ORGANIC GROWTH

Findings from the True Ensemble™ Data Insights 2024 Survey

BlackRock.

THE ENSEMBLE PRACTICE

By The Ensemble Practice LLC

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EXECUTIVE SUMMARY

The data from the first True Ensemble™ Data Insights study conducted by The Ensemble Practice in partnership with BlackRock® suggests that advisors may grow faster if they invest more time and money in marketing. Additionally, depending on their growth goals, advisors might consider working with clients that are on the lower end of their target client range relative to assets under management (AUM). Finally, networking is still working—quite well, in fact. It works even better when combined with marketing.

Serving clients with larger AUM is an increasingly popular strategy for many advisory firms and can be a factor in a firm's growth. However, without creating a thoughtful service model and allocating the right amount of time, this approach might hurt a firm's long-term growth and ability to attract new generations of wealth.

Likewise, over-relying exclusively on client referrals versus a comprehensive referral plan can limit organic growth opportunities. Client referrals continue to be the foundation for consistent growth for many advisory firms, but over-reliance on one lead source can result in slower growth than having diverse sources.

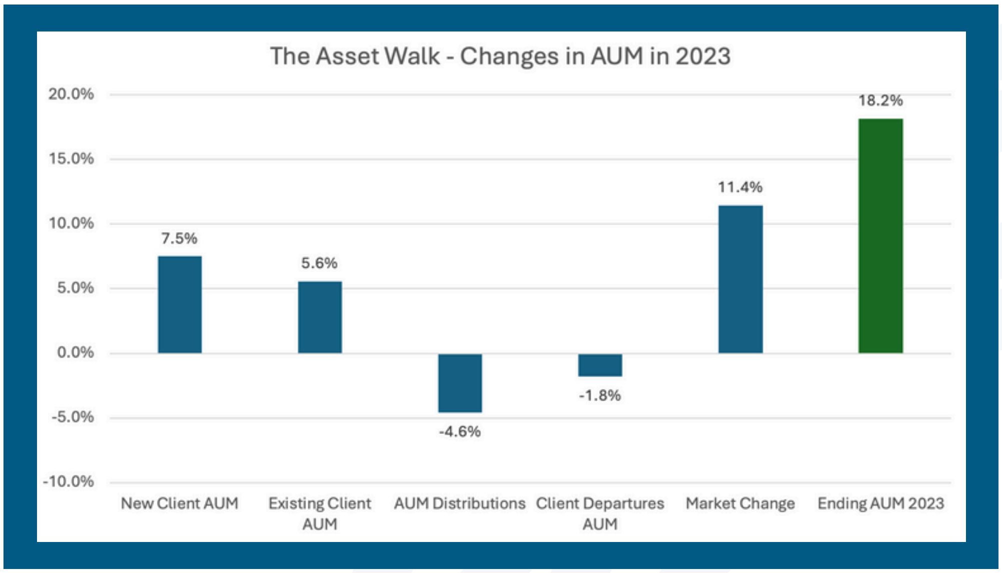
In April and May of 2024, BlackRock® and Ensemble Practice solicited data from 240 advisory firms who answered questions about their business growth, profitability, and employee compensation. This report focuses on the insights derived from the data regarding firms' growth and seeks to answer critical questions that many advisory firms are asking:

- How should we measure growth?
- How fast are other firms growing?
- What are the best sources of opportunity to grow my firm and develop my team?
- What are the strategies of the fastest-growing firms?

In this report, we deployed correlation analysis to examine the characteristics of the fastest-growing firms and analyze their success across different strategies.

MEASURING GROWTH

Our data shows that in 2023, advisory firms grew their revenue by an average of 11.4% and their AUM by 18.2%. The number of households serviced increased by 8.6%. All three measures of growth point to a year of opportunity and success. However, the way in which the industry measures growth can be confusing and often disguises what we are attempting to measure. Market appreciation has helped, but a firm's business development (activities related to promoting the firm, creating opportunities, and gaining new clients) determines whether it will meet its growth goals in terms of revenue and AUM.



