Prospecting in Wealth Management (A)

The wealth management industry is hampered by a lack of transparency — on the part of clients — that makes business development like the apocryphal case of the polar bear in the white-out snowstorm.

Wealth Management (Part A)

Shannon Stanford was exhausted as she climbed into her Range Rover, headed home a few minutes shy of 8 pm. This was her third night this week attending networking events — which had returned to pre-pandemic levels recently — and she wasn't yet re-acclimated to the grind. Tonight she'd spent the evening at a Provisors group while her husband and kids were at home. It may have been time well invested, she hoped, because one of the attorneys she'd met with said he had a client about to go through a liquidity event, and he suggested that he might introduce Shannon as a new wealth manager. Maybe, she thought, tonight wasn't a total bust.

This was her life, ever since getting recruited to Steinbern Global Wealth Management a decade ago from her sales job at IBM: a persistent schedule of networking events with professionals who might refer business to her. She'd learned in Bernstein's legendary training program that activity was the key to success, and she worked hard to maintain the firm's requirement of having at least 15 in-person meetings a week. Those meetings, many of which were nights and weekends, had to be woven around client service and ongoing education on the capital markets, and usually resulted in 60-70 hour work weeks for her. That was a lot of time away from fun and family, she thought, but in general, she enjoyed her job — lots of good food and wine, many interesting people and a generous compensation package.

That said, she was struck by the inefficiency of her work life. Success in her job meant cultivating relationships with attorneys, CPAs and other advisors of affluent people so that those professionals might occasionally refer a clients to her to manage their money. In any given year she'd meet with more than 100 different professionals, but only a handful would ever refer business to her. The rest represented massive amounts of wasted time and money. There had to be a better way, she thought.

THE WEALTH MANAGEMENT INDUSTRY

Shannon is one of more than 700,000 financial advisors in the United States, who advise families and individuals on their investments and other financial matters. Sometimes called 'wealth managers,' their ranks are growing at nearly 5% a year. Despite the development of roboadvisors, the wealth management industry continues to be dependent on human advisors to consult with clients on a myriad of financial issues. Advisors are typically well-compensated, with media annual earnings of $90,000, or about 30% above average. Compensation varies widely, however, depending on the location of the advisors practice — those in California and New York, for example, earn a median of $150,000. And advisors serving the high net-worth (HNW) and ultra-high-net-worth (UHNW) usually make more than $400,000 per year. As wealth concentrates in the top 20% of households, those advisors are seeing compensation advance rapidly.

The core service of a financial advisor/wealth manager is the management of liquid assets, such as stocks, bonds and cash, and compensation of the financial advisor is usually directly

tied to the amount of assets under management (AUM). As financial needs have become more complex and investment management has commoditized, wealth management firms have repositioned themselves to provide so-called holistic services that includes advice and planning on tax efficiency, estate planning, spending, alternative assets, family financial dynamics and risk management (including life-property-liability insurances).

Overall, the wealth management business is a $1.3 trillion global business, expected to grow at a 10% annual growth rate through 2030 as it expands to $3.4 trillion — with more than 50% of that in North America. Further, as wealth concentrates to the top fifth of the population, the opportunity for financial advisors who work with affluent clients grows even more.

The market is broadly understood to include several levels of wealth. With no widely accepted sharp divisions, the market is broadly defined as follows:

- Family Office ($1 billion and above investable assets)
- Ultra High Net Worth ($100 million to $1 billion)
- Mega Millionaires ($10 million to $100 million)
- Affluent ($1 million to $10 million)
- Mass Affluent ($500,000 to $1 million)
- Retail (Below $500,000)

Market sectors are also dependent on the age and growth profile of the client. For example, a 30-year-old with $1 million who is accumulating wealth is much more attractive to most advisors than a 65-year-old with $1 million who is no longer building wealth and may be spending down.

HOW ADVISORS AND THEIR FIRMS MAKE MONEY

Financial advisors and their firms earn money several ways:

- Most commonly, they charge a fee for all investable assets that they are managing. Traditionally, that amount was 1% of AUM, or $10,000 on $1 million. That percentage has always scaled down as account size enlarges - 0.50% on $10 million, for example — but over the past few years there has seem downward pressure on fees generally. As fees compress, advisors are looking to gain efficiencies in their practices to maintain their standard of living.
- Some advisors and/or products pay commission or generate revenue shares. For example, an advisor who helps a client with a large concentrated stock position hedge their exposure to swings in that stocks price might use an exchange fund that generates a first-year commission of 100% of the fee charged to the client, and then 10% for every year following.
- Some advisors charge for all carte services, such as financial planning. Such fees could run from a few hundred dollars to $50,000 or more, depending on the complexity of the case.

- Some advisory firms generate income by lending out securities owned by their clients, often for options trading purposes, while others generate income by routing client transactions through certain exchanges for a portion of the spread between what a buyer pays for a security and what a seller sells that same security for.
- Some advisory firms are affiliated with banks, and they may earn money through traditional banking services, such as lending.

