FP TRANSITIONS®

THE VALUE OF TIME:

Quantifying how client focus increases the value of your business

AN IN-DEPTH ANALYSIS OF THE SUCCESS FACTORS OF TWO ADVISORY PRACTICE MODELS

SEI New ways. New answers.®

As the advice industry evolves, different business models for financial advisor practices have emerged. FP Transitions® used its extensive database of advisory practice valuations to mine thousands of records compiled over a decade in support of their consulting, succession planning and mergers and acquisition activities. This complement to SEI's "A data-backed solution to building a more profitable advisory business" white paper represents an exhaustive analysis of the database in search of clues that could unlock a firm's potential economic value. This analysis is designed to help owners assess their firms' current value and position relative to their peers as a foundation for achieving growth and profitability.

Specifically this research looks at how two business models compare in terms of current operations and long-term growth as well as potential future value: Investment Managers (IMs), advisors who focus principally on the investment process, and Client Managers (CMs) who delegate the investment function to a third party and concentrate on gathering and building client relationships.

Whether you aim to increase value, recruit new talent, sell your business or build a legacy, we believe the insights gleaned from this research can help you assess your business model and consider ways to maximize your firm's value.

THE RESEARCH METHOD WE USED

FP Transitions' analysis relied on its internal database of more than 8,000 valuations of investment advisory practices conducted over the last 10 years (2006–2016). (See the Appendix for a more detailed explanation of the research methods.)

Some of the key data elements that drove valuation include:

- Operating margins and expenses
- Historic and current revenue
- Historic and current assets under management (AUM)
- Demographic client data, including age, type, growth and concentrations
- Owner demographics, including licenses, age and industry tenure
- Employee data
- Practice management data, including time spent on specific activities

The firms were ranked and two categories were created to represent distinct practice models. These groups, labelled as **Investment Managers (IMs)** and **Client Managers (CMs)**, were selected based on time allocated to investment-related functions.

1. Advisor-defined fields encompassed strategy, such as investment research and analysis, while portfolio balancing constituted a combination of asset allocation, tactical order execution and overall servicing of existing portfolios, including money in/money out.
2. **IMs** were segmented based on greater than or equal to 10% of their time spent on investment research and greater than or equal to 10% of time spent on portfolio rebalancing.
3. **CMs** were segmented based on less than or equal to 5% of owners' time spent on investment research and less than or equal to 5% of owner's time spent on portfolio rebalancing.
4. Once identified, the two categories represented 50% of the total advisory practice valuations universe.

The IM and CM practice models were analyzed according to the following criteria:

- Revenues
- AUM
- Expenses
- Employees
- Clients
- Profitability

A QUICK LOOK AT OUR INITIAL OBSERVATIONS

At first glance, the data showed similar metrics for both models:

EXHIBIT A

Practice Information	Investment Managers	Client Managers
Average AUM	$65,945,383	$80,818,606
Average AUM per client	$468,960	$321,817
Average number of clients	165	285
Average number of clients per advisor	84	120
Average number of **licensed** employees	1.88	1.18
Average number of **unlicensed** employees	1.35	2.19
Owner's age	58	55
Owner's time in industry/years independent	26/16	24/18

- IM advisors had higher AUM per client, but CM advisors had more clients.
- Both models had a similar number of employees, but CM advisors had the ability to manage more clients per advisor.
- Advisors of similar age, experience and number of years as independent advisors led both models.
- Client demographics were similar with CM advisors serving slightly younger clients (27% under age 50) vs. 23% for IMs, but again, the difference was negligible.
- Generally, profitability for the two models also was similar.

At this point, the analysis team was surprised at how similar the two practice categories were because they had expected a greater difference. It was time to delve deeper.

THE MODELS BEGAN TO DIVERGE WITH EXPENSES

EXHIBIT B

Average Expenses	Investment Managers	Client Managers
Advertising/marketing	$ 5,542	$ 12,849
Payroll	$ 131,960	$ 215,391
Occupancy cost	$ 25,514	$ 35,024
Leased equipment and technology	$ 10,280	$ 17,017
Other	$ 62,122	$ 111,238
Expenses %	**29.15%**	**37.38%**

The models began to show more substantial differences when we considered expenses. Expenses for the CM model (37%) skewed higher than those of the IM (29%) model in part owing to the fact that it cost more to service a larger number of clients—as shown by higher payroll, occupancy and equipment/technology expenses. Advertising/marketing expenses, which encompassed client communications, events, etc., also were higher for the CM model, and factored into our growth discussion on the next page.