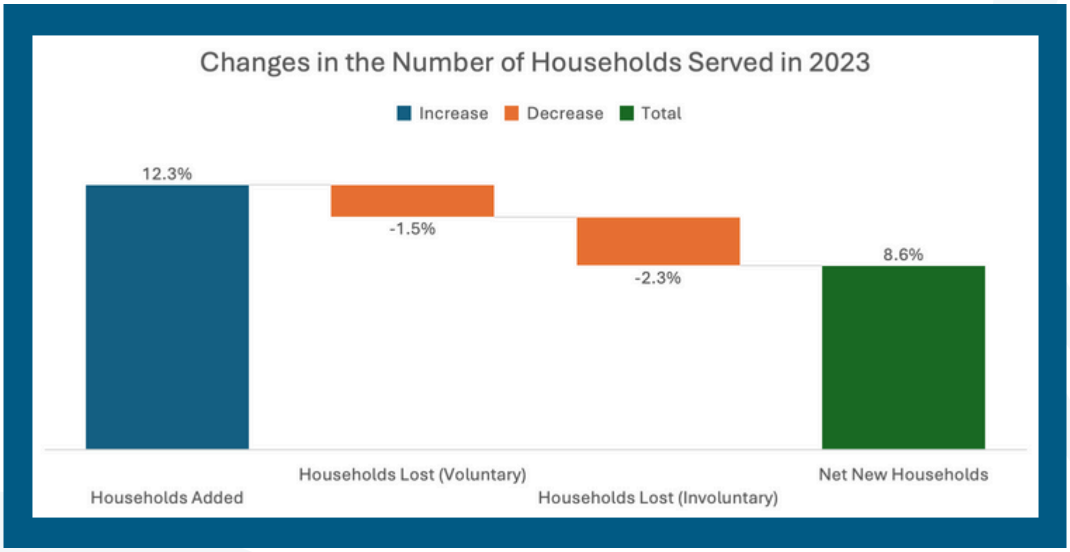
In this report, we will focus on growth from new client AUM. We recommend that firms do the same and incorporate this metric into their vital statistics on the health of the business.

In 2023, firms participating in our study added an average of 8.3% to their AUM from the addition of new clients. This statistic is perhaps the best measure of the ability of a firm to capture organic growth opportunity and it is consistent with the results from 2022 reported in similar studies, giving confidence to the measure's statistical validity.

Both existing client AUM contributions and distributions in 2023 appear to be significantly larger than we have previously seen. In our consultancy experience, contributions have ranged from 3.0% to 4.0% per year for the last 10 years and distributions have ranged from 1.5% to 3.0% per year. The sustained high performance of the market can explain the increased contributions, but the larger distributions are more difficult to explain and may be due to factors such as clients aging. Still, at almost 5.0% loss of assets, if this level of distribution continues, it will create a headwind that will be difficult to overcome. After all, it negates half of new client assets.

Revenue growth is a popular measure of growth, but it has two potential challenges. First, it tends to include the effect of the market, which, in a year like 2023 when the S&P 500 returned 24%, can make a firm appear to be growing faster than it is. Tracking new revenue, net of markets, if a firm can do that, would address this issue but the second remains. Revenue growth tends to lag the actual asset dynamics by two quarters. For example, a client with $10 million in AUM added in December 2023 will not show any improvement in revenue in 2023, but the successful addition of such a client will be visible in the New AUM from New Clients or New Households Added metric. The AUM billing model tends to slow down the growth of revenue in great markets, but also the decline in good ones.

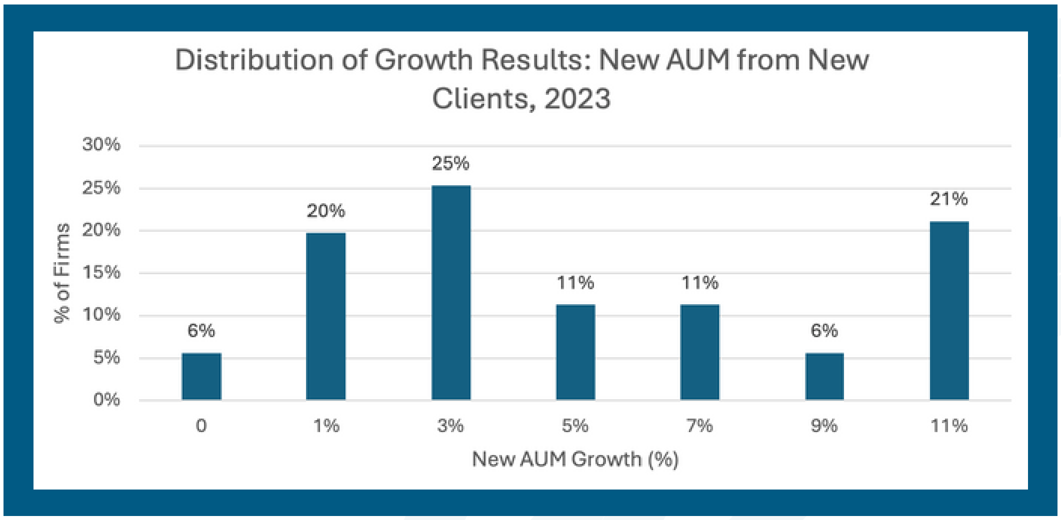
We also encourage firms to review and measure the total change in client relationships (i.e., client households) serviced. A change in assets is more closely connected to revenue growth, but if a firm maintains good discipline and stays true to its minimum levels of compensation, the number of households can be telling in forecasting levels of organic growth. This metric has advantages over net AUM from new assets because it does not lag—the client count increases instantly when the contract is signed, while the assets may arrive later. It can also be a more accurate indication of the success of a growth strategy in a year in which the addition of one large client "saves the day" for AUM growth when the relationship may not be very sustainable.