TYPES OF WEALTH MANAGERS AND FINANCIAL ADVISORS

Today's wealth advisor is the transformation of the traditional stockbroker, and so the most visible wealth managers are legacy brokers and are referred to in the industry as wirehouses. Some familiar names are Merrill Lynch and Morgan Stanley. The companies typically have multiple offices in any metropolitan areas, representing themselves as teams. For example, the Steven Jones Team at Merrill Lynch might be in an affluent area and its advisors might focus on people in that neighborhood, while the Cindy Stewart Team at Merrill Lynch might be in a different part of town and focus on that area. The teams would be unrelated to each other, but share the Merrill Lynch affiliation. Advisors are often paid on a revenue-share model, with successful experienced advisors keeping 45% of the revenue they generate, while newer or less successful advisors might get only 25% of their revenue.

Over the past decades many wirehouses advisors have moved to become independent advisors, usually working in a regulatory category of Registered Investment Advisors (RIAs). A wealth management RIA is always affiliated with a platform company such as the RIA-support departments of Fidelity Investments or Charles Schwab. that provides a multitude of services including custody of client assets, trading services, software, marketing support, compliance etc. Advisors pay for such services as an expense. RIAs are the fastest growing type of advisor.

Banks are also wealth managers. Most larger banks and many regional have wealth management divisions, and some have multiple divisions that target different part of the market. For example: US Bank alone has four wealth management departments catering to relationships of $75 million and above, $3 million to $75 million, $250,000 to $3 million and below $250,000. Other banks that are prominent in wealth management are Goldman Sachs, Northern Trust and the Bank of New York Mellon.

There are other types of wealth managers as well. Many large insurance companies, such as Equitable and Northwestern Mutual, now position themselves as wealth managers and offer investment management services along with insurance.

Finally, the last several years have seen the development of 'roboadvisors,' which are companies that use various levels of artificial intelligence to manage assets. Wealthfront, Betterment and Marcus Invest are a few well known robos in what is becoming a crowded space for low-cost services.

HOW ADVISORS GET NEW CLIENTS

Wealth managers acquire clients in a variety of ways, and landing a new client often involved influence from several channels.

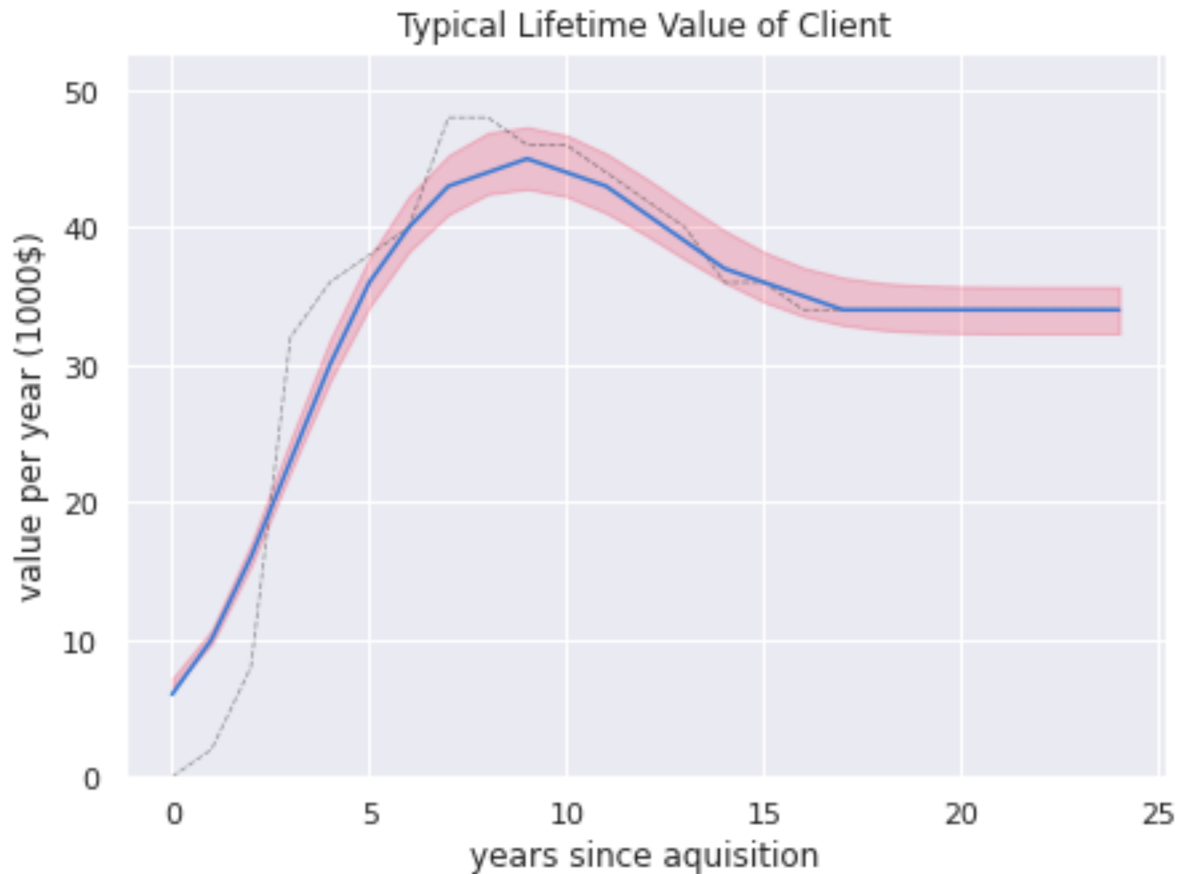
- Referrals of new potential clients from existing clients are, predictably, the most efficient way to get new business. Theoretically, if the wealth advisor builds a good relationship with her clients, those clients will refer others proactively. The challenge is that the vast majority of clients do not refer others, for a variety of reasons ranging from a discomfort in advising others about their personal finances to a perceived liability if there's a bad outcome. As a result, client referrals are valuable but so infrequent to be unscalable.
- Direct marketing is popular among mid-level advisors. One of the traditional methods is to host dinner seminars at upscale restaurants, such as Morton's. Attendees are typically solicited with targeting direct (snail) mail.
- Increasingly, leads are sourced online, through paid or organic search. In some cases the advisors are advertising themselves; in others, their affiliated firm conducts massive campaigns and distributes leads.
- Some advisors buy leads, either explicitly or by paying to be a member of a referral network such as SmartAsset, which collects leads online and distributes them to members.
- Networking/COI Referral Marketing - By far the most effective and scalable growth practice, which involves building a group of professionals who have the types of people the advisor would like to have as clients, and then convincing those professionals to refer their clients to you.

