 40%. Based on our analysis, we estimate that the average firm has lost a minimum of 25% of year-over-year revenue. The continued volatility in the market remains as a potential threat to the sustained profitability of RIA firms at current asset levels, not to mention at levels measured as of October 2007.

The growth in assets held by individuals has been the primary driver behind the growth in the number of RIAs selecting to practice in the independent channel. During this time frame, most advisory firms have benefited from the following macroeconomic trends driving growth within the independent RIA channel:

- A shift in investor sentiment in recent years has led to an increase in the demand for objective advice provided by independent RIAs.
- As the baby-boomer generation enters retirement, there is a transition or “rollover” of assets accumulated in traditional pension plans to self managed accounts.
- As pensions continue to decline as an option



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offered by corporations, more individual investors are taking on the responsibility to accumulate wealth for their retirement in self managed accounts.

Post baby-boomer generations transition jobs more frequently than baby boomers, creating an opportunity to “rollover” assets accumulated in corporate sponsored plans to self directed plans.

RIAs in the independent channel have clearly benefited from their positioning in this high growth market segment, and most didn’t have any choice but to grow their businesses significantly. One Moss Adams study highlighted firms that, on average, were able to triple their assets under management (AUM) over the course of the last five years.

As firms were able to grow assets at this pace, they benefited from a corresponding increase in revenue over the course of the same time frame. During this expansion what many of these RIAs didn’t consider, however, was the implementation of scalable operations within their practices. As a result, while these firms were busy expanding their top lines, they did so with compressed profit margins as the cost of acquiring and serving new accounts increased.

The primary contributor to decreased profit margins was that most advisory practices had a lack of focus on the profit drivers and, as a result, didn’t invest in an infrastructure that would create long term value for their business. Many firms maintained manual processes in their operations specifically in multiple areas of portfolio management including portfolio construction, portfolio monitoring, cash management, rebalancing, asset location, tax management, trading and reconciliation. Accordingly, as accounts and assets grew, most advisory practices were forced to grow their staff to support their current client base. There is certainly nothing wrong with this approach, so long as RIAs understand that they will be leaving money on the table.

Let’s consider some key questions:

What is the true cost of the manual processes in terms of time and salary (including the opportunity cost of spending less time with clients and referrals)? Will current staff support two- or three-times the number of accounts and assets as your firm continues to grow?

If not, what additions to staff will need to be made? What will that cost? Will it be easier or harder to implement an operational change when your firm is double or triple its size?

What impact will turnover of key staff members have on your business continuity and what cost will you incur to train and retrain staff?

What impact does a recurring manual process have on your long term value creation and how will this ultimately impact the owner’s exit strategy?

Most firms don’t address these and similar questions because it often seems more important to just keep growing.

Some RIAs choose to address these key questions early and thoroughly evaluate their internal processes to increase their operating efficiencies. While these firms have diverse profiles ranging from size — as measured by AUM — stage of their life cycle from a “break-away-broker” to a mature established firm, or investment philosophy of active to passive, they all are focused on driving oper-

ating efficiencies for the sole benefit of increasing profitability. While the tactics vary, common themes addressed are:

- Increasing standardization in portfolio construction
- Introducing more sophisticated investment strategies
- Increasing consistency in applying investment recommendations across accounts
- Investing in systems that bring automation to daily portfolio management tasks as well as SEC-mandated compliance tasks

Different firms will apply different tactics when appropriate at varying stages, but the goal remains the same -- to drive operational efficiency. Furthermore, the most successful and profitable firms made these adjustments ahead of their peers. They invested the time and money necessary to grow before, not after, they added staff.

Make no mistake... it certainly requires effort for firms to transition their operations to the next level. However, the alternative is growth of the firm with continued margin constraints, where increased AUM only leads to increased head counts and negative margin expansion. Leading firms are embracing scalability as they grow, meaning they have more profit to invest in marketing, research, recruitment, etc. Profitability may be difficult to sustain, or take advantage of, for those who fail to adapt in this competitive environment.

Operational evaluation and change is virtually inevitable for any RIA looking to succeed in the next five years. Take solace that you do not have to undertake transformation alone. Leading vendors, like [Tamarac Inc.](#), will offer consultative support (not just technology) to make the adoption of a new process as efficient and easy as possible. That is why many advisory firms, after having gone through the process, express how they wish they had committed sooner to the changes needed to support asset and revenue growth.

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*Please attend our pre-conference workshop, "Increase Your Firm's Efficiency and Profitability," at this year's Technology Tools for Today® (T3) conference on February 26, 2009 from 1:30pm to 5:30pm at the Dallas InterContinental Hotel in Addison, TX.*