# Super-Ensembles: The Firms Who Are Shaping the Future of the Industry

Pershing Advisor Solutions®

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# Contents



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THE ENSEMBLE PRACTICE

# In Brief—What You Need to Know in 30 Seconds

- ✓ There are roughly 250 super-ensemble firms in the industry. Super-ensembles not only have over $1 billion in assets but are establishing a brand, are seeking to dominate their local markets, are managed by dedicated management, have a sophisticated client value proposition, and are growing aggressively, among other attributes.

- ✓ Super-ensembles are setting the standard and defining the competitive marketplace. They are the fiercest competitors among RIAs and will likely be the ultimate "consolidators" in the industry.

- ✓ Super-ensembles have the highest pre-tax income per owner ($1,448,512) and revenue growth (18.6%) across firm-size categories, as well as the highest revenue ($16,348) and AUM ($2,584,808) per active client across firm-size categories.

- ✓ Super-ensembles are deliberate in their growth and more likely to use business development goals and incentivize new business than their smaller peers. 80% have a defined target for non-owner lead advisors.

- ✓ Super-ensembles differ in that they have a "firm-first" mentality and consider themselves to be more like "corporate" organizations than traditional partnerships. They have dedicated management who are able to be decisive in action.

- ✓ In order to grow beyond the $1 billion mark, firms must do the following: define a vision that unifies the partner group, institutionalize business development, establish a sustainable ownership structure, develop a practical corporate governance system, find a way to add "lateral partners," and learn how to grow into new markets.

- ✓ For firms that desire to become a super-ensemble there are steps they can take to achieve that goal: implement the management methods of a super-ensemble, attract talent with experience working in larger organizations who can impart knowledge, develop the right culture, prioritize growth, and consider mergers or acquisitions as means of growth.

# Executive Summary

A group of 250 advisory firms is shaping the future of the industry and setting the standard for pace of growth, productivity, client service and best practices for career tracks and succession. These "super-ensemble" firms are highly regarded by their peers and seen as an example to follow. They are the employers of choice for talented people joining the industry. Increasingly, they are becoming a well-known brand that clients recognize. Some are expanding in multiple markets and creating national presence. All are successful and powerful competitors that every advisor needs to be aware of.

Super-ensembles are firms from which every business owner can learn, and their business practices are quickly becoming the standard to follow for the rest of the industry. This is why we believe it is important to study and understand super-ensembles—who they are, where they came from and where they are going. This paper will examine these questions and find answers that can help firms of every size learn from the largest firms in the industry and define their strategy for competing against them.

Super-ensembles are the most effective consolidators. As fellow practitioners, they were a much better cultural and practical fit than any other entity. Super-ensembles have also turned themselves into formidable competitors. They challenge their fellow RIAs in a way the wirehouses never could—on their own field with the same advantage of independence.

A key advantage of being a super-ensemble is the ability to attract top clients. The results of the Pershing LLC-sponsored 2014 *InvestmentNews Financial Performance Study* support that effect.[1] Clearly, the largest firms in the industry attract top clients. Super-ensemble firms have average assets under management (AUM) per client of $2,584,000 compared to the $1,000,000 average for the industry.

The *InvestmentNews* studies sponsored by Pershing are conducted every year and alternate between measuring financial performance (the 2014 edition) and compensation (the 2013 edition). The surveys are the longest running in the financial advisory industry and are considered the most authoritative source of management data.

Super-ensembles outperform the industry in terms of both profitability and growth. On average, the typical super-ensemble had $1,450,000 pre-tax income per partner and grew revenue by 18.6% in 2014, outperforming smaller firms. In addition to their strong organic growth, super-ensembles are hungry to grow through acquisitions and mergers. Thirty-seven percent of super-ensembles are actively searching for acquisitions, and 6.3% are interested in a merger with a similarly-sized firm.

To grow to $1 billion in assets under management, super-ensembles establish a corporate governance structure that allows them to be decisive in their actions, methodical and disciplined in their execution and inclusive in their decision-making. Their management structure relies on dedicated management and leadership training.

Finally, super-ensembles are in the process of transitioning their leadership from their founders to a new generation of capable leaders. They train and develop that next generation with care and patience. Still, the entire industry has yet to be tested on how best to achieve that transition. While the ideal structure should not be vulnerable to the efforts and talents of one person and have natural continuity built in, even the billion-dollar firms find themselves vulnerable to the influence of key founders.

[1] Unless otherwise stated, all data is derived from the 2014 *InvestmentNews Financial Performance Study.*

## What Are the Super-Ensembles?

A super-ensemble is defined as a firm with over $1 billion in assets under management (AUM). In addition to achieving this asset level, which is somewhat arbitrary, super-ensembles are further defined as firms who:

- Are establishing a brand
- Are seeking to dominate their local markets
- Have a sophisticated client value proposition
- Have a complex organizational structure that allows for leverage
- Are governed and managed by dedicated management
- Have the budgets and other resources to invest in technology and operations
- Are growing aggressively, perhaps acquiring and expanding in other markets
- Are planning to be part of the marketplace and the industry for many years to come

Based on this definition, there are as many as 250 super-ensembles in the industry today. A list of RIAs compiled by *InvestmentNews* magazine contained 202 firms over $1 billion as of January 1, 2014. Fifteen additional firms had over $900 million and, therefore, could conceivably be over $1 billion by the time you read this paper.

It is notable that many of the top RIA lists exclude firms who have a broker-dealer affiliation or own a broker-dealer, thus omitting important members of the super-ensemble club. Such "hybrid" firms include prominent entries such as Edelman Financial, HighTower, United Capital, Plante Moran and Moss Adams. If hybrid firms were included in the listing, there would be approximately 250 super-ensembles across the country.

## Why Are Super-Ensembles Important?

Every firm has to account for the presence of the super-ensembles in the market. They are setting the standard in many important management categories and defining the competitive marketplace.

Super-ensembles matter to every size of firm because they:

- Are the fiercest competitors RIAs will face in the future
- Will likely be the ultimate "consolidators" of the industry
- Set the standard for compensation and career tracks for professionals
- Establish the benchmarks for productivity and profitability
- May be your future merger partner

Historically, RIA firms have existed in a collaborative community without much sense of competition between them. However, the consolidation of the industry, combined with a diminishing number of clients who do not have an advisor already, is leading to intensified competition. In such an environment, super-ensembles are the competitors who demand attention.

## Capable Competitors

Super-ensembles have turned themselves into formidable competitors. They have a strong brand supported by large marketing budgets that extend to multiple markets. If you haven't noticed them, look around. They are advertising on the cover of magazines, sponsoring large charity events and appearing in print and television. They are publishing books and conducting research targeted at top clients.

Super-ensembles have a very compelling value proposition: they have large and sophisticated teams that extend beyond the partner, offering valuable capabilities such as tax expertise and access to better resources including trust solutions or custom investment solutions.

## Super-Ensemble Consolidation

If we look at the accounting industry as an example, the winners of the consolidation process were not private equity firms, but rather the largest accounting firms. KPMG, PWC, Moss Adams and others grew to international or regional dominance by merging with other smaller firms. As fellow practitioners, they were a much better cultural and practical fit than any other entity.

In the financial industry, super-ensemble RIAs are quietly doing the same through mergers of individual partners and sometimes entire firms. The mergers are usually targeted to provide a foothold into a local market. The merged firm serves as the starting point for expansion into a different geographical location. It provides local presence and a known brand, as well as leadership for the local office. Typically, that existing presence is quickly supplemented by additional client services, backed by an aggressive campaign targeting top clients in the market and advertising the additional services and depth brought by the super-ensemble. Usually, the top partners from the large firm will start visiting the local office and attending marketing meetings with the local partners. Frequently, the firm may even relocate young, ambitious partner-candidates to help build market share quickly.