In 2023, on average, firms added 12 client households for every 100 clients serviced but lost two and let go of approximately two. The result was approximately eight net new relationships for every 100 clients—a result consistent with the 8.3% increase in AUM net of market performance in the same year.

WHO IS GROWING?

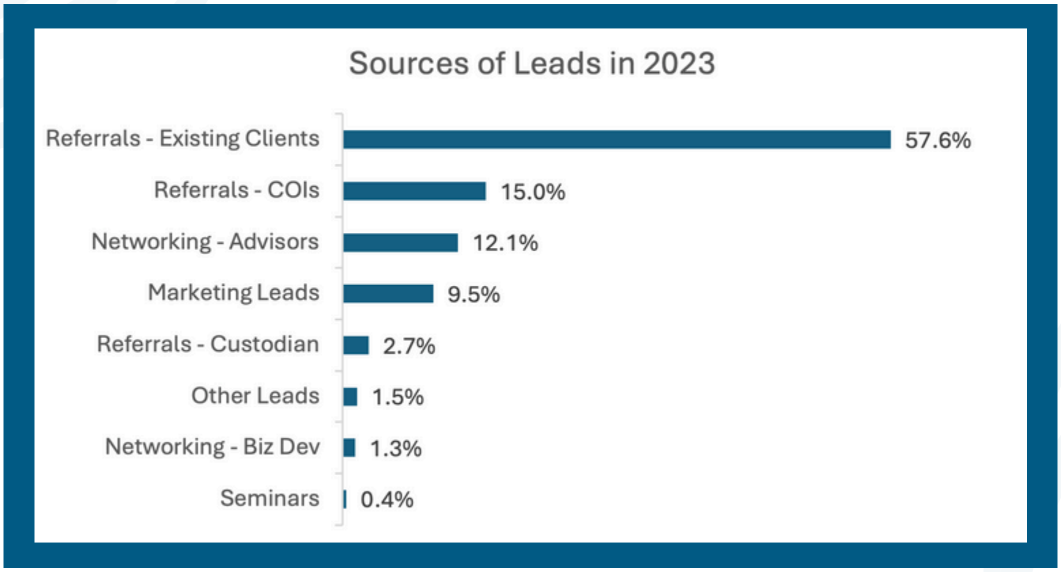
Averages are notorious for disguising the state of a group or industry. When we examine the distribution of growth results as measured by net new assets from new clients, we can visually see that while 51% of all firms grew by less than 5%, there was a strong cadre of firms that grew much faster, including 21% of firms which grew a rate of 11% or higher. In other words, the average new AUM from new clients was a satisfying 8.3%, but 73% of firms had a growth rate below 9%.



COMPONENTS OF GROWTH

A lead is someone who expresses interest in working with a firm—for example, when an advisor receives an email saying, “I have been thinking about hiring an advisor and a friend gave me your e-mail.” Currently, the industry appears to convert more than half of its leads into clients, with the typical firm generating a median of 66 new leads yearly and converting 34 into clients.

Leads are a primary source of growth—the product of a firm's marketing and other reputation-building efforts, including networking, strategic alliances, and exceptional work with existing clients. Leads are a precious resource, but only 62% of all firms—less than two-thirds—track the leads they generate. Firms that don't track this metric may not know if their number of leads is rising or falling over time. Peter Drucker says, "What gets measured, gets managed." Tracking leads can be a valuable tool in helping a firm achieve its growth goals.



