June 2020 | DeVoe & Company Study Report

DeVoe & Company

It's Time for a Human Capital Revolution

Preparing G2 for future leadership role is mission-critical for the industry

Human Capital

The Time is Now

It has never been more important for the RIA community to engage employees and highly capable future leaders. Over the next decade, the founders of RIA firms will increasingly transition out of their firms and next-gen leaders will take the reins.

So, the question naturally emerges: Is the next generation of leaders ready to run the firm?

The short answer is unfortunately: No.

At least advisors don't think so. Our recent survey uncovered key concerns voiced by RIA leaders about the ability of G2 (the next generation) to run with the baton. But more importantly, it uncovered significant opportunities for improvements in human capital planning. "The RIA industry is approaching a succession crisis," said David DeVoe, Founder and CEO, DeVoe & Company. "But the succession issue is actually just a symptom of a more profound human capital ailment."

Employees are the most valuable assets of an RIA. *People* are what make or break the success of any given firm. Most advisors know this. And across the industry, there are firms that do exceptionally well at managing, supporting and engaging their employees. Some are stand-outs at career pathing; others at coaching or creating winning team cultures. A select few even compensate their people effectively. But overall, the industry is not investing in their people the way they should.

"RIAs take care of their clients better than any other model in the financial services industry. It's time for advisors to put that same energy into their employees."

David DeVoe, Founder | CEO, DeVoe & Company

Despite the knowledge that their people are so critically important, there is a lot of work to be done. The responses to a recent DeVoe & Company survey—which includes senior executives, principals, and owners of RIA firms ranging in size from $100 million to more than $5 billion—highlight that many advisors fail to give their next-gen leaders and staff the attention they need. The result: Succession plans, if not entire businesses, are on the edge of peril.

While our survey and the current situation in the industry raise many red flags on fundamental best practices associated with human capital, there are tangible actions principals and next-gen leaders can take to improve quickly. Ultimately, an integrated and comprehensive human capital plan will drive contribution, engagement, and loyalty. The power of human capital is real. It is time for a human capital revolution.

NextGen Transition Confidence Is Low

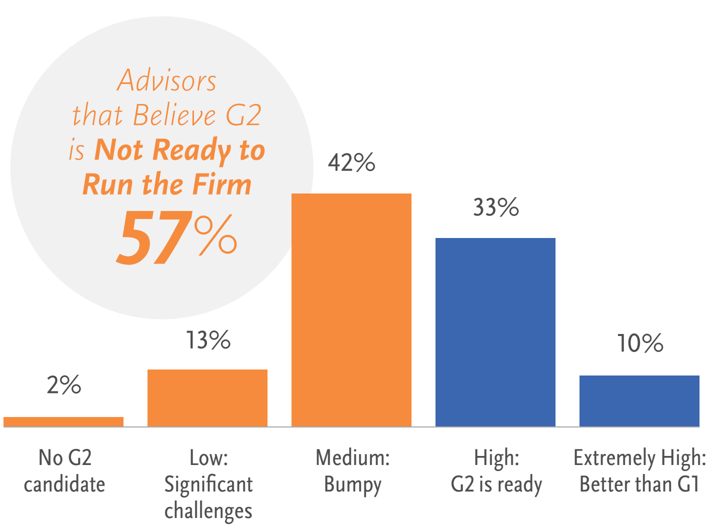
The industry is on track to experience a surge in transitions, but the *planning* for that is not keeping pace. The RIA industry is aging, especially among firm leaders. According to J.D. Power, the average age of financial advisors has steadily increased to 55,[1] but that's for *advisors*. The primary driver of transition activity is driven by RIA *owners*. DeVoe & Company estimates that the average RIA *owner* is in their early 60s.

Most advisors plan to sell internally – a wonderful trait about the industry. However, the current level of confidence that the next gen is ready to run the firm is shaky at best. More than half (57%) of the surveyed RIAs said that a leadership transition from founders to G2 would be *bumpy—or worse*. More concerning, 13% said that it would present a *significant* or *severe challenge*. A small percentage of firms simply state that no qualified next-gen candidate exists within the firm.