TAKE A DEEPER DIVE: Analysis of advisors' time

On closer examination**, divergence between the two practice models was greatest with respect to the way advisors/owners spent their time.**

EXHIBIT C

Time Allocation	Investment Managers	Client Managers
Investment research	23%	2%
Portfolio rebalancing	14%	0%
Client meetings	20%	37%
Client service	20%	21%
Prospect meetings	6%	12%
Marketing/advertising	4%	7%
Other (Includes compliance, staff management and "other." Refer to the appendix for the percentage for each)	15%	21%

- IM advisors spent more than one third of their time (37%) on investment management-related activity (investment research and portfolio rebalancing).
- By comparison, CM advisors spent less than 3% of their time on research and no time on portfolio rebalancing, which freed up roughly one third of their time.
- While the timesaving measures were good, it was important to understand **how CM advisors spent their time to make a difference in the business.** The CM advisors spent the extra time on client acquisition and client management—more than half their time (56%), in fact, compared to IMs (30%):

Activity	CMs vs. IMs
Client meetings	37% vs. 20%
Prospecting	12% vs. 6%
Advertising/marketing	7% vs. 4%

Coincidentally, CMs spent the same amount of time (37%) in client meetings—**nearly twice as much time as IMs (20%).**

THE KEY POINT

CM advisors spent the time otherwise consumed by investment management activities on "asset gathering" and retention activities.

GROWTH & VALUE: Did the investment in "asset gathering" pay off?

The next obvious question to resolve was whether spending more time on asset gathering and retention activity paid off in a measurable way. The data revealed meaningful differences between the two models in terms of client growth and the resulting growth in AUM and revenue, as illustrated in Exhibit D.

EXHIBIT D

Growth and Value Measures	Investment Managers	Client Managers
Annual client growth rate	3%	5%
Average number of new clients/year	4	14
Annual asset growth rate	11%	18%
Annual revenue growth	8%	10%
Annual revenue per client	$3,783	$3,018
Total asset growth	**$7.2 million**	**$14.5 million**

FIRM GROWTH: How did the two models differ?

- Our analysis showed that CM advisors were growing their client base at an annual rate of 5% vs. IM rate of 3%.
- Considering that CMs had more clients (285 vs. 165), the growth rate difference was significant.
- Consequently, CMs grew their practices by about 14 new clients per year—as much as three times more clients than IM advisors that added about 4 new clients per year.

CLIENT SIZE

As noted earlier, IM advisors served fewer clients, but their clients tended to be larger, as measured by the AUM per client. The average assets per client for the IM model were approximately $469,000, while the average assets per client for the CM model were lower, averaging nearly $322,000 per client. This makes sense as an investment manager spent more time on fewer clients and those clients had more assets.

NEW CLIENT ASSET GROWTH

As with any advisory practice, firm growth was derived from three possible sources:

- New money from new clients
- New money from existing clients
- Portfolio growth

Holding the portfolio growth factor constant, as asset performance growth was relatively similar for both models—we looked back at where the advisors for each model were allocating their time [see Exhibit C on page 5] to assess firm growth characteristics from new and existing clients.

- **The analysis showed that CMs were acquiring assets faster.** The firms in our study added an average of 14 new clients per year at an average of nearly $322,000 for a total of $4.5 million in new assets; this compared to four new clients per year on average for IMs at approximately $469,000 for a total of $1.9 million in new assets.

There appeared to be a direct correlation between the time spent on client relationship activities, including client meetings, prospecting and marketing and asset growth. In the case of the CM model, 56% of the advisor's time was devoted to these activities, whereas IM advisors spent more time (37%) on investment-related activities than on relationship-building efforts (30%).