Unlike consolidators—who usually acquire a stake in the firm, pay a substantial amount of capital and then become a passive investor—super-ensembles tend to merge firms into their operations and are very active and involved in how the firm is managed. Their goal is to expand the local firm and help it reach clients it could not get to before. Their appeal is in the tremendous value of the equity they offer and the ability to quickly increase the income of the local partner. They are not financial wizards and deal-makers with fancy spreadsheets. Rather, they are fellow advisors who still work with clients and who have the same culture and mentality as the local partner. In other words, they have a strong appeal to the partners who are not looking to cash out immediately. Finally, super-ensembles have a cadre of young and ambitious professionals who can serve as the retirement exit for the local partner.

Some super-ensembles may already be under institutional ownership, such as a CPA firm or a trust company, but they are not part of a consolidation effort. Rather, they are a consolidator themselves. At some point, every super-ensemble must determine if it wants to be a target or an acquirer.

## Setting the Standard for Compensation

The advisory industry is growing, and the demand for experienced professionals is high. Super-ensembles are powerful competitors in the market for talented staff. Their size provides more security for career development and more diverse careers. As larger firms, they tend to have better compensation in terms of cash and perhaps better training programs. What is more, the compensation practice of the top firms has become a standard for all other firms in the industry to follow.

The impact of super-ensembles is especially visible in the careers and compensation of lead advisors. Following the market logic, as demand increases, so does the compensation for lead advisors. On average, super-ensembles pay a premium of 25% over the average firm for the advisor position, according to data from the 2013 *InvestmentNews/Moss Adams Adviser Compensation and Staffing Study (*2013 *InvestmentNews Study)* sponsored by Pershing LLC. The result is an advantage in retaining the best professionals.

Moving up the career ladder, super-ensembles offer a more defined and structured process through which a professional can become an owner. As advisory firms grow larger, they expand the ownership of the firm to include key employees. The pace of "partner admission" is rapid, and most of the large super-ensembles are aggressively adding partners (owners). According to the 2013 *InvestmentNews Study,* 42% of surveyed super-ensembles have added another owner in the last five years.

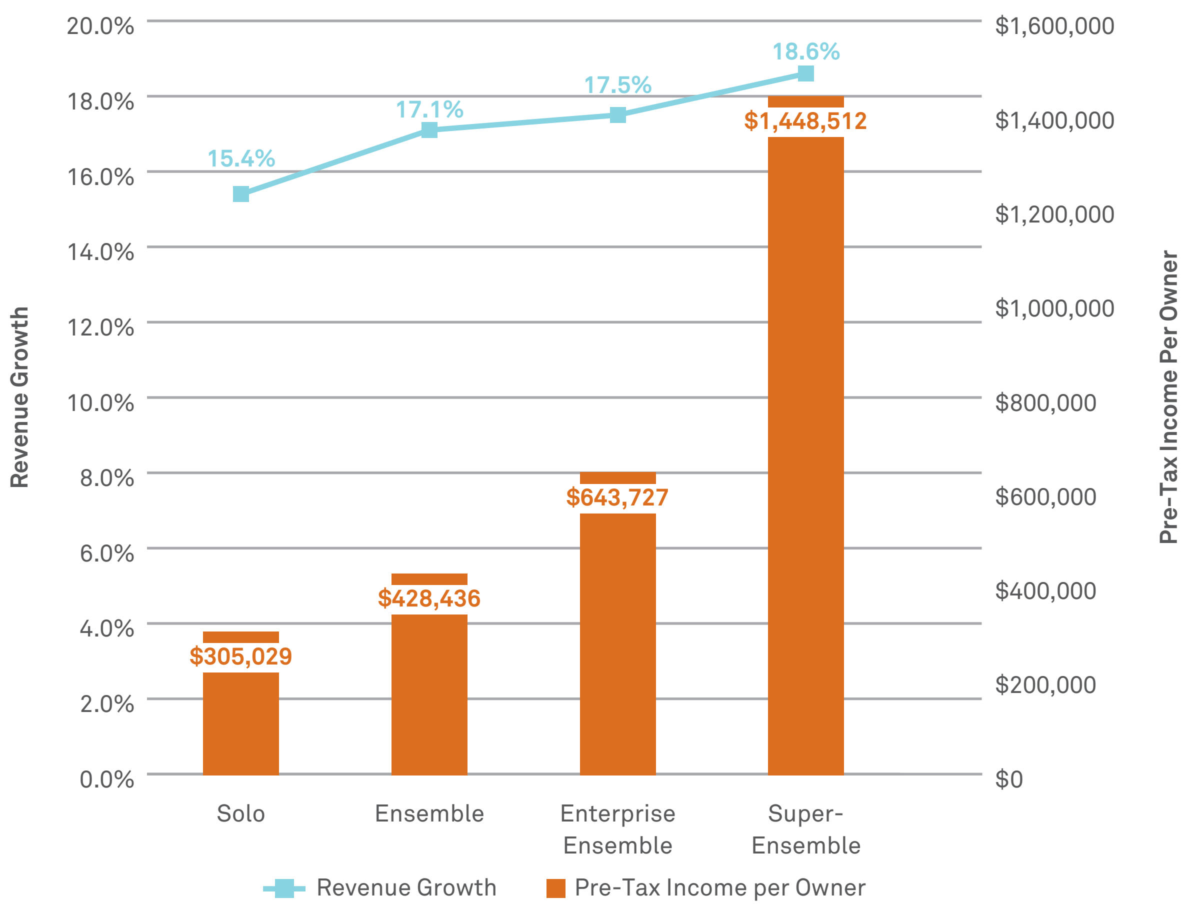
# The Results of Super-Ensembles

The financial results of super-ensembles show the advantage of attracting top clients and top talent. Super-ensembles create outstanding income for their owners and generate faster growth than any other type of firm. These results are clearly seen in the data from the 2014 *InvestmentNews Survey.*

## Owner Income and Revenue Growth

On average, the typical super-ensemble had $1,450,000 in owner income in 2014 compared to $640,000 for enterprise-ensembles (firms with AUM between $500 million and $1 billion), $430,000 for ensembles (multi-professional firms with AUM under $500 million) and $305,000 for solo firms (one-advisor practices). Super-ensembles were also the fastest growing firms with 18.6% growth, followed by enterprise firms with 17.5% growth and ensembles with 17.1% growth. Small firms grew the slowest with an average growth rate of 15.4%. As shown in **Figure 1,** larger firms enjoy a high level of profitability and income.

