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Industry Trends: The Seven Secrets in Building A Billion-Dollar Practice

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There is a common mindset that all successful billion-dollar-plus consultants have, which, in large part, have contributed to their success. When you put yourself in that mindset, it becomes clear why these senior consultants have been so successful. In order to successfully execute today's new advice business model, you must think and behave differently. This is what distinguishes you from brokers, bankers, accountants, planners and insurance agents. Senior consultants who have a billion dollar plus practice understand:

1. **The financial services revolution has already occurred.**

For well over a decade now, thousands of top investment management consultants have been delivering a level of professional investment and administrative counsel unprecedented in commission sales to their institutional and high net worth clients. Over the past four years the internet has created account transparency which makes it increasingly clear to the client whether the advisor is adding value and/or fulfilling their fiduciary obligations. This has resulted in all clients who are interested in value being added and their advisors acting in a fiduciary capacity being attracted to the fee-based investment management consulting model. The financial services industry is well into the process of being reordered around advice, which is driven primarily by the initiative of the individual advisor. Major financial services institutions are not much closer today to competing on the basis of the value they empower their advisors to add than they were 10 years ago. Though there is a general sense that the industry is moving toward advice and away from commission sales, it is based on the initiative of the individual advisor, not their firms. There is no institutionalized competition for high skilled advisors who have personally taken the initiative to fulfill their fiduciary responsibilities and engage their professional investment and administrative counsel for an on-going advisory fee. The culture, structure and technology of the financial services industry remains geared toward commission sales, not the advisor fulfilling fiduciary responsibility and adding value through the engagement of their professional investment and administrative counsel for an ongoing advisory fee.

2. **To be successful, you must understand you are the value added.**

You are the value added because you have brought the technology, hired the staff, built the investment process and have assumed the initiative to provide a high level of professional investment and administrative counsel. What makes you successful is that you don't rely solely on external support, which limits you in the value you add by virtue of the vision, processes, methodologies and technologies of supporting institutions being more narrowly focused on product distribution and commission sales.

3. **It is not possible for you to consistently deliver continuous, comprehensive counsel and fulfill your fiduciary responsibilities for a large number of clients unless you devise a proprietary investment process and technology necessary to address all the values required by regulatory mandate and client directive which are essential for the investor achieving their long-term goals and objectives.**

It is not investment products that add value, it is process, or what you do with investment products that adds the value. This requires an investment in time, technology and people to develop and evolve the process and service methodology around which your practice is built. This investment process (asset/liability study, investment policy, strategic asset allocation, portfolio construction/manager search and selection, performance monitor, tactical asset allocation) has evolved in the institutional markets around addressing and managing a broad range of investment and administrative values as required by regulatory mandate. It is how we articulate and deliver this investment process that adds value, not investment products. Thus, adding value becomes a skill, an art form, for each practitioner, even though the process may become well-defined and more commonly replicated. If the client doesn't perceive or understand the values you address and manage, then there is, in

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fact, no value being added. The value added is in how you manage and deliver the process to each individual client.

4. **To be successful your practice must have a well conceived account minimum and client focus.**

Engaging your counsel for an on-going advisory fee is a significantly different enterprise than commission sales. The comprehensive, continuous counsel required of us is equally time-consuming for clients with substantial assets, as it is for clients with more meager assets. Much more labor is required if one is going to add value and fulfill their fiduciary responsibilities than in commission sales. There is no limit in the number of clients to which a commission salesman might sell an investment product, but there is a limit in the number of clients to whom an investment management consultant can provide continuous, comprehensive counsel. Most successful consultants have less than 100 clients, and at most, a consultant can provide continuous, comprehensive counsel to 200 clients (allowing ten man-hours per client per year).

