

## The Largest RIAs Race to Scale

By Ann Marsh

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Over the past 30 years, the fee-based RIA space has grown by leaps and bounds, from zero to close to \$2 trillion in cumulative assets under management. That number is still dwarfed by the \$9.3 trillion that research firm Cerulli & Associates estimates is in the hands of full-service brokerages, insurers, trust companies and banks. But the figures look poised to eventually flip as RIAs work to address their top challenges: boosting their efficiency, customizing their technology and differentiating themselves from the competition.

### Top 50 Leaders

Top 50 RIAs	Firm	City	State	AUM (billions)	Accounts	Employees	Investment advisors	Custodian clearing firm	Website
27	Creative Planning	Overland Park	KS	\$2.26	7,677	11-50	11-50	TD Ameritrade, Schwab	thinkingbeyond.com

"Banks see the threat coming" from RIAs, says Jeffrey Thomasson, founder of Oxford Financial Group in Carmel, Ind., the second-largest RIA in the country and one of the fastest growing. Thomasson predicts a seismic shift if RIAs manage to increasingly professionalize and build businesses that can survive the demise of their founders. "It's like a tsunami. It's about 100 miles off the coast, but it's coming."

*Financial Planning's* comprehensive listings of the nation's top RIAs provide a snapshot of a profession in the throes of a dramatic sea change. If the experts' projections pan out, RIAs as a group will bulk up to as much as four or five times their current size. Chip Roame, managing partner at financial industry consulting firm Tiburon Strategic Advisors, believes their cumulative AUM will grow 12% a year, with much of that growth likely being fueled by influxes from brokerages and banks, as well as acquisitions.

The top firm on *FP's* list is GenSpring Family Offices in Palm Beach Gardens, Fla., which grew to nearly \$17 billion in assets under management today from just \$500 million in 2001. About half of that explosive growth came through acquisitions of smaller firms like Cymric Family Office Services in Costa Mesa, Calif., which managed \$645 million when it was taken over in 2008.

In-depth interviews with a half-dozen of the top firms, smaller but fast-growing competitors and industry experts, reveal that the biggest challenges they face in staffing and efficiency all coalesce around the need to grow. "What's driving the growth is an increasing sophistication of affluent investors," says Michael Stolper, founder of the No. 3 firm, Veritable, in Newtown Square, Pa. "They want to work with a firm that is constantly on the prowl for the best and brightest solutions in the marketplace, and not just the products of one firm."

### Top Challenges

The top challenge large firms face is a difficulty in attracting, retaining and cultivating staff. Grooming them to become the next generation of owners of their companies is also a problem.

"We have a Help Wanted ad that's out all the time and yet we've had very little success hiring experienced people," says David Lees, the senior partner of MyCIO in Philadelphia. "We can find people with a sales background or an accounting background only, but it's hard to find a good investment person who can speak financial planning." At No. 9 on the *FP* list, the firm counts 41 former and current corporate CEOs, chairmen and presidents among its clients.

As with most employers, bad hires can come at a steep price. Scott Wood, a co-founder of True North Advisors in Dallas, says he's made the mistake of hiring a couple of former broker-dealer employees who transitioned poorly to the lower-key RIA culture. One left the firm and took \$300 million in client assets with him. With a bit more than \$1 billion in assets under management, Wood and his company aren't on *FP's* Top 50 list. But as with his larger brethren, he's discovered that painful lessons can be part and parcel of the growth process.

Thomasson also learned the hard way. He says that he and his team devised a program to cultivate talent only after 10 to 15 years of trying and failing to perfect their people formula.

Good people cost money, as do good technology and compliance. Many RIAs cite efficiency as their second-biggest challenge. Differentiation is cited next. All RIAs want to persuade prospects that they offer a unique service. Often they do this by creating their own vehicles, from hedge funds to limited partnerships - to give clients access to investments they can't get anywhere else.