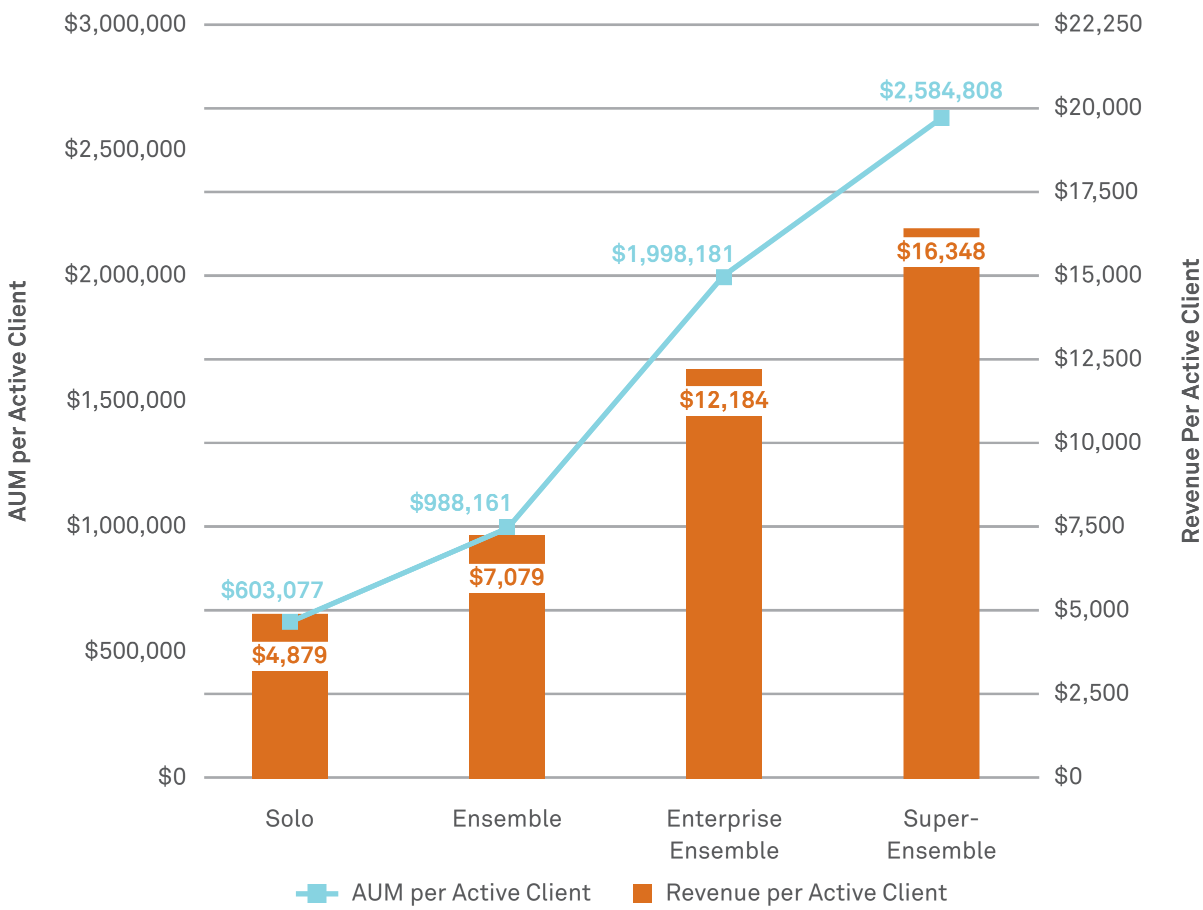
Figure 1: Pre-Tax Income per Owner and Revenue Growth across Firm-Size Categories



## Attracting Top Clients

Another key advantage of being a super-ensemble is having the ability to attract top clients. The results of the study clearly demonstrate this effect. The size of the average client relationship appears to be a perfect function of the size of the firm, i.e., the larger the firm, the larger the average relationship. As shown in **Figure 2**, super-ensembles enjoy the largest client relationships.

Figure 2: Revenue and AUM per Active Client across Firm-Size Categories




Super-ensembles have clients with revenues between $12,184 and $16,348 on average, as shown above. What are the possible sources behind this relationship?

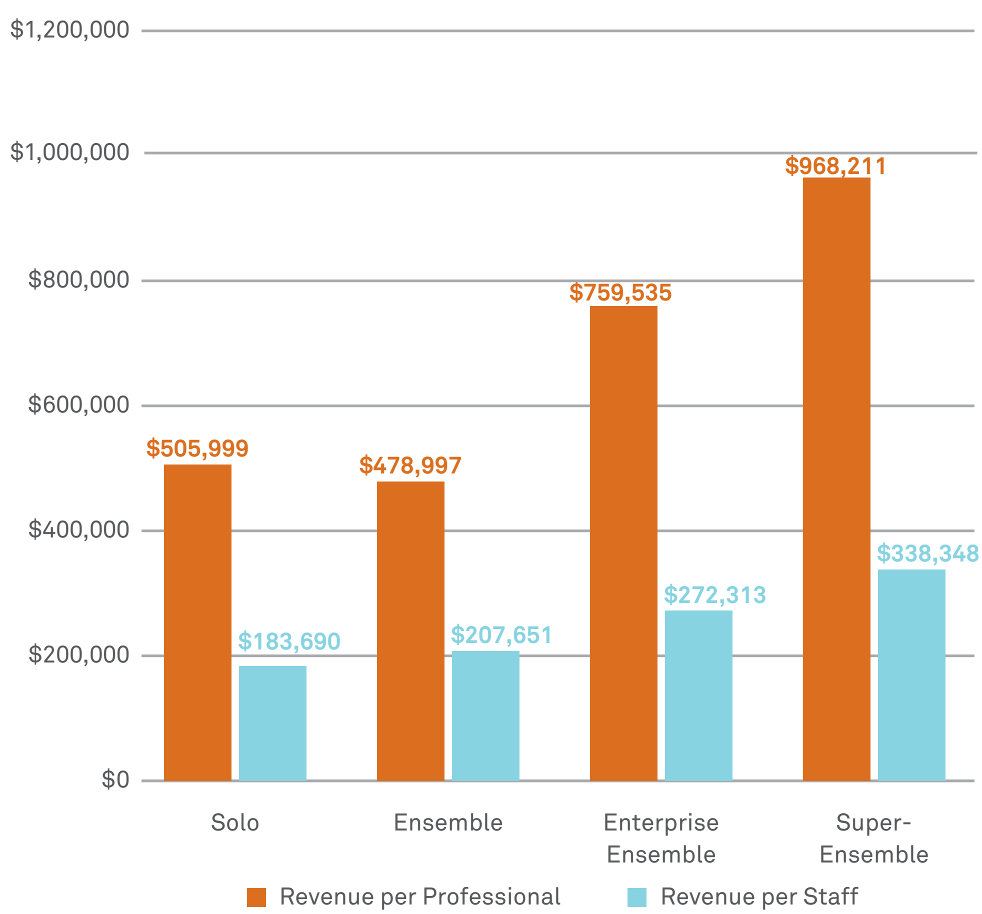
- The power of the brand: The wine list of a good steakhouse will have several hundred wineries on it, but any sommelier will tell you that clients tend to buy mostly the same 10 or so Napa cabernets. Such is the power of having a brand and the resources to create one.
- Another hypothesis is that firms are large because they are able to attract bigger, better and more profitable clients. In other words, the larger client relationships are the cause and not the result of size. There is certainly strong logic behind this hypothesis.
- The other possibility is that the larger the firm, the more likely it is to attract larger client relationships. Perhaps wealthier clients prefer to work with larger, more prestigious firms, while top referral sources prefer to make referrals to larger firms. There is anecdotal evidence in our consulting experience that this is the case—top CPA firms and attorneys prefer to refer to the top wealth management firms.
- Finally, perhaps client relationships grow parallel to the growth of the firm. In other words, as a firm matures, the careers and wealth of its clients grow as well.

## Productivity

The advantage in client size creates an additional advantage in productivity, as can be seen in **Figure 3**. Super-ensembles have a revenue per staff of over $338,348. Note, however, that as the productivity of staff grows with the size of the firm, it also starts to flatten out. This suggests that the revenue per staff reaches a plateau even after a firm grows and becomes a super-ensemble.

On the other hand, the revenue per professional continues to grow as firms become larger. For example, super-ensembles have revenue per professional of above $968,211 compared to revenue per professional of over $759,535 for enterprise-ensembles and $478,997 for ensembles.

Figure 3: Productivity across Firm-Size Categories




The combination of continuously growing revenue per professional and converging revenue per staff implies that larger firms use leverage. This means that these firms surround their professionals with more support staff, thus enabling their continued increase in productivity. An apt analogy would be the relationship between doctors and nurses. The addition of nurses to a practice allows doctors to be more productive.