In order to make it economically viable for you to create the infrastructure (people, process and technology) within your practice that is necessary to add value and fulfill your fiduciary responsibilities, you and/or your partners must collectively have $40 million under advisement. (See "How are Top Advisors Growing their Business in a Difficult Market?" *Senior Consultant,* April 2003, http://www.srconsultant.com/Articles/2003-04-Top-Advisors-Grow.pdf.) Thus, you need 200 clients averaging $200,000 each or 100 clients averaging $400,000 each to build a successful world class advisory services business. Smaller clients can be served, but the account minimums must be sufficiently large to make it economically viable to secure the resources necessary to add value, fulfill your fiduciary responsibilities and afford an attractive service model. You maximize the value you add and sharpen your value proposition by focusing on a small number of very specific market segments in the individual (mass, retail, high net worth, ultra high net worth) and institutional (defined benefit, defined contribution, public funds, profit sharing plans, foundations and endowments, and Taft Hartley plans) markets in which you serve. In your trade area, the level of your counsel should be sufficiently high in the market segments in which you serve, that you are continually upgrading your client base and your account minimums.

5. **You must continuously upgrade and enhance your people, process and technology in order to grow your practice.**

The years of dumbing down advice to the lowest common denominator are over. Though the high net worth and middle market (less than $100 million) institutional markets are terribly underserved, the window of opportunity is beginning to close. There are not enough investors to economically sustain all the industry's 600,000 licensed financial advisors in engaging their counsel for an on-going advisory fee. Differentiating yourself by enhancing your value proposition is the primary means by which you win marketshare. There are far more investors who want value to be added than there are advisors who are capable of adding value.

EVERYONE [INDIVIDUALS AND INSTITUTIONS] IS INTERESTED IN RISK, RETURN, TAX EFFICIENCY, LIQUIDITY, COST STRUCTURE AND ACHIEVING THEIR LONG-TERM GOALS AND OBJECTIVES

The threshold in order for continuous, comprehensive counsel to be economically viable for the financial advisor is a prospective client must have $100,000 in liquid investable assets. For most advisors, this is the bare minimum. There are only 15 million households that have $100,000 or more in liquid investable assets which account for over 90% of all US wealth. Assuming the advisor can serve as many as 200 clients, there are only enough clients to sustain 75,000 of today's 600,000 advisors. If the average advisor served 100 clients, there would still only be enough clients to support 150,000 financial advisors. Even if you were to assume that only 250,000 of the 600,000 licensed financial advisors were active, there are a lot more advisors in the business today than the marketplace can sustain. Not only is the higher end of the market underserved, but the early adopters who are adding value and fulfilling their fiduciary responsibilities are reducing the pool of available prospects, making it increasingly difficult for those who follow. As in the institutional market, the high net worth market is becoming a zero sum game. The only way to win clients is to take them away from someone else with a better value proposition. The window of opportunity is beginning to close. It is not important that all advisors "get it;" in fact, it is important that they all don't get it, because there are not enough clients to go around.

6. **Except for income and estate taxation, there is little difference in the investment values most important to the individual investor and those most important to the institutional investor, thus creating a bias for institutional accounts.**

Individuals and institutions rank the values which are most important to them in the same order. Everyone is interested in risk, return, tax efficiency, liquidity, cost structure and achieving their long-term goals and objectives. High net worth individuals arguably require a higher level of administrative detail to be managed than institutions, yet institutions offer far more assets and have a federal mandate under ERISA, UMIFA, UMPERS requiring a prudent process, thus making them more attractive clients for the time and resources expended.

7. **High level professional investment counsel requires a team to execute.**

A division of labor and the delineation and management of well-conceived functional responsibilities allows you and each member of your team to consistently meet and exceed client expectations and the expectations of each team member. The building of a high performance business team is essential to driving down cost, consistently providing high level counsel and effectively pricing your services.

Each of the above secrets are not only essential to the success of billion-dollar-plus practices but, in essence, defines who they are.

In a marketplace that is driven by the old commission sales/product distribution model where the emphasis is on selling a "hot" product, the opportunity to add value is extraordinary. By simply showing the client the actual results achieved in a commission brokerage account and explaining it is not possible to add value through a series of disjointed, unrelated transactions, the consultant is positioned to add value with almost any prospective client.