Fully loaded client acquisition costs vary widely, but range from $5,000 to $60,000 depending on the type of client, the asset level and how the client was acquired.

THE CLIENT RETENTION CONUNDRUM

Client retention in the wealth management industry is extremely high, due to the intimate nature of the relationship and inability of most clients to properly evaluate their advisor, with most advisors reporting retention of more than 90%-95%. That drives lifetime value of a newly acquired client to great highs (see chart below), but also makes it nearly impossible to build a business by luring clients from competitors.

The result of the retention conundrum is that inertia is arguably the major factors preventing any advisor's business growth. There is a long-proven moment in time, however, when people will consider changing their advisor: when their personal financial situation changes in a material way. Insiders call such events 'money in motion,' and they include the sales of businesses, initial public offerings, inheritances or transfers-upon-death, divorces, lottery winnings, retirements and a handful of other happenings.



That said, the retention conundrum puts an extremely high metric on lifetime value. Since clients, once landed, are unlikely to leave, lifetime value in the wealth management industry is sky high: annual revenue times margin times 20-ish years.

The COI Model

Steinbern is considered the gold standard of advisor training, with a prescribed method of business development had proven itself over many years — so much so that it was a wildly successful firm for the ultra-high-net worth (UHNW) segment despite having a modest array of services and, until recently, an antiquated investment program. The company recruited mid-career professionals, usually with no financial services experience, and put them through a grueling three-month full-time training program in New York City. There they learned the Steinbern philosophy:

Every financial advisor's career success would depend on their ability to have a dozen or so successful professional service providers provide a steady stream of referrals to them. Those trusted advisors would typically be personal CPAs, estate planning attorneys, divorce attorneys, and mergers-and-acquisition practitioners. To develop such a cadre of referral sources and keep replenishing the group, the Steinbern model requires advisors to conduct 15 meetings per week with potential referral sources, and each potential referral source would be

met with every six weeks or so for six months. Each encounter would follow a formula of escalating content designed to inform the potential referral source about Steinbern and the advisor, screen them for appropriate clients and convince them that Steinbern was the right place to refer clients. Sprinkled in among those meetings were events and entertainment, so a personal relationship could develop — after all, people don't care about how much you know until they know how much you care. By doing the 15 meetings per week and constantly refining and refreshing the group, you'd develop an ongoing flow of referrals to build the advisors business.

Inherent in the process is the assumption that the clients to which the advisor would be referred had a need — or at least some interest — in hiring a new financial advisor.

Also inherent in the COI process, however, is the fact that in any market there are hundreds of financial advisors courting the same professional service providers, so the competition is intense and there aren't enough referrals to go around. As a result, for every 40-50 people whom a financial advisor would take through the multi-meeting cultivation process, perhaps one or two would actual generate a referral.

SHANNON'S INSIGHT

Pulling into her driveway at 8:30 pm, Shannon wondered what she could do to make her business-building more efficient. She knew literally dozens of the top referral sources in town, but she didn't know who their clients were or who was likely to need a new financial advisor. 'Money in motion,' she thought. If there was a way to know whose financial circumstances were changing dramatically, she could then either approach them directly with a personalized approach, or could network her way backwards to them. But how could she learn of money-in-motion events?