AGGREGATION – IS IT WORKING FOR WEALTH MANAGEMENT?

By Derek Burke and Kathy Freeman Godfrey

DIGESTING MODEL RISK IN LIGHT OF RECENT BANKING FAILURES

Maybe bigger is better! Recent turmoil in the banking world (that will have repercussions on their wealth businesses) has reminded all of us of the ever-changing risks that confront practitioners in this exciting and rewarding, but volatile, endeavor. We see market developments as an opportunity to once again ask: "what will the drivers of future success be?" This is an exercise that we are engaging in with our respective clients as we work to help them evolve to meet the future. From our work, we share a few perspectives.

The industry's conventional wisdom is and has been that advisors are going through generational turnover (true); that some advisors are poor business people but adept advisors (sometimes true); that many are of insufficient size to compete in the future (depends); that succession risks are addressed through transactions (in the short-term); that advisors' salvation rests with consolidators (short term), and there is money to be made by many (we'll see). Do recent bank "disruptions" cause one to re-think some of the current assumptions?

To assess the industry today, one needs to consider recent drivers of change: consolidation, scale, independence, duty, talent, demographics, flexibility, and money.

> *First, it must be acknowledged that the industry has evolved under advantageous conditions.*

SVB bought Boston Private Wealth in 2021 to expand its offering and provide wealth management solutions to its rapidly expanding client base. At the time, ever-rising capital markets, historically low-interest rates, and varying levels of client sophistication and transparency had created benign conditions in which to grow assets and values. However, when considering the future, there are questions that one must ask: what if markets meander sideways for the rest of the decade, interest rates stay high (but well within long-term historical bounds), fee models evolve and result in less revenue predictability, technology becomes harder/costlier, Gen Y and Z become more knowledgeable and demanding than past clients, all while the current leadership departs the scene? With all those variables - is it reasonable to extrapolate past success?

We believe that success is possible - but there will be fewer yet more successful firms. So, what is needed to succeed?

FOR ADVISORS

When working with advisors, we always start our conversations by asking them what they want to achieve (as they do with their clients). Often advisors seek outcomes that aren't necessarily congruent, e.g., grow through acquisition but maintain the intimacy of the founder's culture. An honest discussion of future opportunities presented requires real engagement on the necessary trade-offs that come with business growth. Not surprisingly, we believe that the future of wealth management will be radically different from the past. This isn't terribly controversial; however, if one agrees with that outlook, then one must also acknowledge that the changes required must also be radical.

Will next-generation advisors be willing and able to make these changes?

Growing scale and maintaining culture may sometimes conflict. High-touch, personalized service operating in tandem with efficiency enhancements may create challenges. Moreover, as senior advisors recede into the sunset, next-gen advisors will transition to an environment unlike the one in which they grew up. But are they expecting more of the same? Successful integration and model evolution will require addressing the motivation of the firm's employees, whether advisors, the leadership team, or staff. Intentionally diagnosing and understanding their personality tendencies and talents, and how their comfort zones or capabilities may be pushed out of alignment with change, is critical. Those who have helped to build a business that thrived on innovation and white-glove client service will be challenged to find comfort in a larger, regimented firm looking to scale. Finally, there is no doubt that scale impacts economics; but joining a large firm impacts independence. Thus, a trade-off. Which is better depends on a variety of factors. (We especially wonder how next-gen advisors will transition into larger, more rigid, and formal settings)

FOR MANAGEMENT

The responsibility to manage these risks and exploit these opportunities rests with management. This challenge is exacerbated by the fact that many of the most successful wealth firms are led by inexperienced management. To be clear, this doesn't mean that these folks aren't smart, talented, creative, thoughtful, etc. Given their past success, most are! However, many lack career experience which has been focused on transformational change. Unseasoned management facing generational change in uncertain/hostile financial conditions should give one pause. Key questions for these rapidly growing firms: how do you attract the needed talent (and what are those skill sets)? How does management address the tension between scale and innovation? To be sure, growth through acquisition will test any leadership team's integration skills.