The question then becomes attracting and acquiring clients. By building their own investment process, billion-dollar-plus consulting practices take control of their cost structure, which allows them to aggressively price their services relative to their high cost competitors. The use of hard-dollar pricing (e.g., a $40,000 flat fee not tied to assets) for institutions and individuals can be far less expensive than asset-based fees but requires a well-run practice and economies of scale

Top consultants with billion-dollar-plus practices, who have process, team and technology in place, can often provide high level professional investment counsel for less than the client is paying in transaction costs alone. There is little doubt why these senior consultants have grown their practices from $50 million to over $1 billion in the last five to ten years, and there is little doubt why many of these senior consultants have set their sights on growing their businesses to over $100 billion in the next ten years. The financial services industry is well into the process of being reordered around high level counsel for the next 50 years, but the major financial services institutions are not prepared to compete in a new emerging business environment that prefers and will demand high level professional investment and administrative counsel.

For consultants who are committed to adding value and who are highly focused, this is a marketing opportunity of a lifetime. With the right mindset, literally any consultant who has a passion for process and service can build a billion-dollar-plus practice. The demand for value to be added in terms that the client can understand is so great and the number of senior consultants capable of providing high level professional investment counsel is so small that it is difficult to fail, even if one focuses on the higher margin individual investor who may not have millions to invest.

In examining the above seven secrets in building a billion-dollar-plus practice, we learn how top senior consultants become successful and how they provide a track upon which support firms and enterprising consultants can run in building their businesses around the new advice business model. As we look at these seven secrets in more depth and review the associated web-links, one cannot help but to conclude that this is the most exciting time ever for the financial advisor to be in the financial services business. There is a quiet shift in power to the financial advisor who has created the processes, technology and infrastructure within their practices necessary to add value and fulfill their fiduciary responsibility. These investment management consulting practices/firms are rapidly growing their assets under advisement and compel us to take a deeper look at what makes them successful.

> **THERE IS A QUIET SHIFT IN POWER TO THE FINANCIAL ADVISOR WHO HAS CREATED THE PROCESSES, TECHNOLOGY AND INFRASTRUCTURE WITHIN THEIR PRACTICES NECESSARY TO ADD VALUE AND FULFILL THEIR FIDUCIARY RESPONSIBILITY**

The Advice Revolution Has Already Occurred

Though the advice revolution started 40 years ago with the advent of Nobel Prize-winning modern portfolio theory, we are just now at a point in the evolution where the financial services industry is beginning to be reordered around advice and the investment and administrative values that consultants address and manage for their clients. The opportunity is that this evolution is fostered by the initiative of the individual practitioner. No major financial services institution is prepared to acknowledge fiduciary responsibility and compete on the basis of the value its advisors add. Thus, there is an extraordinary opportunity for individual consulting practitioners to build massive businesses.

This new advice business paradigm is not well understood by the 600,000 financial advisor financial services mainstream. The focus of the mainstream has been on the commission brokerage/product distribution model, which has evolved into a highly efficient, well-oiled machine. Yet, with the transparency of the internet, the emergence of zero-trading cost environments and the resulting permanent repricing of trade execution, the commission brokerage business has awakened to the fact that it will not be able to sustain its present overhead over the long term in a declining commission brokerage rate environment. Thus, the financial services industry is suddenly embracing advice and high level professional investment counsel as its future, but it does not fully understand nor is it culturally ready to consider all its implications. Institutionalized advisor support will continue to be difficult to engineer until supporting firms acknowledge their advisor's fiduciary responsibility.

Meanwhile, over the past ten years, today's top senior consultants, who are offering high level counsel and are acting as a co-fiduciary, have evolved their own crude investment process and assembled awkwardly-fitting software and hardware into a well-oiled, sophisticated delivery platform. (See "How are Top Advisors Growing their Business in a Difficult Market?" *Senior Consultant,* April 2003, http://www.srconsultant.com/Articles/2003-04-Top-Advisors-Grow.pdf which walks you through the staffing and technology around which top advisors build their practices.) Top advisors have a chief administrative person(s) within their practices who are primarily focused on process administration, making hardware and software function as an integrated system. They have a portfolio manager(s)/technical analyst(s)/CIO within their practice to construct and continuously monitor each client's portfolio so that the full

range of investment and administrative values, required by regulatory mandate and client directive, are addressed and managed. These top senior consultants have taken the investment process and continuous, comprehensive counsel and have made it into an art form. They can interview a prospect, and in nine out of ten times, they can make them a client. Because the senior consultant has been particularly active in winning the middle market institutional investor (which, at under $100 million, is not the primary focus of either commission brokerage or major institutional consulting firms), their work has largely gone unnoticed by the financial services mainstream. Yet, these senior consultants have defined the culture, processes, technology and methodology of advice, and are keenly aware that the financial services industry en masse is not remotely close to competing on the basis of advice, pricing or service.