Now, it was interesting to look at the total story by examining total asset growth, which included new money from existing clients + new clients + portfolio growth:

- A growth rate in AUM of 18% for CMs vs. 11% for IMs yielded significant results.
- On average, **CMs in the study were adding twice as much in AUM ($14.5 million) annually,** compared to IMs with $7.2 million in total asset growth, as shown in Exhibit E on page 8.

REVENUE GROWTH FOLLOWED FROM GROWTH IN AUM

The research showed that advisors who focused on relationship-building activities were growing more than those who focused on investment management.

EXHIBIT E

	Investment Managers	Client Managers
Growth Comparison		
Net AUM growth	$7,253,992	$14,547,349
Net revenue growth	$ 43,329	71,531
Net new clients	4	14
AUM Growth Detail		
AUM from new clients	$2,321,352	$4,585,892
AUM from market/organic	$4,932,640	$9,961,456
Revenue Growth Detail		
Revenue from new clients	$18,725	$43,006
Revenue from market/organic	$24,603	$28,524

Market/organic growth represented the difference between net AUM and AUM from new clients; and the difference between net revenue and revenue from new clients.

- CM advisors in the study added more than $71,000 to revenue compared to just over $43,000 for IM advisors.
- Of the revenue growth for CMs, $43,000, or 60%, was attributable to new client growth vs. almost $19,000 in new client revenue for the IM model, or 40%.
- **Note that revenue growth from new clients was not subject to market fluctuation.**

CM advisors in the study added more than $71,000 to revenue, compared to just over $43,000 for IM advisors.

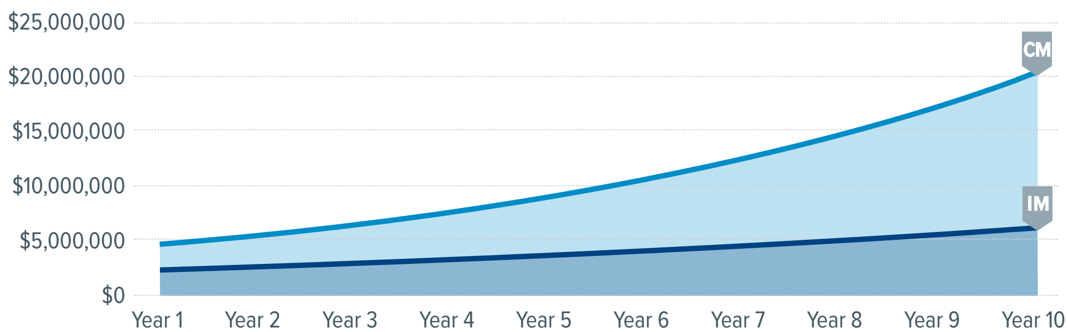
CM VS. IM: Increased value at firms over time

Now here's the million-dollar question: **Does a focus on client management rather than investment management make any difference to the value of your firm over time?** Admittedly, valuation of an advisory practice is never as simple as a single number—and no valuation method is foolproof. Many factors go into determining the value of a practice—and that value is not necessarily, what a buyer would pay or what a seller would accept. That said the analysis establishes that the difference in client, asset and revenue growth of the two distinct models has implications for value.

In Exhibit F, we simplified this analysis to focus only on new money from new clients—ignoring AUM added by either market growth or new money from existing clients.

- The chart below shows what the average IM and CM advisors in our study may expect in terms of asset growth from new clients over a 10-year period.

EXHIBIT F: New assets from new clients



- The dollar figures of $4,585,292 and $2,321,352 were used as the n=1, or year 1, asset growth. The AUM growth during that same period was $825,460 and $255,348. From there the rates used to calculate asset growth for CMs and IMs was 18% and 11%, respectively. The model assumed the same percentage growth rate for each year for each type of practice, but dollar amount growth was different in each year.
- **Summary:** There was a major difference; over 10 years a CM model increased AUM from new clients by $20,340,513 compared to $5,938,104 for the IM model. While both numbers were impressive, the CM increased AUM from new clients by $14,402,409 more than the IM.

Next, we move to the value of the firm. Again, we keep it simple by focusing on new clients only.