For an industry that, as a whole, will likely experience a surge in transition activity over the next few years, this is cause for alarm. But, the data becomes even more concerning for larger firms.

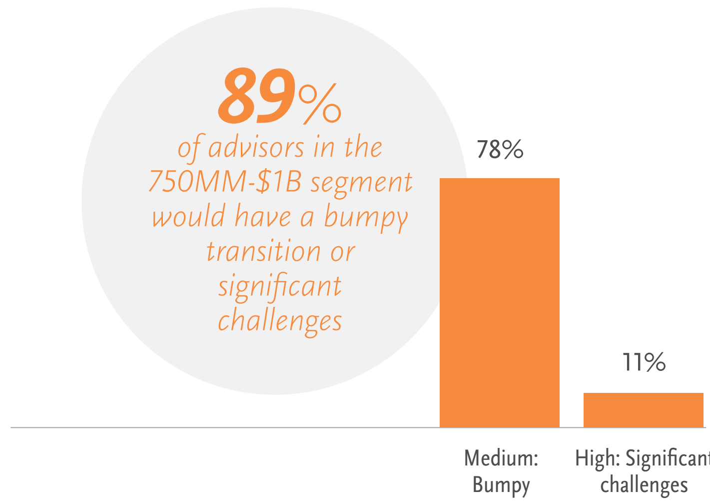
A staggering 89% of firms with AUM between $750MM and $1B are not confident in their NextGen's ability to make the transition. This is a surprisingly high number, especially for firms that have accomplished a degree of scale. The concern on 'NextGen readiness' compounds a delicate transition situation.

If the company transitioned leadership / management to G2 today, how would you rate G2's readiness?



1. *Technology, Social Media Critical to Bridging Financial Advisor Age Gap, J.D. Power Finds, 2019 press release, J.D. Power.*

Transitions are even more difficult with $750-$1B RIAs



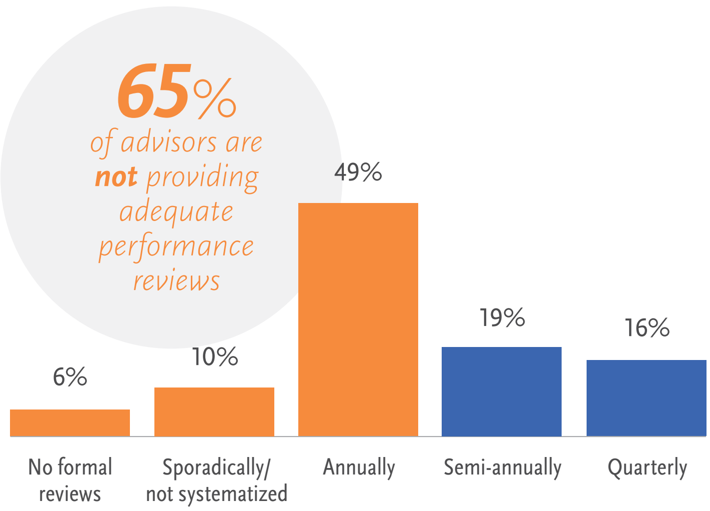
RIAs of this size are often struggling with the ability of G2 to afford to buy out the founders. Many advisors in this segment will be challenged to solve a more complex equation.

If active coaching, career pathing and leadership planning are not implemented, individual firms and the industry at large will face hardships. Preparing the next generation to become leaders takes time and energy. "Succession planning is more akin to a journey than an event," said DeVoe. "Advisory firms that start this process and commit to ensuring their G2 is positioned to run the firm will have a greater set of options and a more secure path forward."

Advisors are encouraged to start preparing their future leaders today. Principals will benefit from taking a sober inventory of their G2, assessing the skills they will need to transition into management and leadership. Then they have to actually put a plan in place.

The study also showed the potential power of doing this succession work. One third of advisors stated with conviction that their next generation is ready for the transition – and a further 10% are confident that the company will be in an even better position once this transition occurs. This is the aspirational point of arrival: The next generation of leaders have been selected well, coached effectively and given progressively greater responsibilities. They are now in a position to take the company to the next level.