As enterprising consultants make it clear to the investor that there is no value added in trade execution, the opportunity becomes more profound. The financial services industry is in the process of being reordered for the next 50 years, and the major financial services institutions are not on the field, in the stadium or even in the game. Advice is an entirely new and different business paradigm than commission brokerage, and it will be years before the culture, structure and technology of the major financial services firms can begin to catch up.

In this resulting advice vacuum, over the next five years we will see many enterprising individual consulting practitioners build their consulting practices into billion-dollar-plus firms, and the price for advice will drop. This will make it even more difficult for large high cost structure firms to compete, as it requires both a streamlining of organizational structures and the centralization of enabling process and technology with which they are not familiar. This may very well be the reordering of the financial services industry that everyone anticipates, but it may not look anything like it does today. Institutions have to find a way to cost effectively add value. It is distinctly possible that the industry will be driven by a much smaller number of very capable individual practitioners with massive practices.

You Are the Value Added

In order to be successful, every senior consultant who has $1 billion or more under advisement has had to come to the conclusion they cannot rely on anyone other than themselves to add value for their clients. Certainly 20 years ago, ten years ago, or even five years ago, consultants knew they could not count on their brokerage or clearing firms for assistance in building a consulting platform. As a consequence, most of the innovation in the process, methodology and technology of advice has come from leading consulting practitioners. Top consultants are successful because they have assumed the initiative to add value and have been forced by necessity to become innovative in responding to the needs of their clients.

TOP CONSULTANTS ARE SUCCESSFUL BECAUSE THEY HAVE ASSUMED THE INITIATIVE TO ADD VALUE AND HAVE BEEN FORCED BY NECESSITY TO BECOME INNOVATIVE IN RESPONDING TO THE NEEDS OF THEIR CLIENTS

Clayton M. Christensen, a Harvard Business School professor, observed in his best selling book, *The Innovator's Dilemma,* that when successful companies are faced with a big technological leap that transforms their markets, all choices are bad ones. Doing nothing is not an option as Merrill Lynch, et al., have discovered, since the advent of internet brokerage has repriced trade execution. Facing a major innovation like internet brokerage with a "head in the sand" strategy can maintain profits only in the short term. Long term, however, marketshare and profits are going to be eaten away by low-cost upstarts like Schwab and Ameritrade.

Yet, Christensen sees all the alternatives for established financial services firms taking the big technological leap as having significant risks as well. Competing with trade execution start-ups by adopting their technology forces an established company to behave like a start-up itself. That means making big bets on unproven technologies and markets that may never be capable of providing decent earnings.

Christensen writes, "Under traditional planning processes, it is impossible to justify enormous investment to compete in emerging, yet-to-be profitable markets. Investing in disruptive technologies is not a rational financial decision for established companies. But by the time the new markets are large and profitable enough to justify the investment, it is already occupied by entrenched competitors." Of course, venture capitalists make such risky bets all the time, since they are prepared to accept big losses in exchange for big gains. But at most established companies, managers, employees and stockholders are not prepared to take such an enormous risk. Thus, the spoils of the advice revolution will go to companies and individuals who are willing to think like venture capitalists. This is not an easy thing for established companies and managers.

The Process and Technology Imperative

The investment process is an art form and is, by definition, different for each client. Though eventually the six services that comprise the investment process (asset/liability study, investment policy, strategic asset allocation, portfolio construction, performance monitor and tactical asset allocation) will be well known, knowing how to apply the investment process to each client will determine the value you add. Highly successful senior consultants have an intimate understanding of the investment process and how to use it with each client. This makes the science of consulting into an art form.