EXHIBIT G: Value add from new clients

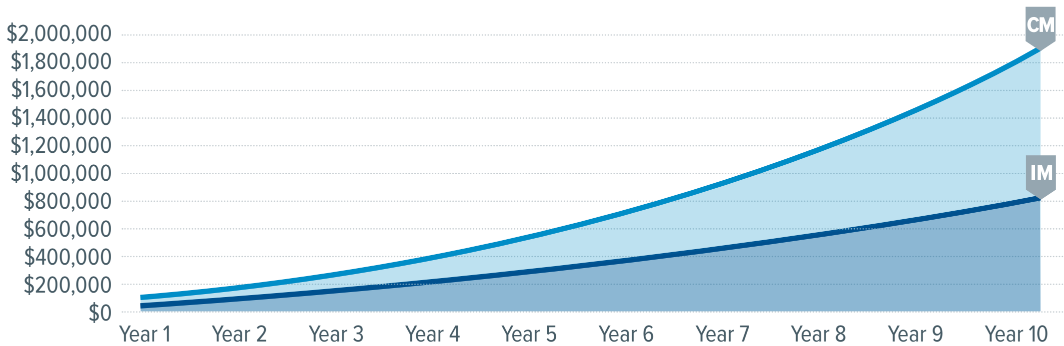


Exhibit G illustrates the value added to the firm from new clients over a 10-year period for both an IM and CM model.

- The first-year valuation started by identifying the revenue growth from new clients, which was $43,006 and $18,725 for the CM and IM, respectively. This was multiplied by 2.35, which was the valuation/revenue growth factor that FP Transitions published each year. To be clear, it was altered slightly to fit with the advisor profiles identified in the data. This calculation gave a first-year addition in revenue of $101,065 and $44,005 for a CM and IM, respectively.
- Year over year the new revenue could be calculated by fees taken, which were 0.74% and 0.90% for CM and IMs, respectively. This, multiplied by the valuation/revenue growth factor gave the yearly increase in value of the firm.
- **Summary:** Again, there was a major difference over 10 years. The CM advisor increased the value of the firm by $1,897,109 and the IM increased its value by $815,902. Again, both numbers were impressive, but the CM increased the value of its firm by $1,081,206 more than the IM.

LET'S GO BACK TO OUR ORIGINAL QUESTION:

"Does a focus on client management rather than investment management make any difference to the value of your firm over time?" **Over 10 years, it was literally a million-dollar question!**

CONCLUSION

The fact is that both advisory practice models are valid and potentially very rewarding for both the advisor/owner and the firm's clients. The approaches, however, result in very different types of firms. How investments are handled—or, rather, how much time an advisor spends on investment-related activities, appears to be the determining factor for achieving long-term growth and profitability.

CHALLENGES FOR THE IM MODEL

We acknowledge that many advisors are content with the status quo and enjoy actively managing client investment portfolios. Many of these advisor/owners may have no interest in growing their practices or selling their firms. Understandably, they favor the notion of dealing with fewer clients whose account values are higher, on average. Key-person-dependent firms seeking growth, however, will need to focus more on growing existing client assets, both in terms of enhancing portfolio performance and encouraging existing clients to add new money to their accounts. Existing client satisfaction and retention are essential for the IM model and the sustainability of the firm.

CHALLENGES FOR THE CM MODEL

Most of the advisors we deal with have made the strategic decision that they indeed want to grow their business—either because they seek maximum value upon retirement, or because they are building a legacy firm. Advisors that choose to follow the CM model will need to be prepared for that growth and build out the infrastructure to support that future growth. They will have to think more like a business than a practice, which will involve an adjustment in the way advisors acquire, service and retain both talent and clients in an increasingly competitive marketplace.

IN SUMMARY

The goal of the analysis was to determine factors that contributed to long-term growth and value. Advisors are always asking for the "answer" to their firm's valuation. By looking at the two different types of advisors, this research has unlocked some of that mystery:

- The way that advisors spend their time—focused on either investments or clients—makes a difference.
- The data shows that focusing on the client builds clients at a faster rate than focusing on investments.
- Over the long run, a client focus builds a greater firm value and a higher return on the use of the advisor's time.
- As any business book will tell you—it's true—put the client first!