# How Are Super-Ensembles Created?

Super-ensembles are firms with tradition, but many are also forged today. While the majority of super-ensemble firms were started in the late 1980s and early 1990s, there are also many examples of super-ensembles who are being created today as the result of mergers, successful transitions to independence by wirehouse teams and strategic "tuck-ins"—the additions of experienced partners who have their own practices.

The long, historical success of super-ensembles confirms their ability to prosper through many years. The correlation of a long history and firm size proves that large firms possess the legacy of an entrepreneurial start-up. Their growth story includes utilizing mergers, strategic partners, aggressive marketing and steady organic growth over many years to become super-ensembles.

## Growth Trajectory

In their first decade of existence, super-ensembles set the foundation for growth. Consistent with the typical firm structure of the time, many of the firms began as small partnerships of two or three founders who often maintained their own practices. This structure of separate practices under the same roof is also called a "silo" structure. The founders managed their own clients. In order to build a human capital structure around the founders, the firm needed to generate enough revenue to afford the cost of support labor. To reach this level, firms continued maximizing their own productivity and some looked to mergers and tuck-ins as a way to expand capital resources. Tuck-ins were a merger of an advisor with a book of business into the firm and likely the ownership group.

Toward the end of their first decade, many super-ensembles had the need and the money to begin adding advisors to the staff, in addition to the back-office personnel. The addition of staff advisors began the move away from silo practices into an ensemble firm. The organizational establishment of super-ensembles during the first decade positioned them well for the favorable growth opportunities the industry has mostly enjoyed over the most recent 10 years.

Figure 4: Growth of a $1 Billion Firm Over the Last 10 Years

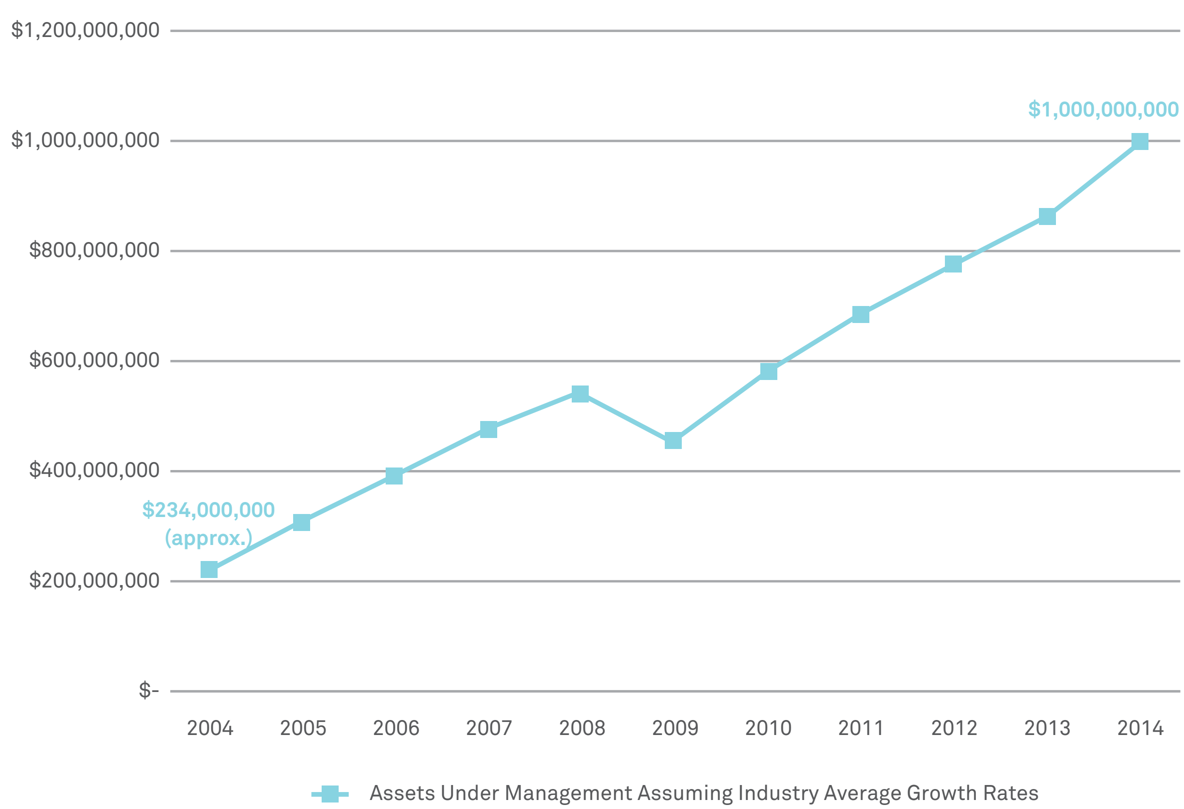


**Figure 4** demonstrates the growth of a $1 billion firm today if assets grew equal to the industry average growth rate for each of the 10 years. Based on the growth rates, a $1 billion firm may have only had under $250 million 10 years ago. This makes an assumption that the firm was able to grow the organization to handle the increased capacity demands and keep up with the industry growth trend. The practical implications of this growth cast a difficult path. Over the 10 years, a firm would double in size twice—from near $250 million to $500 million and from $500 million to $1 billion. The human capital in the firm would also have to increase, although not necessarily at the same rate. Firms that prepared a culture of business development and continued to hire and leverage their people were able to absorb more of the industry-wide growth and develop into super-ensembles.

## Creation Through Organic Growth

The primary method of growth of a super-ensemble is through organic growth—the addition of new clients through business development. Other means of growth that we list complement organic growth. The firm's ability to generate new assets through their own efforts produces a high return on investment to the owners and a culture of self-sufficiency. Firms that were prepared to capture the strong industry growth over the last 10 years took advantage of favorable conditions to become super-ensembles.

Two super-ensembles demonstrate the success of applying discipline to organic growth: Balasa Dinverno Foltz in Chicago and Dowling & Yahnke in San Diego.

Balasa Dinverno Foltz (BDF) has developed a strong culture of business development. The leaders of the company coach and emphasize growth with each advisor they hire. This includes developing individual marketing plans, business developing training and developing niche market specialization.

Dowling & Yahnke (D&Y) emphasizes hiring top talent as a way of creating great client service and also fueling growth. The firm is staffed with very qualified and credentialed advisors. The advisors come from top academic programs and many have completed multiple qualifications, such as obtaining an MBA and CFA in addition to a CFP®.

## Creation Through Merger

A super-ensemble can also be created through the merger of two firms. This strategy relies on the success of the leadership to highlight the combined strengths and align the distinct cultures of the two firms into one cohesive entity. The actual merger should not be viewed as the path to a larger size, because it is the management of the new combined firm afterward that determines the sustained size and success of the firm. In addition to size, a merger can be used to increase the number of equity owners and ease founder succession, add leadership and specialized skill, and reach new markets.

Private Ocean in the San Francisco Bay Area was created in 2009 from the combination of Friedman & Associates and Salient Wealth Management. Both of the originating firms started more than 20 years ago and were well-established advisories. Private Ocean was emerged from the merger as a super-ensemble poised to grow. The new name signified a new legacy and culture for the combined firm. The result was a firm with a strong identity and a great team that looks to continue growing.

A merger was the process behind the creation of one of the best-known and largest firms in the industry–Aspiriant. The firm was the result of the merger between Los Angeles-based Quintile and San Francisco-based Kochis Fitz. The combination of two very successful firms and two highly talented teams created a powerful competitor in the national marketplace with great talent, culture and ambition.