It is not uncommon today for young consultants to find their clients not being able to discern the on-going value they add. This is because they did not do an asset/liability study to properly set up the relationship; or their quarterly performance monitor is poorly conceived or delivered, not articulating the values they address and manage; or they have not explained how each of the six financial services that comprise the investment process add value

in their own right. The context in which value is added is the investment process. You are the institutional memory who knows the investor better than himself, who creates a prudent framework or process through which value is added. The senior consultant knows what part of the investment process needs to be reinforced by the questions the client asks. The senior consultant also takes every opportunity to educate the client so better decisions can be made. thus making the value-added readily discernible.

Top senior consultants also understand the importance of technology. As human beings, we are only capable of thinking three dimensionally, we can't think beyond nine possible interrelated investment outcomes. Yet, if we are to manage the retirement objective for 500 clients, addressing the investment values of risk, return, tax efficiency, liquidity, cost structure and time; and if we are to use just 10,000 investment options, each having 100 description points, we would have to manage three billion interrelated investment outcomes in order to add value. Clearly, a process and technology are necessary in order to add value in terms meaningful to each individual client. The financial services industry is just beginning to understand that if we limit ourselves to three dimensions, without the processes and technology necessary to add value and fulfill our fiduciary responsibility, it is not humanily possible to add value.

Individuals and Institutions Share the Same Investment Concerns

Except for taxation, there is no difference in the investment values most important to the individual and those most important to the institutional investor. Both groups have even ranked the values in the same order of importance. As senior consultants created and evolved their investment process and technology, they found that institutions were just as interested in risk, return, tax efficiency, liquidity, cost structure and progress made in achieving their long-term goals and objectives as were individuals. In fact, much of the evolution of the six financial services (asset/liability study, investment policy, strategic asset allocation, portfolio construction, performance monitor and tactical asset allocation) that comprise the investment process was inspired by ERISA which mandated fiduciary responsibility for investment intermediaries acting on behalf of investors which led to the development of a "prudent process." Senior consultants quickly found middle market institutional investors (defined contribution plans, profit sharing plans, defined benefit plans, foundations and endowments, public funds and Taft Harley plans) with less than $100 million were not being served by the large national consulting firms, and the institutional brokerage services being provided were an adjunct to commission sales. As they offered professional investment and administrative counsel to individuals, they found they were increasingly attractive to foundations and qualified plans; and over a period of years, their practice became evenly split between individuals and institutions. But more importantly, even though half their clients were individuals, 90% of their assets were institutional. There is a distinct middle market/institutional market bias in consulting practices of $1 billion or more, and at $10+ billion, there is a large institutional investor ($100+ million) bias that begins to emerge. The larger the practice becomes, the more attractive it is to larger clients. As consulting practices get larger, service and time become increasingly important as time begets service. Thus, a conscious decision is made by top consultants on the time required to serve a client and the number of clients who can be served. Large firms do not necessarily have a large number of clients, and the number of clients that each consultant serves doesn't have to be large either. Many middle market consulting practices have only 10 clients per consultant, though each clients' investment assets may be over $100 million. Clearly, successful senior consultants have geared their counsel to institutions which, by virtue of ERISA and their fiduciary responsibilities, have a higher appreciation for professional investment and administrative counsel than uninformed individual investors. Service at this level is an art form; everything is custom. It also doesn't hurt that the middle market institutional market is underserviced and represents far more assets per investor than the higher margin, high net worth market. Very attractive, high margin, high net work practices can be built, but the cost structure of those practices makes them vulnerable to lower cost institutional competitors. Thus institutional business becomes an important means to drive down cost and build market presence.

EXCEPT FOR TAXATION, THERE IS NO DIFFERENCE IN THE INVESTMENT VALUES MOST IMPORTANT TO THE INDIVIDUAL AND THOSE MOST IMPORTANT TO THE INSTITUTIONAL INVESTOR

High Net Worth and Middle Market Institutional Investor Markets Are Underserviced

Simply being accountable for investment recommendations and a client's overall investment performance and acknowledging fiduciary responsibility is beyond the financial services mainstream. The key to a senior consultant having built a billion-plus-dollar practice is they can address the fundamental investment values of risk, return, tax efficiency, liquidity, cost structure and time which are required by regulatory mandate and are essential for all investors in achieving their long-term goals and objectives.