APPENDIX

AVERAGE CLIENT MANAGER VS. INVESTMENT MANAGER ANALYSIS

	Client Manager	Difference as a %	Investment Manager
Value	$1,300,950	122%	$1,066,589
T12	$715,310	132%	$541,620
AUM	$80,818,606	123%	$65,945,383
Product Mix			
Fees	47%	72%	65%
Commission	39%	122%	32%
Hourly	4%	239%	2%
Insurance	8%	377%	2%
Recurring/Nonrecurring			
Recurring	71%	83%	86%
Nonrecurring	29%	213%	14%
Client growth rate	5%	147%	3%
Revenue/professional	$281,764	96%	$292,864
# of clients	285	173%	165
Revenue/client	$3,018	80%	$3,783
AUM/professional	$32,729,193	90%	$36,476,228
AUM/client	$321,817	69%	$468,960
Clients/professional	120.05	144%	83.58
Revenue growth	10%	129%	8%
AUM growth	18%	168%	11%
Fees charged	0.74%	83%	0.90%
Owner's Time			
Client meetings (%)	37%	184%	20%
Compliance (%)	4%	81%	5%
Investment research (%)	2%	7%	23%
Advertising and marketing (%)	7%	170%	4%
Client servicing (%)	21%	109%	20%
Prospect meetings (%)	12%	210%	6%
Staff management (%)	8%	156%	5%
Portfolio rebalancing (%)	0%	3%	14%

(continued)

AVERAGE CLIENT MANAGER VS. INVESTMENT MANAGER ANALYSIS (continued)

	Client Manager	Difference as a %	Investment Manager
Owner's Time (continued)			
Other (%)	9%	167%	5%
Owner's average hours per week	41.06	98%	41.93
Practice Info			
# of owners	1.50	104%	1.44
Owner's age	54.46	94%	57.99
Owner's time in industry	24.08	93%	25.79
Owner's time independent	17.89	110%	16.27
Licensed employees	1.88	159%	1.18
Unlicensed employees	2.19	163%	1.35
Average client tenure	9.32	89%	10.48
Expenses ($)			
Advertising/marketing	$12,849	232%	$5,542
Licensed employee payroll	$138,146	166%	$83,071
Unlicensed employee payroll	$77,245	158%	$48,889
Referral fees	$14,855	132%	$11,239
Occupancy cost (per year)	$35,024	137%	$25,514
Leased equipment	$4,867	191%	$2,545
Technology	$12,150	157%	$7,735
Other	$96,383	189%	$50,883
Expenses %	37.38%	128%	29.15%
Client Demographics			
Under 30	4%	103%	4%
31-50	23%	120%	19%
51-70	51%	97%	52%
Over 71	19%	84%	22%
Corporations/institutions	5%	143%	3%

METHODOLOGY

From FP Transitions' valuation database of 8,000-plus analyses, the most recent data for clients who have had multiple analyses performed was used. Additionally, data sets that contained incomplete data fields and comparison fields, which did not add to 100%, were removed from the overall data. This left a total sample size of over 4,500 individual valuation data sets.

The data was then segmented into three groups, **Investment Managers**, **Client Managers** and a **Middle Group** for comparison. Segmentation was based on parameters across two elements of practice owner's time spent, investment research and portfolio rebalancing. Investment research includes studying the performance of investment products as a guide for client portfolios. Portfolio rebalancing is a self-defined field, which conceptually refers to the application of investment research, and may include portfolio rebalancing, servicing portfolios, executing trade orders, and other actions applied to client portfolio changes.

Client Managers were segmented based on less than or equal to 5% of owners' time spent on investment research and less than or equal to 5% of owner's time spent on portfolio rebalancing. Investment Managers were segmented based on greater than or equal to 10% of their time spent on investment research and greater than or equal to 10% of time spent on portfolio rebalancing. The Middle Group fell in between the other group's thresholds. Once defined, CMs and IMs represented 50% of the total sample size.