## Creation Through a Strategic Partner

A strategic partner can produce a captive network of clients and referrals that the advisory can attract and service. The strategic partner is typically an institution with an existing client base, such as banks, law firms and accounting firms. The proximity of the institution to the clients' wealth and the personal relationship places them in a good position to refer quality leads to the advisory. The dynamics of the referral is based on the institution directing the lead to the advisory. This means that the institution is endorsing the relationship. In some strategic partnerships, advisories reciprocate a business development incentive to the partner. Compliance and ethics regulations will determine if the reciprocating incentive is allowable.

Moss Adams Wealth Advisors (MAWA) began as a stand-alone advisory firm by the name of Financial Security Group (FSG) before being acquired by Moss Adams in a strategic move. Moss Adams is the 14th largest accounting firm in the US and purchased the advisory firm in 2000 to offer wealth management to its premier accounting client base. MAWA today stands as one of the top firms in the advisory industry but also as an integrated part of the services offered by one of the top accounting firms in the country.

## Creation Through Aggressive Marketing

A final means of creating a super-ensemble is through aggressive marketing. Essentially, the firm attempts to establish a volume of prospects that the staff advisors can capitalize upon. The strategy requires the firm to use various media and formats to interest potential clients into contacting a firm representative. This aggressive marketing approach differentiates from the typical advisory approach because it casts a broad net to the mass market versus developing a deep foothold in specific markets. Two contemporary examples of aggressive marketers are United Capital and Edelman Financial Services.

United markets to the general public through multiple mediums, including a series of seminars, 401(k) events, direct mail and a referral network. The firm claims to have 12,000 active leads being "nurtured." As an example of the strategy, the 140 marketing campaigns run by United are said to have generated $4.3 million in incremental revenue in 2013.[2]

Edelman is one of the fastest growing independent firms on the strength of an aggressive multifaceted media strategy. The firm uses radio shows and television appearances of the founder, Ric Edelman, combined with a relentless marketing campaign inclusive of 600 nationwide seminars and direct call campaigns. Each year, Edelman is said to bring 4,500 new clients to the firm.[3]

[2] joinuc.com/growing.

[3] riabiz.com/a/6078222886240256/how-ric-edelman-manages-to-bring-on-4500-new-clients-each-year-by-force-of-personality-while-diminishing-key-man-risk-at-the-same-time.

# Where Are Super-Ensembles Headed?

The last five years have seen outstanding growth throughout the industry, and super-ensembles took full advantage of this opportunity. On average, super-ensembles recorded 24.2% growth in AUM and 18.6% growth in revenue based on the 2014 *InvestmentNews Study.* This pace of growth implies that even at their impressive size, super-ensembles will double in assets every four years. Growth is not only the outcome of good markets and strong contributions, but it is also a key part of the strategic intentions of super-ensembles.

Super-ensembles achieved 12.9% growth in AUM from new clients, 12.4% from market performance and 4.4% from contributions from existing clients. In addition, top super-ensembles lost only 1.8% of AUM to clients who departed the firm and 3.6% to distributions of AUM.

## Business Development Drivers

The study shows that the acquisition of new clients is faster for top firms. The data in the survey allows us to examine how the top firms drive that growth.

Super-ensembles are deliberate in their growth and are more likely to use business development goals and incentivize new business than their smaller peers. More than 17% of super-ensembles have a defined business development target for partners, and 80% have a defined target for non-owner lead advisors. For those firms, the target is $10 million in new AUM for the practicing partners and $8.8 million in AUM for the lead advisors. In contrast, only 29% of all other ensembles have a business development target for partners, and just 43% have a target for lead advisors. It seems that these firms rely more on a "best efforts" approach.

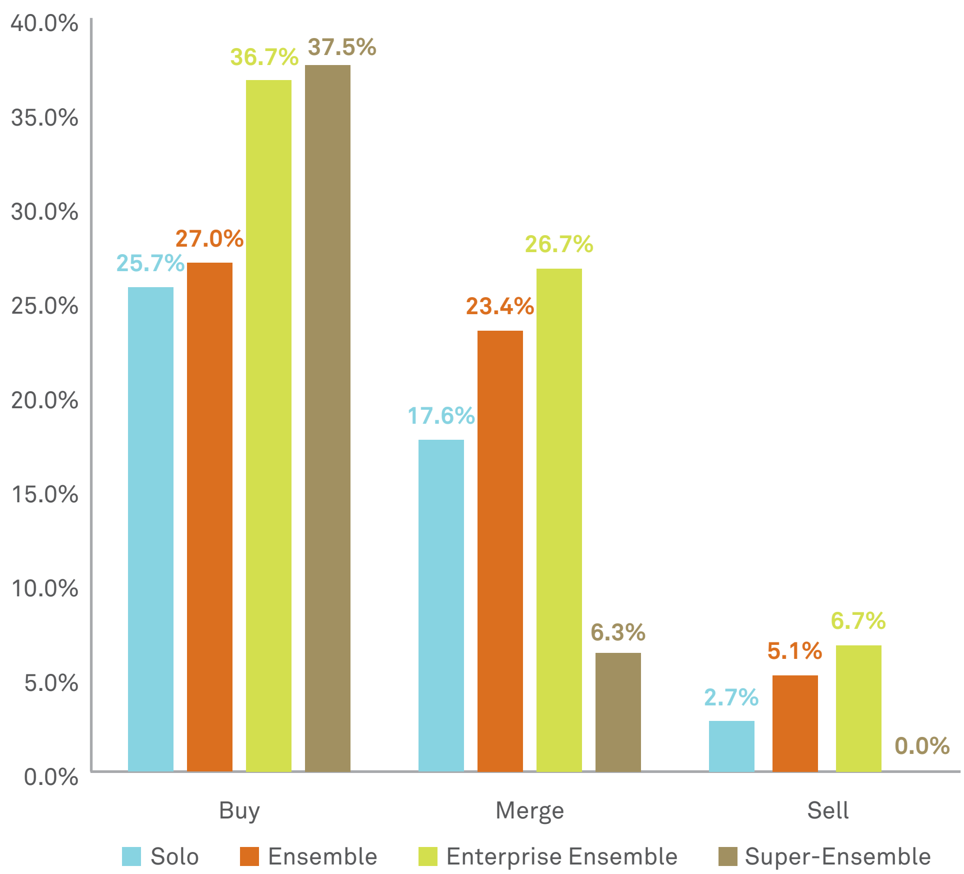
The establishment of a target for business development creates discipline and is more likely to produce results than simply stating a goal. Moreover, the presence of a target allows the firm to measure results and to create incentive compensation tied to business development.

## Mergers and Acquisitions

As rapidly as super-ensembles are growing organically, their desire to grow even faster has them turning increasingly to non-organic sources of growth, such as mergers and acquisitions.

As shown in **Figure 5**, 37.5% percent of super-ensembles are actively searching for acquisitions and 6.3% are interested in a merger with a similarly-sized firm. Note that no super-ensemble considers itself interested in selling the firm. However, the results of consolidation are already apparent at the largest size, too. As many as 13% of super-ensembles are owned by a third party (a network firm or an institution).

Figure 5: Consolidation Trends




The outstanding results of the super-ensembles are a function of market positioning, reputation and resources, but they could not have been achieved without a cohesive group of owners (partners) and great leadership. Finding the right balance between the engagement provided by a partnership and the decisiveness of the executive business model is key for super-ensembles.

# Super-Ensemble Partnerships

While the majority of super-ensembles are majority-owned by a group of professionals (87% according to the *InvestmentNews Study*), most consider themselves to be "corporate" organizations rather than traditional partnerships. Super-ensembles tend to focus on having dedicated management rather than partner meetings. That being said, the first step that enables super-ensembles to exist is the "firm-first" mentality.