The largest source of leads in the industry is existing clients, who contribute 57.6% of all opportunities created. Leads from existing clients are also more likely to become clients, as they are often easier to close. On a relative basis, referrals from existing clients have a +4.4% higher probability of success compared to other types of leads when it comes to closing clients.

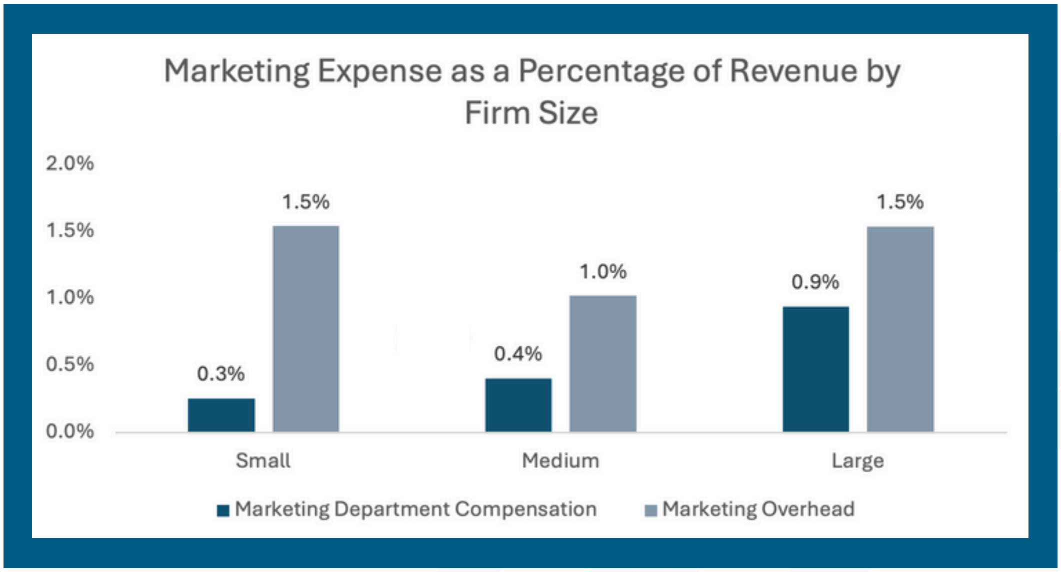
Referrals from Centers of Influence (COIs) such as accountants and attorneys also contribute significantly to growth, accounting for 15.0% of all leads. Networking by the firm's advisors brings 12.1%, and marketing brings 9.5%. A marketing lead is one that cannot be traced back to a specific advisor, COI, or existing client. This is the kind of prospective client who says, "I read your article and wanted to reach out to see if you can work with me."

While leads from custodian referrals appear to be a marginal source at 2.7% of the overall study results, it is important to note that they are often the primary or secondary contributor to the growth of RIAs who participate in custodian referral programs.

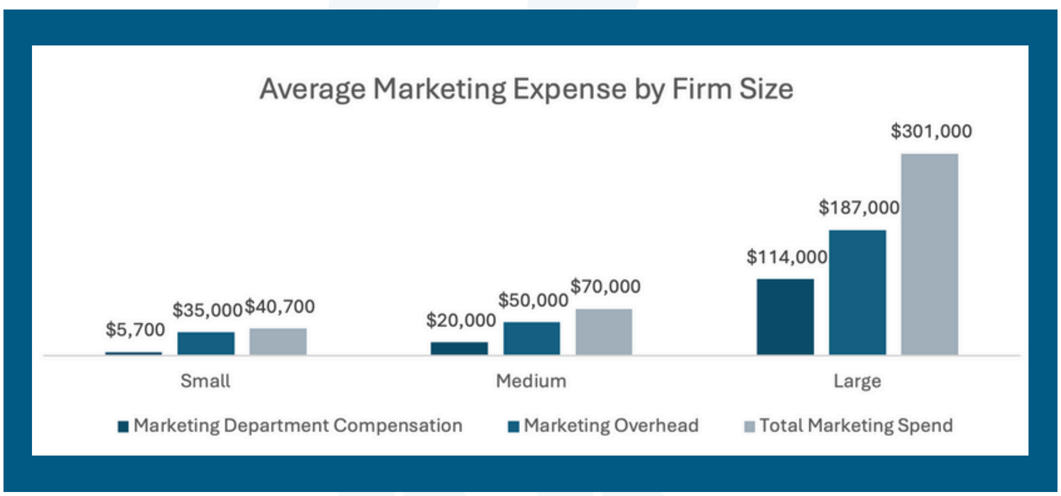
All sources of leads are important. Firms should focus their strategic initiatives in areas where they can drive sustainable growth and may want to deploy initiatives in multiple directions, provided they have sufficient resources to track and follow up on the opportunities generated. Resources, however, can be a function of size.