"We are currently working on some limited partnerships that we believe will provide many of our clients with better access to managers, in a diversified way at a lower cost," says Craig Rawlins, president of investment advisory services business of the No. 5 firm, Harris myCFO, in Chicago. Harris myCFO is using these

partnerships to meet the \$5 million to \$10 million minimum investment requirements of several commodities fund managers.

"Even if you were an investor with \$100 million and you were investing \$10 million in one asset or strategy, you would have trouble getting the diversity we think you should have," Rawlins says. "By pooling clients' money, they do get the right mix," in addition to lower overall fees.

Veritable, which also offers partnerships, further differentiates by generating highly customized internal analytics for clients. The sheer variety of unique strategies and investment vehicles would be almost unimaginable 30 years ago before the first RIA opened up shop.

### **Top of the Heap**

One of the ironies for advisors in the industry is that while any good RIA will advise his or her clients to diversify, they often can't do the same for themselves. Too much of her net worth is trapped in the illiquid value of her company. Often it takes a giant like GenSpring, the No. 1 firm, to solve that dilemma. Not that GenSpring regards itself as particularly large, yet.

"We are still the midgets in the land of the wealth management giants," says GenSpring CEO Maria Elena Lagomasino, given that so much money remains with traditional institutions. Lagomasino oversaw \$300 billion in client assets as CEO of JP Morgan Private Bank prior to joining GenSpring. "We are still such a new industry."

As with most of the companies on our list, GenSpring, as its full name indicates, is also a family office, an advisory formed to serve ultrahigh-net-worth families. *FP's* list of the country's largest family offices contains many of the same names as those on the main list. That's because 2,500 to 3,000 family offices, according to Cerulli, hold half of the roughly \$2 trillion in the RIA space. Furthermore, family office assets under management are concentrated among the largest RIAs.

It's the rare RIA that can go from hanging out one shingle to building up to billions of dollars under management. But two of the largest firms on our list did just that: Oxford at No. 2 and Veritable at No. 3 were each started by a single entrepreneur.

Both forged a new space for objective advice at a time when the concept was novel. In that way, they and other RIAs like them paved the way for a new species of financial service. Founders Thomasson and Stolper still sit at the helms of those companies. It certainly helped that the birth of their businesses coincided with the outset of what would become the longest running bull market in the history of the country.

With that bull market over, poor returns will take a bite out of RIAs' organic growth, while multiple internal factors will continue to drive them to scale. One is the average age of advisors, which is typically pegged at mid- to late-fifties. As they look toward retirement, these small- and big-time pioneers are often selling to larger organizations.

GenSpring was founded in 1989 as Asset Management Advisors by a handful of families. These days it claims more than 700 client families, with most new clients having investable assets of \$25 million and up. A source of growth will continue to be defections from banks and brokerages. Lagomasino is an example of this trend herself, having spent 22 at Chase Manhattan and JP Morgan.

In recent years, thousands of captive brokers have broken away from the large institutions and gone into business on their own. Many are driven by the depressed stock prices of their former employers who can no longer rely on valuable stock options to retain them. Some of these breakaways can transition quickly to independence, except in cases where legal troubles from an antagonized mother ship slow them down. Others struggle to make the transition. In many cases, breakaways "are not good entrepreneurs," says Mark Hurley, co-founder of Dallas-based Fiduciary Network, which invests in large RIA firms. "They are good employees."

Those who establish themselves continue to pull money away from the commission-driven world. "What motivates client transition usually relates to service. Our gain is someone else's loss in those examples," says G. Moffett Cochran, founder of New York-based Silvercrest Asset Management Group.

Cochran and his team are No. 4 on the *FP* list and serve 350 families. A former business unit at Donaldson Lufkin & Jenrette and, as such, not a typical breakaway, the Silvercrest team left Credit Suisse after the bank merged with DLJ. Since then, Vulcan Capital, founded by Microsoft co-founder Paul Allen, acquired a significant stake in the firm.