The unpredictable element of this new "disruptive technology" is actually not very unpredictable. The question is whether clients prefer value to be added with this new technology or whether they prefer the old commission brokerage technology, where it is not possible to add value through a series of disjointed, unrelated transactions. The metaphorical bet on the new advice business model and its associated economics is not as problematic as Christensen would suggest, as investors clearly prefer value to be added. Christensen presumes brokerage firms will not choose to compete on the same basis as internet brokers, e.g., Schwab and Ameritrade. He is right; the margins are not there and their investment is huge. The initiative is the the senior consultant's. The senior consultant will give away trades for free and beg the questions of whether any value is being added or whether fiduciary responsibility is being fulfilled. The same institutional cultural inhibition to make massive investments in "disruptive" advice technology will not go away. This is why top senior consultants have experienced exponential growth in their assets under advisement. There is an advice vacuum and no institutional competition. It is easier for the advisor to create within their practices the processes and technology necessary to add value than it is for their support firms. There is absolutely no question that clients prefer value to be added.

Given the advice vacuum that exists within the marketplace and the fact that highly desirable high net worth and middle market institutional investors remain underserviced, there is an extraordinary opportunity to build a massive business for those prepared to provide high level counsel. (See "What is Your Value Proposition," *Senior Consultant,* January 2000, http://www.srconsultant.com/Articles/2000-01-ValueProposition.pdf, which walks you through formulating your value proposition into an institutional quality presentation.)

A High Performance Business Team is Essential

Highly successful billion-dollar-plus consulting practices are in no way similar to a commission broker building a book of business. A billion-dollar-plus consulting practice is a well-organized business enterprise employing at least three people dedicated to (1) client service/new business development, (2) operations/administration and (3) portfolio management, necessary to provide continuous comprehensive counsel. Most of these practices have six or more employees, including consultants. Between quarterly updates, there is significant value that can and must be added by responding to client inquiries. One practice has a rule that the phone cannot ring more than three times, and in over 90% of the cases, all client questions can be answered on the spot. This, of course, implies that much of the ongoing daily operations of the business have been delegated to highly accomplished members of the team. (See "Building a World-Class Business," *Senior Consultant,* March 1999, http://www.srconsultant.com/Articles/1999-03-BldgBusiness.pdf, which walks you through creating a division of labor within your practice and building a world-class business team.) This not only frees up time for the principal partner and lead consultant to win new business but establishes that the enterprise has created transferable value. The investor is buying professional investment and administrative counsel derived from a highly disciplined investment process executed by a team. The counsel provided to the investor does not solely depend on the consultant, it transcends the consultant. Thus, with successor management in place, a consulting practice is self-sustaining and has a life of it own. This allows it to be sold, thus providing a liquid exit strategy with a multiple for the founding consultant. (See "Creating Transferable Value in Your Practice," *Senior Consultant,* August 2001, http://www.srconsultant.com/Articles/2001-08-Transferable-Value.pdf.)

Ultimately the most powerful motivating consideration for practitioners to build their business around advice rather than commission brokerage is that substantial value can be created in a consulting practice, something not possible in a commission brokerage practice. In the next five years, we will see top senior consultants create large regional consulting firms with hundreds of billions of dollars under advisement that will have a market capitalization of hundreds of millions of dollars. This model could be the reordering of the financial services industry that everyone anticipates but doesn't yet know what it will look like.

Conclusion

By being aware of the mindset of billion-dollar-plus practices, we gain insight into what the financial services industry will look like and how individual practitioners can emulate the success of leading consulting practitioners in this truly extraordinary opportunity to growth the investment management consulting industry. Everyone wants high level, comprehensive, continuous counsel; and a relatively small number of consultants are capable of adding value and fulfilling their fiduciary responsibility. Thus, an advice vacuum has been created that will move the entire industry. For those who are prepared, this is a glorious time to compete. Whoever adds the most value wins. ■

Notes

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