InvestmentNews

ADVISER COMPENSATION & STAFFING STUDY

2018 UPDATE

PRODUCED BY

IN RESEARCH

IN PARTNERSHIP WITH

THE ENSEMBLE PRACTICE

SPONSORED BY

BNY MELLON | PERSHING

FIRMS INVESTING IN STAFF REAPED THE REWARDS OF GROWTH

For the first time, the 2018 *InvestmentNews* Adviser Benchmarking Study has an added compensation and staffing update in the financial performance report published in even numbered calendar years. The reason behind the inclusion of a human capital management update is that it may be the single largest driver to firm success and therefore deserves greater attention. While this update assesses changes in compensation, it more importantly studies the staffing decisions that impact results.

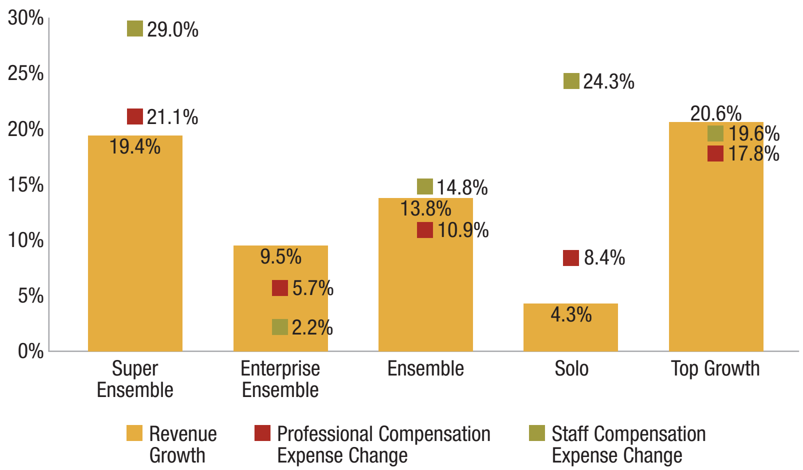
Advisory firms in 2017 experienced great prosperity with high revenue growth and expanding organizations. For firms in this year's study, revenue grew 11.7% in 2017 compared to 4.8% in 2016. The noted challenge of managing a growing firm is scaling the organization to maintain momentum. The primary challenge for a growing advisory firm is that growth is not free, and requires more time and attention from the owners, more work from the staff and more sophistication of processes. Managing the evolving needs of a growing organization means designing more capacity, creating better leverage and attracting new talent.

Times of growth create decisions for firm leaders which, at some levels, are philosophical: Is the source of growth abundant or scarce? If the future holds abundant opportunities for growth, the correct decision is to add talented people to the team, thereby extending the capacity of the firm to absorb continuing growth. On the other hand, if the growth is viewed as scarce and unlikely to continue or difficult to replicate, then a more appropriate decision may be to use the excess profits from today to invest in your current people, technology and processes with which the organization can operate optimally.

The philosophical view the firm takes toward abundance and scarcity governs compensation and staffing decisions. To characterize differing views, we observed the budgeting decisions of firms based on the firm size and recent revenue growth rates.

Year-over-year, compensation expense grew for all firms. However, comparing the growth of the staffing expense against the growth of revenue may provide some indication of the perceived challenges and opportunities firms are choosing to address. For example, well-established firms, such as Super Ensemble firms with over $15 million in annual revenue, continue to invest in people at a rate that exceeds their smaller counterparts, as measured by the increase in compensation expense as a percentage of revenue from 2016 to 2017. The increase in compensation expense includes pay raises for existing staff and compensation to newly hired personnel.

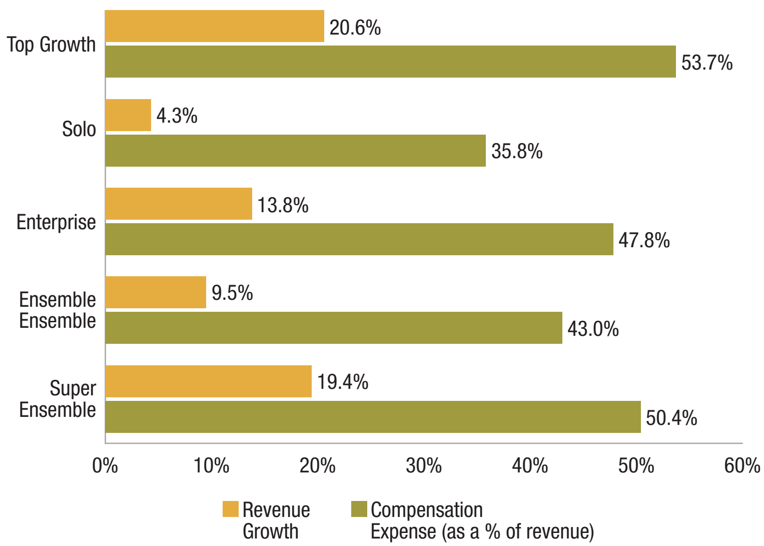
Figure 1: 2016 to 2017 Revenue and Compensation Expense Growth by Firm Category