## Firm-First Culture

Many of the lasting structures in human society are grounded in the "leap of faith" that if we submit our selfish interest to the greater goal of the "group," we will ultimately achieve an outcome that is more satisfying and perhaps more prosperous for ourselves. Concepts such as family, community and nationhood all draw on the fundamental premise that we should subject ourselves to something bigger, and by doing so, we will be happier and richer. A partnership is this kind of concept.

The culture of putting the firm first enables a shared set of values and communication patterns to develop, with all owners developing a mentality of being a steward of the firm. A good partner has to be able to focus on the bigger goal and act in the best interest of the firm, even when the personal benefit is unclear or during times when the firm will infringe on the partner's selfish interest. Doing so makes the firm durable from within and strong in its cohesion. In return, a partner gets a "promise" from the firm that his or her fundamental rights and values will be respected, protected and promoted. This two-way promise has to be reciprocal to work; in order for the firm to provide longevity of practice, client service and ultimately equity, it has to receive the unconditional promise that each partner will think of the firm first. Otherwise, the firm is nothing but an opportunistic band of individuals who may or may not take the next step together.

This concept is so important because the partners' investments are interconnected, long term and subject to risk. In most partnerships, it is not possible to trace every dollar of contribution or cost back to a partner, nor is it desirable—the contributions are intertwined by design. It is also very difficult to focus on a long-term goal if partners can grab their clients and run away, thereby stripping the firm of resources and endangering the vision. Finally, when the firm is taking on risk and working under competitive and unclear circumstances, partners want to know that their fellow partners are focused on the future, not on where the lifeboats are located. When Hernán Cortés reached the shore of Mexico, he burned his own ships—there was no way out other than achieving the mission.

A partner who cannot think in terms of the best interest of the firm is a bit like an advisor who cannot think of the best interest of the client—perhaps more harmful than helpful. Such partners damage the enthusiasm and spirit of the owner group and create a "rain on every parade" atmosphere. Repeatedly asking "What is in it for me?" is the single most destructive behavior a partner can exhibit because it chips away from the foundation of the common good. A great question to ask when joining a partnership is: "What will I accomplish and achieve here?" However, "How will this profit me?" is a terrible question to ask at every turn. Such partners have to be asked and coached to change or the partnership would be better without them.

Not all partners will immediately be able to think this way. The firm-first mentality is an acquired habit and does not come easily to most advisors. It is particularly difficult to those who are in a partnership for the first time—advisors who merged into the firm or got promoted to partnership. Their entire history may have been one of focusing on their personal bottom line, and this focus may have been very effective in finding success as a solo professional or growing their career. Such new owners will need time to learn to trust their partners and to trust that the firm will achieve more than they can individually. Patience and encouragement are necessary to help new partners. However, patience should not equal indifference, and at some point, the behavior has to change.

This brings us to the discussion of whether every partner needs to be good at everything. While partners do not have to be functionally good at everything, culturally they better be. If every partner sets an example and a precedent, a partner who is deficient in some areas creates a poor example for those who aspire to be partners. The presence of partners who can't manage people will make the implicit statement to others that managing people is not important. The presence of a partner who can't develop new business will do the same.

## Managing the Firm

There are many successful models of corporate governance, and they all work well as long as they are supported by the values of the partner group and accepted by all partners. Some firms have a strong, almost dictatorial leader who forges ahead and has a lot of authority to make decisions. Such a leadership style can be good in times of crisis or rapid change, where decisiveness trumps inclusion. Other firms are very "republican" in style and repeatedly bring all partners to the table for most of the decisions. Such a style can build strong relationships and unity among the partners and leave them feeling empowered. Most firms are somewhere in the middle, and many styles can work as long as there is agreement and acceptance among the owners.

For the management structure of the firm to be effective, the partner group has to carefully consider the lines between ownership and management. Involvement of the owners in management creates excitement and a strong connection between decisions and the client practice. On the other hand, it also consumes time and can substantially slow down decision-making. Dedicated management brings specialization and decisiveness but also poses the danger of partners becoming glorified employees. Whatever the decision, firms should choose a model that reflects their desire for involvement as a firm.

Behavior usually changes in the face of some source of accountability. The accountability can be a higher power: a spouse, a parent, a promise to yourself or an entry in your dear diary. Whatever the source, there has to be a lever fulcrum that pushes the change. In a good partnership, that source of accountability should be the partners and the firm. The right of the firm to tell partners whether they are doing well or not and to ask them to change behavior if necessary is fundamental to building a strong partnership. If there is no mechanism for the firm to check the behavior of a partner, then the concept of partnership quickly deteriorates to a state of anarchy of accommodations.

Most firms have a tendency to look for a formula that rewards or punishes partners for "doing the right thing." However, formulas rarely reflect important factors such as developing staff, contributing to the strategy of the firm, participating in management or developing intellectual capital. Formulas are mechanical and frequently backfire, resulting in a variety of unintended consequences. Most of all, they turn partners into the equivalent of street musicians who only play when you give them a dollar.

Compensation plays its role, but the system of accountability comes first from the firm—represented by its partners—taking the time to tell every partner how they are doing and what they should focus on. Such a process should be regular, much like performance evaluations. If a firm can force itself to have the difficult conversations, it will only make the partnership healthier. Interestingly, partners who receive some criticism are very often thankful for it: they already knew about the issue and feel relief when it is brought to daylight and discussed openly.

## The Importance of Dedicated Management

To grow to $1 billion, a firm needs to establish a corporate governance structure that allows it to be decisive in action, methodical and disciplined in execution and inclusive in decision-making. The ideal structure should rely on the office and a defined process, while remaining somewhat independent of the people who occupy the office and participate in the process. The structure should also have natural continuity built in by not relying on the efforts and talents of one person.

To achieve such a structure, super-ensembles need to establish several key governance structures:

- **The CEO:** No ship can function without a captain, and super-ensembles are led by CEOs with broad authority to manage the firm.
- **The COO:** Most super-ensembles already have a chief operating officer, and this is one position that is most often hired from the outside (as opposed to internal promotions). The result is better operations and a more productive firm. The next step for super-ensembles is to elevate the role of the COO from simply managing the back office to being the second or third in command in the firm, managing the overall infrastructure the firm needs to pursue its strategy.
- **Executive Term Limits:** A key concept in this discussion is the notion that authority comes from an office and is "bestowed" to the person in that office. Nothing reinforces the power of the office over the power of the person more than the notion of term limits. A CEO should not be a CEO for life, and the same is true for other executive positions. The terms are most often implemented for the executive committee, but over time they should also be applied to other positions, including the CEO.

Firms that are part of a larger structure and have institutional ownership understand this concept better. The presence of the institutional owner creates a more functional board of directors (since that's often how the institutional owners exercise their control and rights) and a more disciplined governance process. The ideal super-ensemble will have a corporate governance structure that resembles institutional ownership, even if all owners are practicing partners in the firm.

Practically every super-ensemble has a CEO. The CEO is the key to executing the firm's vision and to having a functional leadership. Simply stated, leadership means making difficult decisions with the long-term strategy of the firm in mind. The difficulty of those decisions favors the emergence of a single leader and is the reason why larger firms are gradually converting their governance model from a partnership to a more corporate structure. In fact, the lack of effective leadership may be the root cause behind large firms getting stuck and being unable to reach super-ensemble size.

Leadership by definition is goal oriented. A firm needs a leader only in the presence of a vision and the determination to pursue that vision (strategic plan). Leaders emerge in the context of the goal to be pursued, and a good leader is defined by the goal rather than in absolute. Note that the CEO does not have to necessarily define the vision. Sometimes the vision emerges as the product of the collective ambition of a broad partner group. In fact, ideally, the vision of the firm is developed and shared by all owners and other stakeholders. The vision should be democratic, but the implementation should be decisive.