How often are formal performance reviews given to employees?



Talent Thrives Under Performance Management

Performance management is critical for building a team that's motivated and focused on shared goals. According to a Gallup survey, teams with managers who provide feedback experience 12.5% greater productivity than teams that don't.[2] Imagine the impact on your client's satisfaction if your advisors had 10 to 15% more time to support them. Or imagine your company's profit margin expansion if your advisors were able to serve 10 to 15% more clients than they currently do. The power of effective employee reviews extends throughout the organization – it is not just good for the business, it is good for clients and employees, too.

The data also indicates that advisors have a critical 'opportunity for improvement' themselves. Our survey found that 65% of RIAs conduct performance reviews once per year or less. And only 16% provide sporadic or no reviews whatsoever.

RIAs are not alone. Many firms across industries don't do performance management that well.

Employees at firms with infrequent reviews don't receive feedback on their progress, are unaware of performance gaps, and can even be focused on outdated goals. As a result, neither the employee nor the company benefits from prompt course corrections, the staff becomes less engaged, and surprises at 'bonus time' leave all parties frustrated. To paraphrase Peter Drucker, "what you don't measure, you won't improve."

Conversely, many companies today – under the guidance of leading HR management consulting companies – are moving toward providing more frequent feedback. Conversations between managers and employees about development are ongoing and serve to:

1) Establish expectations
2) Continually coach
3) Create accountability

While other industries or larger companies may be ahead of the curve in moving toward newer people management systems, RIAs can learn from their efforts. "RIAs who shift in the direction of treating performance management as a continual conversation will be rewarded by employee loyalty and satisfaction – and, in turn, business improvements," said DeVoe.

"Performance management is critical for building a team that's motivated and focused on shared goals."

2. *The Secret of Higher Performance," Gallup®, May 3, 2011*

Building and developing an open dialogue between managers and team members goes beyond 'performance' discussions. Truly getting to know and understand team members builds trust over time. These discussions are beyond formal review meetings but fit in the rhythm of the team's work schedule on a regular basis.

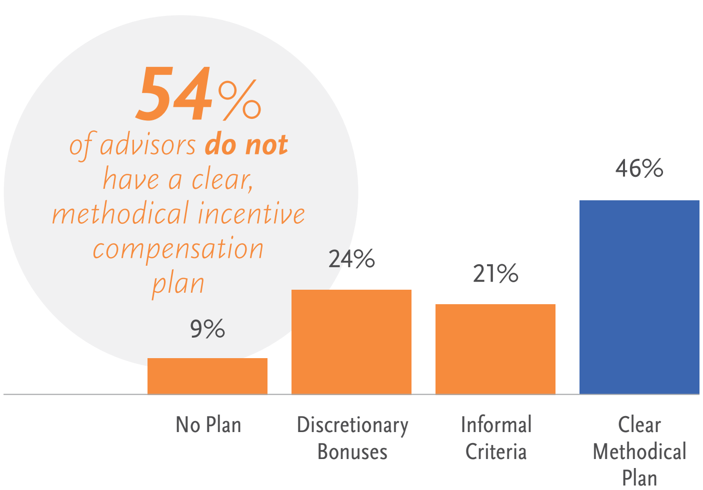
Performance reviews also help foster loyalty. An effective performance review process deepens the relationship between an employee and the firm. Reviews not only clarify accountability; they help build skills and reinforce motivations.

And what better way to reinforce these critical success drivers than intelligently tying them to their compensation.

Incentive Compensation Plans Need Alignment

Having an intelligently designed reward system is critical to the success of any organization – and is paramount for any company that depends heavily on their people. For the RIA community, the lack of effective compensation plans is emerging as one of its greatest challenges. According to our study, more than half of RIAs do not have a clear, methodical incentive compensation plan.

How would you describe your company's incentive compensation plan for advisors?