Super Ensemble	Enterprise Ensemble	Ensemble	Solo	Top Growth
Multi-professional firms with at least $10 million in annual revenue. (n=43)	Multi-professional firms with between $5million and $10 million in annual revenue. (n=46)	Multi-professional firms with $5 million or less in annual revenue. (n=250)	A firm with a single client-facing professional. (n=46)	Firms that ranked in the top-quartile of year-over-year (2017 over 2016) revenue growth. (n=91)

In general, firms that invested the most in staff reaped the reward of high growth rates. While the fastest growing firms likely shared their gains with staff in the form of bonus compensation, and this contributed to a higher compensation expense, the fastest growing firms also invested more in their people to create the growth. The 2017 *InvestmentNews* Adviser Compensation and Staffing Study highlighted that the larger firms pay higher base compensation for professional positions than smaller firms. In other words, firms that invested in higher base compensation had higher growth. Most base compensation is paid in salary and established at the beginning of the year, whereas incentive compensation is expected to be influenced by firm success and paid after results are achieved. In this year's study, the top quartile of fastest growing firms had an average increase in professional base compensation expense of nearly 29% between 2016 to 2017, resulting in an overall compensation expense of nearly 54% of revenue for 2017. These firms invested in base compensation and added professionals in preparation for growth—which they were subsequently able to accomplish.

Figure 2: Compensation Expense as a Percent of Firm Revenue and Revenue Growth by Firm Category



Compensation expense is an investment in the business. Staffing costs are the largest expenditures for the firm, and while the data demonstrates spending more on staffing expenses may lead to greater growth, positive results do not occur without mindful organizational management, including:

- Creating capacity through adding the right positions to allow the firm to grow
  - 72% of firms stated to be near capacity, but another year of high AUM growth – 17% on median in 2017 – is driving them to full capacity quicker
  - The most dependable way to create capacity is to grow it from within, and the largest – who are also often the most long-standing – firms lead the way in cultivating talent all the way up to partner status: 12.5% of Super Ensembles promoted or hired a new partner
- Recruiting and hiring the right people for the positions the firm needs
  - 33% of all firms hired to fill a newly created position, on par with last year's study. But this year saw unfilled professional positions increase to 8% of participating firms, from 3%, and hiring to replace departing professionals to 30%, from 21%, underscoring an increasingly difficult environment to attract and retain professionals.
  - Super Ensembles were most active with 77% hiring for a new position
  - Support Adviser was the most frequently hired position demonstrating firms are interested in developing their own future Lead Advisers
- Creating leverage by organizing the people of the firm to optimize the time of skilled professionals and the return on owner's investment
  - For a $1 million revenue firm, 29% of staff are owners and income per owner is $409,000 compared to firms over $10 million in revenue where 13% are owners and income per owner is $779,000
  - Only 24% of surveyed firms are considered "high leverage" – that is, have a high ratio of support and service professionals for every senior advisory professional – maximizing the time of top leadership

Firms in 2017 grew at the fastest rate since 2014 and diagnosing this growth demonstrates the staffing decisions of the top firms. This study serves to illuminate those decisions by exploring firms' capacity management, talent acquisition and leverage creation strategies in depth.

This report, an update to the 2017 Adviser Compensation & Staffing Study, collected full compensation information on just those advisory firm staff who were new to their position: by either a promotion, a transfer, or a recent new hire. That data, from over 1,100 advisory firm employees and the recruiting and hiring statistics around their new position, are contained in the appendix of this study. Data was also collected on all position-by-position increases in staff W2 compensation, and was leveraged to create updated compensation projections based on figures collected in last year's study. Both troves of data are featured in the appendix of this study. Finally, please note that while the survey did collect firm income statements, that data, while referenced in this report, can be found in tabular format in the appendix of the companion 2018 InvestmentNews Study of Pricing & Profitability.