Breakaways can succeed rapidly because they are accustomed not only to working in groups, but to managing multiple-partner relationships with custodians and other companies. In other words, the ramp-up to professionalization can be easier for breakaways than it is for organically grown independents.

### **Enterprise Value**

That's a big deal, experts say, because to build market value, an RIA enterprise requires professionalism and scale. It also requires professionalism to achieve scale. Whether RIAs ultimately succeed in shifting the center of gravity away from commission-based operations will depend on whether they build durable business operations.

This requires them to build not just great investment advisory practices and not just great entrepreneurial skills, but professional capabilities, as well. This is no small task.

Of the estimated 19,000 RIA firms registered with the SEC, Hurley estimates only 1,200 to 1,300 have more than \$300 million in AUM. Of that number, he thinks only 100 to 200 are in the process of building the kind of operational businesses and cultures to endure and flourish over successive generations. They are the only RIAs in a position to make acquisitions. As Thomasson puts it, "The rest are barbershops."

True North's Wood cites a panoply of reasons why neither he nor other RIAs can afford not to grow. "If you don't have growth, you don't compare favorably to your competitors," he says. "Your employees need to see growth to feel good about your company or else their career paths will outpace your firm. You need to grow to stay independent. If you sell out to a bank and lose your independence, clients will leave."

"If you are not growing, the second or third generation of advisors will not buy your stock. That means there won't be liquidity. At the same time, your voice is trying to compete with that of the big banks and brokerage firms. To have all those things you have to have growth."

But growth can also be a red herring. In that sense, the *FP* list is not the ultimate measure of the true value of the firms on it. Revenue more accurately determines the enterprise value of each firm. The purchase price of any firm is usually a multiple of that revenue stream. And the size of that all-important multiplier typically depends on innumerable factors, including the quality and fidelity of the people at the firm and the robustness of a firm's technology and processes.

Experts say some of the largest RIAs have surprisingly low profitability, which could limit their abilities to transfer ownership. "The numbers are all over the place," Hurley says. "I've seen \$2 billion AUM firms with \$16 million in revenue and \$3 billion AUM firms with less than \$3 million in revenue."

### **Will Giants Emerge?**

One debate in the industry these days centers on whether national brands will emerge to dominate the RIA space. Lagomasino and Thomasson both say they'd like to see their firms go national. Others aren't so sure that's likely to happen. It will be hard to compete with investment banks uniquely positioned to capture capital from the wealthiest clients, says Lees of MyCIO. After a large investment bank takes a company public, for example, it has first crack at approaching the owner who's just experienced a large liquidity event, he says.

"Clients know the banks were there for them," Lees says. "It's cross-selling and synergy. They have that allegiance and that's a very powerful marketing tool. After the IPO, the investment banker will say, 'Hey, will you talk to my retail guys?' Goldman Sachs and JP Morgan do this very well." Partly for this reason, Lees doesn't see any RIAs bulking up to a size to compete with the national sales and marketing programs of large banks.

Nonetheless, one company, Focus Financial, with offices in New York and San Francisco, is facilitating consolidation. It buys large, non-controlling stakes in sizable RIAs and has amassed a portfolio of 23 RIA companies with a cumulative \$45 billion in AUM.

Cochran of Silvercrest thinks it is possible for RIAs to become too large and lose their main allure to clients. "We could easily be \$50 billion over time, but not \$500 billion," he says. "Not everyone wants to be a part of a huge global services supermarket. I would like to think that the appeal of doing business with a smaller, more boutique operation that's dedicated to customization will grow."

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*RIA Database, which compiled the rankings, determines its lists based on discretionary and nondiscretionary assets under management listed on SEC Form ADV. To capture independent, fee-only wealth managers, many large firms with registered reps or a high level of institutional assets were excluded. The list of top RIAs by growth ranks firms by AUM, inclusive only of those with assets that have grown 30% or more since Dec. 31, 2008. The list of the largest multi-family offices includes RIAs with registered reps that did not qualify for the list of top RIAs.*



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