The projected increase in practice value for Investment Managers and Client Managers was then determined based on the characteristics of each of these sample groups' data. Analysis of FP Transitions' historical data revealed that on average Client Managers' AUM and revenue from new clients grew (on average) at rates of 18% and 0.74% annually, respectively, while AUM and revenue from new clients grew by 11% and 0.9% for Investment Managers. These statistics served as representative benchmarks for predictions of future growth. Projected year-to-year practice value additions are recursively defined, with each year being calculated based on the previous year's growth projection, given by:

$$V_n=2.35*(RGNC_{n-1}+r*(ANC_{n-1}*(1+a)))$$

Where	With
n = year	**$RGNC_1$** = $43,006 for CM; $18,725 for IM
V = Value Addition	**ANC_1** = $4,585,892 for CM; $2,321,352 for IM
RGNC = Revenue Growth from New Clients	
ANC = AUM Addition from New Clients	
r = average rate of Revenue Growth from New Clients (0.074% for CM; 0.90% for IM)	
a = average rate of AUM Growth (18% for CM; 11% for IM)	

Year 1 data for this model was determined based on data in the Client Manager and Investment Manager groups. Initial (n=1) values of AUM addition from new clients of $4,585,892 and revenue growth from new clients of $43,006 for the hypothetical Client Manager practice were calculated using the average number of clients, client growth rate and AUM per client from the sample data. Similarly, a first-year AUM addition of $2,321,352 and revenue growth from new clients of $18,725 was determined for the illustrative Investment Manager practice.

This analysis yielded a difference in projected value of $1 million between the sample average CM and IM practices at the end of 10 years.

FP TRANSITIONS®

FP Transitions is the leading provider in the equity management, succession and mergers and acquisition space for the financial services industry. As the trusted partner, FP Transitions helps independent advisors build businesses of enduring and transferable value. Since 1999, FP Transitions has operated the largest open market for buying and selling independent financial advisory practices. Its team of 40 professionals are experts at analyzing the intangibles that make a financial services practice unique and valuable, as well as helping advisors manage the equity they have built in their businesses over a lifetime of work. Utilizing their experience in valuing over 8,000 independent businesses, FP Transitions assists advisors in arriving at a plan of succession designed to realize value for the founder and perpetuate the business for the next generation of advisors.

For more information, contact FP Transitions at **800-934-3303** or visit **fptransitions.com**.

SEI New ways. New answers.®

SEI (NASDAQ:SEIC) is a leading global provider of investment processing, investment management and investment operations solutions that help corporations, financial institutions, financial advisors, and ultra-high-net-worth families create and manage wealth. As of September 30, 2016, through its subsidiaries and partnerships in which the company has a significant interest, SEI manages or administers $751 billion in mutual fund and pooled or separately managed assets, including $281 billion in assets under management and $470 billion in client assets under administration. For more information, visit seic.com.

About The SEI Advisor Network

The SEI Advisor Network provides financial advisors with turnkey wealth management services through outsourced investment strategies, administration and technology platforms, and practice management programs. It is through these services that SEI helps advisors save time, grow revenues, and differentiate themselves in the market. With a history of financial strength, stability, and transparency, the SEI Advisor Network has been serving the independent financial advisor market for more than 20 years, has over 7,000 advisors who work with SEI, and $55 billion in advisors' assets under management (as of September 30, 2016). The SEI Advisor Network is a strategic business unit of SEI.

For more information, contact SEI at **888-734-2679** or visit **seic.com/advisors**.

FOR MORE INFORMATION

FP Transitions

800-934-3303
fptransitions.com

SEI

888-734-2679
seic.com/advisors

SEI New ways. New answers.®

Information presented by SEI Advisor Network, a strategic business unit of SEI Investments Company (SEI). Services provided by SEI Investments Management Corporation, a wholly owned subsidiary of SEI.

SEI and FP Transitions are not affiliated. Opinions expressed by third parties are their own and SEI cannot assume the accuracy of the information provided.

Growth projections presented here are hypothetical and provided for illustrative purposes only. This information should not be relied upon by the reader as research or investment advice and is intended for educational purposes only.

SEI has strategic relationships with third party service providers discussed in this material. The experiences described here may not be representative of all firms' experiences.

ALL DATA PRESENTED IN THIS PAPER IS THE PROPERTY OF FP TRANSITIONS.

161766 (09/16)