A CEO is the leader of a firm who has been tasked with executing the strategic plan. To be decisive, a CEO needs to be empowered to make decisions and given the resources to implement those decisions. Both are necessary for the leadership model to function, and in the absence of one, the advantages of the CEO leadership model can quickly turn into dysfunctions. Time and again, we see struggling CEOs who simply can't do their jobs because they have no authority to act. For example, requiring the CEO to seek the consensus of all owners before hiring an operations person not only makes the decision-making cumbersome, but actually defies the purpose of having a CEO.

The ability to identify and develop future leaders is critical for the continued success of any firm. This generation of CEOs will likely retire in the next five to 10 years, and the task of identifying future leaders may be even more pressing than the development of advisors who can handle relationships and business development. In fact, our experience shows that while larger firms have done a good job of training the next generation of advisors, they are missing the next generation of leaders.

## Beyond the CEO

A CEO cannot work in isolation or lose connection with the owners of the firm and other stakeholders (e.g., advisors, employees and, of course, clients). Ideally, the firm has a functioning executive committee (or board of directors) that represents the owners of the firm with members that stay awake at night thinking about the future ownership of the firm.

A good CEO needs to have an executive committee. First of all, there needs to be some balance between the ability of a leader to be decisive and the broad interests of owners and other stakeholders. There is danger in an unchecked executive model of the CEO turning into a dictator and losing the hearts and minds of the other partners. The executive committee provides not only balance of power, but also the right flow of information. A CEO needs to hear and understand the thoughts of the other partners and consider them in decision-making. A strong board can also hold a CEO accountable—and we all need accountability.

Ideally, the CEO is also surrounded by other executives who are able to provide management and leadership in their respective roles. In advisory firms, these executives include the COO (chief operating officer), CCO (chief compliance officer) and CIO (chief investment officer). An executive team allows the CEO to maintain strategic focus and avoid becoming entangled in the daily battles of managing operations. Once again, the executive team also provides the necessary information and perspective.

As Tim Chase, CEO of WMS Partners, puts it: "You have to plan your governance structure for the future of the firm. The earlier you adopt the governance structure that will sustain you as you double your size, the less friction you will experience as you grow."

The presence of a dedicated management team does not mean that the rest of the partners can remove themselves from management responsibilities. In fact, involving all partners in the responsibility of managing the firm is the first step toward establishing strong leadership. Much how democracy requires everyone to participate and understand the choices on which they vote, an executive leadership model requires owners to understand the decisions facing the firm. Otherwise, the outcome is frequently a CEO without a budget or authority—a general without an army.

## Building the Next Generation

Super-ensembles are keenly aware of the importance of developing new leaders—practice leaders as well as executives—and spend much time and resources on the next generation of owners. That next generation of owners (G2) is a group of highly experienced, credentialed and talented professionals whose impact on their firms and the industry as a whole is already felt. The term "second generation" is perhaps not accurate: in a true super-ensemble, there is a continuous inflow of professionals who emerge as key contributors and leaders rather than distinct generations of owners.

Members of the first generation have a sincere desire to leave a meaningful legacy behind and to pass something of value to their successors. The successors value the legacy but are not ready to simply file the picture in the museum—they want to keep painting and see themselves as part of the creation process, not just as curators preserving the original work of art.

Super-ensembles have begun a long-term process of converting their equity structure and leadership model from being "founder-centric" to being more democratic and distributed among a larger group of owners. However, their ability to complete this process is yet to be fully tested. The challenge lies in replacing tens of millions in capital (hundreds of millions in some cases) and taking over the entrepreneurial banner from a remarkable generation of founders.

## Beyond the First Billion

Growth does not stop at a billion. On the contrary, most super-ensembles are asking, "How do we get to $5 billion?" The largest firms of today stand at $15 to $20 billion in AUM. There are only 28 firms with over $5 billion in AUM according to a list compiled and published by *Financial Advisor* magazine[4]. However, if this rate of growth continues (23.7% growth in AUM in 2014 for super-ensembles), we can expect to see today's $2 billion firms reach $5 billion in only five years. That means another 70 to 100 firms will reach the $5 billion level by 2020 based on growth and math alone.

According to the 2014 *InvestmentNews Study,* 47% of super-ensembles say their No. 1 strategic priority is revenue growth, while 12% say they are focused on mergers and acquisitions. Twenty-nine percent list organizational development—the internal view of growth—as their focus.

Studying how the largest firms in the industry deal with growth reveals the path that a super-ensemble must take to reach $5 billion:

› Define a vision that unifies the partner group
› Institutionalize business development
› Establish a sustainable ownership structure
› Develop a practical corporate governance mechanism
› Find a way to add "lateral partners"
› Learn to grow into new markets, perhaps through mergers and acquisitions

[4] fa-mag.com/userfiles/2014_FA_Issues/July_2014/RIA2014_OnlineRanking1.pdf.

## The Vision

A vision is a destination—it is where the super-ensembles want to be in the long term. For most large firms, the vision is not just to be twice or three times larger than its current size, but also to be among the premier firms in the industry and in their market.

A good vision gives the firm a sense of purpose and provides a reason why an ever-increasing number of professionals and owners will devote their energy to the firm. The founders of a firm can speak of "our firm" in a very natural, non-abstract way—much like a family would speak about driving "our car." They drive the car, fill it up with gas and take it wherever they want. They know the car well, and they know all the passengers. A $5 billion firm has a more abstract definition of "our firm" that more closely resembles "our community." They belong to it, it determines their quality of life and defines many aspects that are important to them, but they don't know all the people, nor do they control it beyond their front door.

## Developing Business as a Firm

While super-ensembles have achieved remarkable levels of revenues and assets, for many, the primary source of new clients continues to be the personal reputation of their founders and a select small group of individuals.

The process of involving the firm in business development takes two dimensions:

- **Training and encouraging all professionals to develop new business**
  The training of professionals to develop new business is in its nascent stages in the advisory industry compared to other professional services. Most firms only have a basic marketing planning process that requires professionals to develop a marketing plan and receive some guidance on that plan. The plans do not usually have specific activity or revenue targets and often are not fully accounted for when making promotion and compensation decisions.
- **Developing the brand of the firm so it attracts clients**
  Some of the largest firms in the industry have already begun this process. Aspiriant has a sophisticated branding strategy that develops the firm's presence in all of its markets and spans all methods of communications and client presentations. Firms such as Laird Norton actively use advertising together with branding to reach new markets and new clients. Network firms such as United Capital also excel at firm-level business development. United Capital boasts 12,000 leads that the firm is "nurturing" for its advisors.[5]

[5] joinuc.com/growing.

## Sustainable Ownership Structure

To continue to grow, a firm needs to be able to add new partners and retire existing partners. Demographically, a large group of owners will always have someone who is close to retirement and will thus need to deal with succession. Given the number of partners involved (20 or more), continuity of ownership and practice has to be an established process rather than ad hoc, individual deals, otherwise the potential discrepancy of outcomes can create internal conflict or poor results for the firm.

Continuity of ownership should be an accepted value subscribed to by all owners. It is defined in terms of a:

- Clear understanding of the criteria to be an owner in the firm
- Well-understood definition of what is expected from owners
- Fair and equitable partner compensation method
- Culture that puts the firm above the interest of any individual partner
- Wide-spread understanding of the economics of the firm

The retirement of the founders appears to be logistically the toughest step: they have concentrated positions of stock that are expensive to acquire. However, the transition from the second generation (G2) to the third generation (G3) can also be very difficult. G2 often seeks to recreate the same problem as the first generation—a concentrated position of ownership rather than a more democratic model of governance and ownership that would make every next transition easier. It is similar to a teenager waiting to take ownership of his parents' car: he is waiting for his turn to drive it and is not sharing it with anyone or driving his siblings around.