Finally, if much of a firm's success has been supported by a distinct, client-centric mentality, then how does the acquiring firm integrate its value and its culture without destroying or mitigating the culture that made the boutique thrive? How will the retirements/departures of the founders of the acquired organizations impact the retention of the next generation?

FOR INVESTORS

In absolute terms, lots of money has been made in the early innings of this new era. However, we believe that the future presents a real opportunity.

Because the opportunity is so great, the influx of competitors will not only continue, but accelerate.

Many of these competitors won't be traditional. Engagement by the ubiquitous smartphone will enhance the technical element and necessarily diminish certain aspects of human engagement. Here, scale will matter. But is that the same business as the $500 million fee-based advisor running model portfolios off a TAMP platform with a staff of 6? Can you simply combine an unlimited number of these businesses and build scale through middle and back-office expense savings? Will non-traditional competitors be more experienced and capable of such consolidation? Finally, the engines of past success – the founders – are rapidly leaving the scene. Will past successful business development practices successfully carry forward? If not, will non-traditional competitors become more adept than traditional firms?

FOR CLIENTS

Finally, how does the model impact the advisors' clients? The advisors that we work with genuinely care for their clients and their ongoing welfare. It's more than portfolio management or financial plans that create client loyalty. Many advisors have developed incredibly powerful relationships over decades. That is the secret of their success and why many of us love the business. Can this trust be re-established in a larger, "different" organization? If not, where will the clients go?

Sometimes it's overlooked in the integration equation that clients have their own preferences. The possible/partial disintermediation between themselves and their trusted advisor, in deference to improved technology and scalability, may not resonate with certain client groups. What if the advisor begins taking on a larger book of clients where personalization in the relationship is diminished? Alternatively, what if the advisor is directed to work only with clients over a certain asset level, which eliminates their ability to care for some of their closest relationships? Any change which is negatively perceived by the client will put their loyalty at risk, along with the assets they represent. As client referrals are an essential component of organic growth, this is an especially worrisome possibility.

Finally, another industry convention is that business models supported by better technology and more extensive, more specialized staff will improve client service, though this is not a guarantee. As we think of other industries that have consolidated, and the resulting impact on the consumer, it begs the question, is bigger always better?

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CONCLUSION

We worry that many in our industry are planning for incremental change when we believe dramatic change is at hand. Current events remind us that every business model is a collection of strengths and weaknesses. Most trends ebb and flow over decades. Ideas such as size, scale, independence, client-centric, duty, etc., grow or recede as industry convention. However, our experience tells us that, ultimately, people and the culture in which they operate drive performance. The successful integration of small independent firms into these larger organizations seeking increased profitability through scale will be challenged without executive leadership dedicated to ensuring cultural alignment.

First Republic CEO Jim Herbert acknowledged the challenge of cultural alignment when referencing the departure of the Luminous Capital team, whom First Republic purchased in 2012. When the team departed with the majority of its $16 billion in assets in 2019, Mr. Herbert was quoted as saying, “It was the purchase of an RIA. We’ve only done that a couple of times and we generally avoid it for cultural reasons. Witness…this event, unfortunately.” **[1]**

As a foundational matter, we counsel our clients to focus on hiring the right people, with the right skills, properly incented and rewarded within a culture of merit, inquiry, and respect. Cycles and crisis events will come and go. However, with the right “ingredients,” these management teams can adapt to the ever-changing challenges that they face.

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The Kathy Freeman Company, established in 1992, has been providing retained executive search and consulting services to their clients across wealth management, asset management, and financial technology for the past 3 decades. In addition, the firm is recognized for its annual Talent Trends Research Report, a proprietary study focused on the identification of trends impacting growth across the industry. Kathy Freeman Godfrey is a frequent contributor to industry conferences and publications and provides thought leadership on both human capital and diversity topics.

[1] ‘Luminous’ Advisors Who Bolted First Republic Keep 88% of Assets - AdvisorHub