Unleashing the Power of Well-Designed Compensation Plans

Effective compensation plans help employees see a direct correlation between their goals, their actions and business results. Better yet, they see a correlation between their contributions and their rewards. People don't work for money alone, but they do respond to incentives. These incentives can change behavior, and that's when business results start to improve.[3]

What's more, the benefits of a well-crafted incentive plan go well beyond motivating the ideal behaviors. A recent study highlighted in the Harvard Business Review[4] used interviews conducted in 1,293 private-sector workplaces to learn more about the impact of performance-related pay versus profit-related pay. The researchers found that job satisfaction, organizational commitment, and trust in management were higher at companies that tied pay to individual performance instead of profit-related or profit-sharing pay.

RIA Comp Plans Often Focused on the Wrong Metric

The most common RIA advisor compensation plans focus too heavily on the wrong metrics. Typically, compensation plans are tied to the revenue that a client-facing employee oversees. At face value, this approach seems to make sense: As advisors demonstrate competence, the company moves more and larger clients to them. Also, the more clients an advisor oversees, the more profitable they become as an employee. Finally, this structure incents them to bring in business. Sounds good in theory, but the unintended consequences are profound.

This revenue-based structure ultimately undermines the business: The greater the success of a given advisor, the bigger the problem. That's because this type of compensation model incentivizes the 'hoarding' of client relationships. If each dollar of revenue an individual oversees contributes to higher compensation, each person will consequently fight to keep every dollar as their own. Eventually an inflection point will occur. An advisor will no longer have time to bring in new clients, and this precious business development skill is left unutilized. Or, they will choose to keep bringing in new business, but their clients will receive less and less attention. In this scenario, an advisor may be strongly incented to carve out "their own" business and simply take it away.

3. *"The Key to an Effective Incentive Plan," May 15, 2018, Forbes.*
4. *"How Incentive Pay Affects Employee Engagement, Satisfaction, and Trust," March 15, 2017, Harvard Business Review.*

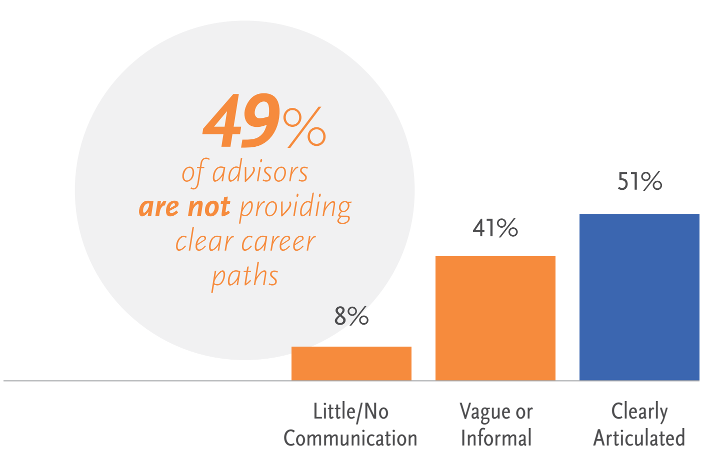
To break out of this predicament, most firms would benefit from crumpling up their revenue-based plans. They should start with a fresh sheet of paper and begin with the core goals of the company. From there, it's important to assess how the responsibilities of a given role contribute to success. Weed through the tens of activities related to each job and prioritize the critical elements. For example, for a client service associate, metrics and factors might include NPS score from all client survey responses, 360-review feedback from peers, and extra initiative like training or mentoring another team member or implementing a service enhancement. These components should become the short list of criteria that drive bonuses – and should be calibrated appropriately. Ultimately, the plan and communication of the plan should reinforce the firm's mission, vision, values, and strategy.

Companies with well-designed incentive compensation plans benefit from desired behaviors driving results, as well as deeper commitment and trust from employees. The halo for long-term loyalty is that employees feel fairly recognized and rewarded.

Career Paths: Charting the Future Success of Employees

A clearly articulated career path can help team members see opportunities to grow within a firm and take tangible action steps to increase their contribution. However, about half (49%) of firms in the survey have not mapped out career paths for advisors or other employees. And nearly 10% say that there is essentially zero communication on the topic.

How would you describe career pathing for advisors at your firm?