## Separating Ownership and Management

A firm with $30 million in revenue will likely have 15 to 30 owners. It is impossible to have an effective, competitive organization with 30 people managing it. The organization will be paralyzed by discussion and politics and incapable of acting. The slow process of seeking consensus and involving every owner will likely be resented by the partners (owners). Not every owner wants to participate in the selection of new client relationship management software, etc. Likewise, not every owner wants to manage or knows how to manage.

Large firms already understand the difference between expecting "local leadership" from the owners (motivating people and leading by example) and firm-level management (making business decisions that impact the management of the firm on a daily basis or over the long term). The result is a corporate governance structure that does not rely on owners getting together, but rather uses corporate offices and other structures to involve the right people in the right decisions.

There are another couple of corporate governance structures that should be considered by super-ensembles as they grow that are currently underutilized:

- The Board (Executive Committee or EC)
  The executive committee of a firm frequently acts as a board of directors, representing the shareholders (owners) and checking the executive power of the CEO. The establishment of an effective EC allows for a more disciplined management approach.
- The President
  The president of a company typically manages the executive team and is more focused on day-to-day execution, while the CEO focuses more on the high-level strategy. Such a structure and distinction may at first seem unnecessary in a services firm. However, there is the potential to use the president's office as a way of grooming future CEOs. The president can thus be the "CEO in waiting" who has a chance to handle some of the top-level responsibilities and participate in the leadership of the firm.

## Corporate Governance

The vast majority of super-ensembles today are still being led by the founders who started them 20 or 30 years ago. As a result, the governance structure of the firm is most commonly dominated by the personalities of the founders. The source of authority in the firm is the individual, not the office. In other words, the firm is following Bob because Bob is the founder and the leader, not because he is the CEO. The same goes for other leaders such as the president of the firm, who is usually another co-founder.

To get to the next stage, the firm has to successfully transition the authority to the office rather than to another person. An army follows a general, not George Patton. This allows for a change of generals without affecting combat success. The same is true of a business: changes in leadership may result in changes in approach and style, but they should not affect a firm's authority.

## Lateral Partners

In a group of 30 partners or more, not every single partner will come from within. In the earlier history of a firm, most partners join the ownership group through internal promotion—they work their way up and earn the right to be owners. This model ensures the continuity of culture because partners "grew up" in the firm and are strongly connected to it.

Unfortunately, if a $5 billion firm is to retain its pace of growth and add the talent it needs, it will have to eventually find a way to add partners laterally—from the outside. Some of those may be owners who join the firm with an established practice and a client base, and others may be valuable managers or technical specialists.

To be successful, the firm will need a mechanism to attract and embrace such partners and quickly integrate them, rather than push them away as culturally incompatible. This seems logical but in practice is very difficult to do, since so much of the information and decisions in a firm flow through a naturally established system of personal relationships and historical patterns of which the newcomers are not a part.

## Growing in New Markets

Finally, a $5 billion firm will find a way to enter new markets, either through mergers and acquisitions or by starting from scratch. While some markets can support very large firms without the need for a second office (e.g., San Francisco, Chicago, New York), eventually the combination of opportunity and desire to dominate the "expanded" market (e.g., Washington State rather than Seattle) will cause the largest firms to enter into a new market.

There are many examples of firms present in multiple markets. Aspiriant is in San Francisco and Los Angeles as well as several other markets. Brownson, Rehmus & Foxworth is in San Francisco, Chicago, Atlanta and New York. Firms like United Capital have been structured from the beginning to be national brands and have acquired pieces of the map strategically.

Managing operations—and even more importantly, managing culture across multiple offices—is a challenge that has always proven very difficult for advisory firms to overcome. There are many examples of firms who have lost a satellite office, i.e., a smaller location with one or two partners. The office either chose to become independent or simply withered away.

To be successful in attacking a new market, a firm will need:

- Critical mass in the new market to convince clients that it is a viable competitor; usually this requires the acquisition of a well-respected local firm.
- Critical mass in the new market to provide careers and attract talent; usually this requires the acquisition of talent in an existing firm and the export of a well-developed career track.
- Leadership that is connected to the broader vision of the firm; frequently this requires exporting leaders or indoctrinating leaders who join through acquisition.
- Culture that can be exported: The new office will have to accept and adopt the culture of the firm. Exporting culture, however, is very difficult. The key to such a transition is the presence of leaders who lead by example and the demonstrated success of the "core." Every professional wants to join a culture that is successful.

Success in business is not just a combination of math and growth. The changes required to reach this rare level of size involve culture, organizational structure and ownership mentality. These changes are potentially difficult and painful, as all changes in culture tend to be. The process of growing is a process of constantly tearing down and rebuilding bits and pieces of the organization so that it is ready for the next phase. The firms who succeed in that mission will be the firms who write the next chapter: the future of the industry.

# Conclusion

Size is not just about quantity, but also quality. Being one of the largest firms in the industry has always been of high appeal to advisory firms. Size brings public recognition and increased awareness among clients, prospective clients and potential business partners. Size also brings the respect of the marketplace and perhaps even the ability to dominate a market. Large size promises economies of scale and better negotiating position. Most importantly, growth in size may bring the ability to attract top talent: the most experienced advisors, the best operations staff and recruits from the top schools in the country.

Being one of the largest firms in the industry is a coveted prize. Achieving that prize requires higher and higher levels of assets and revenues. Today, being a top super-ensemble requires $1 billion in AUM. However, the industry continues to grow and evolve, and tomorrow that level may not be enough. Many of the billion-dollar firms of today will become the five-billion-dollar firms of tomorrow. Perhaps many of today's smaller firms will be future super-ensembles as well.

Being a super-ensemble does not guarantee professional or personal success, and not every firm must strive to become a super-ensemble. Many advisors prefer to work in a smaller firm with closer and more personal relationships between professionals and clients. Many firms will achieve remarkable size but not reach a billion. In fact, there are many competitors in smaller markets who are just as dominant as super-ensembles.

Still, every size of firm can learn from super-ensembles. Many of their management and marketing practices lend themselves to adoption by smaller firms. For those firms who desire to become super-ensembles, the path is clear:

- Act like a super-ensemble
  Even small firms can benefit from implementing the management methods of super-ensemble firms. Dedicating time and resources to management, even if full-time management is not affordable, will keep the firm disciplined. Carefully articulating a strategy and being diligent in execution will help the firm make progress in a systematic manner.
- Attract talent
  The addition of professionals and managers who have experience working in larger organizations can assist smaller firms in finding a way to grow faster and impart knowledge from their larger peers.
- Develop the right culture
  Organizational culture guides the behavior of all the staff in an advisory firm, and having the right culture will secure the success of the firm as it grows. Culture is slow to evolve and change, and creating the "right" culture—even when the firm is smaller—will allow a firm to succeed at later stages in its evolution.
- Merge
  There is no faster way to achieve size and reach the level of resources of a billion-dollar firm than a merger. Mergers are difficult, laborious and risky initiatives, but they have created many of today's largest firms.
- Prioritize growth
  Growing faster starts with making growth a priority of the firm. The single most important marketing resource of a firm is the time of its most experienced professionals. Consequently, in firms where partners prioritize growth and spend a lot of time focused on growth, the rate of growth tends to be much faster.
- Acquire
  Acquisitions are not the exclusive domain of the largest firms and, in fact, many of the mid-size firms can find good opportunities to acquire solo practices and add clients and markets to their business.

For smaller firms who do not desire to be super-ensembles, the best competitive response is to entrench themselves in niche markets and seek to dominate those niches.

The key takeaway from studying super-ensembles is that every firm should manage and organize itself for the next step in its evolution. In other words, every firm should be managing and behaving like a super-ensemble.

# Notes

# Notes

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