Employees across all industries expect and deserve career development. Numerous studies show the power of career paths. Employees are more engaged, ambitious and have more positive feelings about their employer when they see the path forward and what it takes to grow into each successive level. Companies that don't illustrate clear career paths are risking attrition – potentially from some of their best employees who want to learn, grow and evolve. If they don't see the potential at their current firm, they will find another company that can offer a true career development experience. And the most talented of them might just start their own firm.

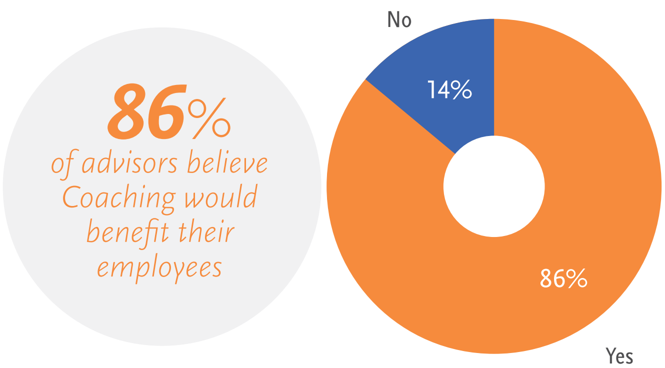
It's important for leaders and employees alike to remember that personal and career development comes in many forms – and that high-performing team members can grow "across" as well as "up" the proverbial ladder. The options are best highlighted in manager, mentor or coach discussions. The investment of time in the *right* people will be returned in spades.

Coaching: An Important Part of Career Development

Working with a "coach" to improve performance is not a new concept. Whether informal or formal, external or internal, coaching is one of the most efficient paths to accelerate success. For RIAs, the process of working in a purposeful coaching process is the best way for those being coached to gain exceptional value from the structured and layered components of performance development, incentive compensation and career pathing.

The good news is that advisors see the power of coaching: 86% of respondents to our survey stated that coaching is valuable for the company and employees. "Just as elite athletes hire coaches to take their game to the next level, today's top RIA leaders understand that an experienced, trusted partner can accelerate the achievement of their goals," DeVoe said. Whether it's an external coach or senior leaders coaching next-gen advisors, these engagements can make all the difference in current and future success for everyone involved.

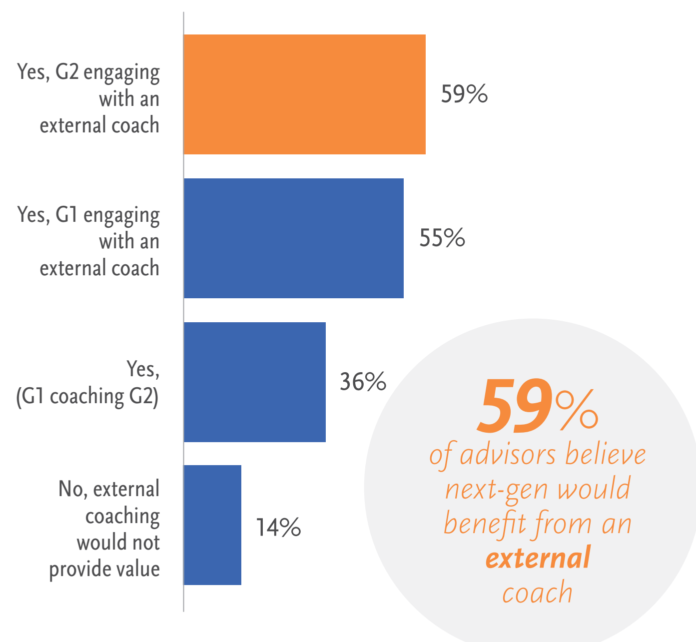
Would the company benefit from formal coaching?



More than half of respondents (55%) acknowledged the value of coaching for G1. Most advisors believe that RIA founders and current leaders who work with an outside coach will run a better company. Leaders need to invest in themselves. Having a thought partner can yield significant benefits.

Advisors also see the value of coaching G2. Perhaps tied back to the concerns about a transition, advisors have signaled that coaching will help the next gen gain the skills to run the company. All coaching is good, but a greater percentage (59%) indicated that next-gen leaders would benefit from external coaching more than internal guidance (36%).

Would the company benefit from formal coaching?



"Whether informal or formal, external or internal, coaching is one of the most efficient paths to accelerate success."

Coaching Accelerates Success

As the saying goes, "it's lonely at the top". As a leader of an RIA, you may not have a lot of people to turn to for advice – at least not people who truly understand what it takes to run a successful RIA.

Imagine having regular meetings with the former head of an RIA that is many times the size of yours. You'd have the ability to work through challenges and opportunities with someone who has sat in your chair and guided an organization like yours to great success.

DeVoe & Company is bringing its team of six former heads of $1B+ RIAs and two consultants trained the 'McKinsey way' – to help leaders like you accelerate your success. With one of our coaches at your side, you can benefit from the rich experience of someone who *has already conquered challenges that you face*.

Become the Leader Your Firm Needs

We have carefully designed two programs to help leaders and future leaders develop their skills and run better firms. The DeVoe Masters Program is a one-on-one engagement model with a former RIA leader. Bi-weekly meetings provide ongoing advice from an experienced leader who knows you and your firm well.

The **DeVoe Accelerators** are multi-faceted, six to 12-month programs focused on taking a specific function or area to the next level. With a group of peers, you will leverage tools, webinars, coaching, and virtual and in-person meetings to help tackle critical initiatives like *Harnessing Your Human Capital or Optimizing the Value of Your Firm*.

Learn More

Visit our website to find out how the **DeVoe Coaching Platform** can accelerate your firm's success.

Conclusion

At their core, RIA firms are businesses of people serving people. And few industries serve people as well as RIAs do. Firm founders and management have invested heavily – both technically and emotionally – to achieve the world-class level of service that they provide their clients.

It is time for advisors to invest as much energy in their staff as they do their clients. It is time for advisors to use their passion and technical skills to craft *human capital models* that are as powerful as their *client service models*. Advisors have demonstrated for decades that they excel taking care of people – their clients. This attribute is a foundational cornerstone to putting the optimal human capital structures in place.

If you're not sure where you stand with your people initiatives, review this list for getting started on driving a top-notch human capital strategy:

- Ensure your team members are receiving formal performance feedback, at least quarterly
- Review your incentive compensation plan: Is it intelligently designed and in alignment with the key business objectives by role?
- Share clearly articulated career paths with your team
- Establish a formal coaching program, which may include internal or external coaches
- Provide clear and transparent information about future transition plans

Don't delay. If you can't work on all of these, pick one area and start there. Your employees truly depend on your firm's focus on human capital planning. Client satisfaction and retention depend on it too.

Taking these steps will help your RIA get on a path to future success. You will foster your team to reach new heights and your RIA to achieve a new level of success. As an unintended consequence, you will likely find that providing greater care to your *employees* ultimately enables you to provide even better service to your clients.

Methodology

The DeVoe RIA Next Gen Transitions Survey was designed to understand the current status and perspectives about human capital planning within the industry. DeVoe & Company surveyed 118 RIAs between November 2019 and January 2020. Respondents were senior executives, principals, or owners of firms ranging in size from $100 million to over $5 billion in assets under management.

About DeVoe & Company:

DeVoe & Company is a goal-based consulting firm and investment bank focused exclusively on guiding wealth management and investment management companies to a higher level of success. We provide consulting, M&A, and valuation services to help you accelerate the achievement of your business goals. Leveraging our team's 300 years of combined experience in RIA business consulting and management, we develop solutions tailored to your unique goals, needs and situation.

The wealth and investment management industries are highly dynamic and evolving at a fast pace. DeVoe & Company can help you better understand your options, determine your optimal path, and craft an implementable plan for you to capitalize on the opportunities.

What We Do

Our mission is to help you achieve success on an accelerated basis. Our services fall into three broad categories:

Business Consulting

Investment Banking

Valuations

Engaging DeVoe & Company

For more information or to engage our services call us at 415.813.5066 or send an email to info@devoeandcompany.com.

Follow us on Twitter
@DavidDeVoe1 and @Devoeco