MARKETING FOR GROWTH

Firms of all sizes should invest in marketing to grow. A successful marketing strategy requires not only a dedicated budget but also the hiring of skilled professionals (employees and/or consultants) to effectively manage and execute marketing activities. On average, advisory firms spent 1.4% of their revenue on marketing and 0.7% on compensating marketing employees.



Small firms (under $500 million in AUM) rarely have a full-time marketing person on staff and spend an average 0.3% of their revenue on marketing compensation. Medium-sized firms ($500 million to $1 billion in AUM) spend 0.4% of their revenue on marketing compensation, and like small firms, typically do not employ a full-time marketing professional. Large firms (AUM over $1 billion) spend 0.9% of their revenue on marketing department compensation, an expense of approximately $114,000.



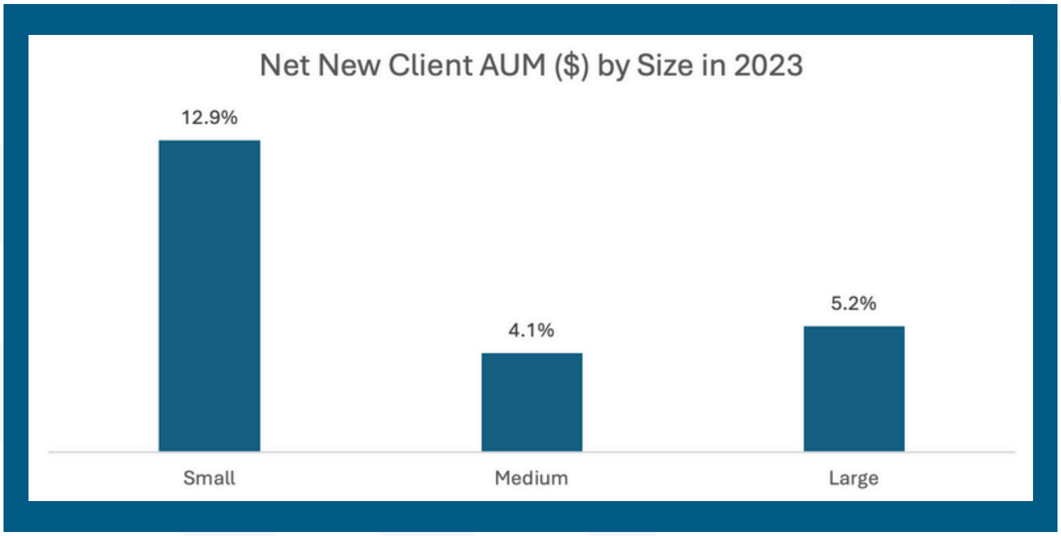
Small firms allocated 1.5% of their revenue to overhead marketing expenses, including client events, sponsorships, branding activities, content production, and networking, while medium-sized firms spent 1.0%. Large firms have a clear advantage when it comes to marketing budgets: While the proportionate spending is like that of small firms at 1.5% of their revenue, the average spend is significantly more at $187,000 compared to $35,000.

Correlation analysis shows that firms with a higher percentage of leads coming from marketing have faster growth than those with lower percentages. As such, regardless of size, firms should continue investing in marketing (or start investing if they aren't already) to support their growth goals.

THE IMPACT OF SIZE

Over the years, we have observed that large firms don't always grow at the same rate as the rest of the industry. In the last year, the strongest negative correlation with growth was size. Large firms typically face challenges when it comes to achieving ambitious growth goals—but they also can have advantages (such as greater resources) that they might not always capitalize on.

Large firms can suffer from the "denominator problem." Achieving a growth rate like that of smaller firms requires significantly larger additions of AUM in absolute figures (e.g., 10% of $100 million is $10 million, whereas 10% of $1 billion is $100 million). In other words, to grow at the same percentage rate, a large firm needs more clients and assets.



In 2023, small firms grew the fastest. Most benefited from the small denominator to achieve a high growth rate of their Net New Client AUM (net of client departures) of 12.9%. Medium-sized firms grew by 4.1%, and large firms grew by 5.2%.

The worst growth is in the "terrible middle"—a term coined by financial planning guru Michael Kitces. Mid-sized firms have the lowest rates of growth and investment in marketing. They lack both the size advantage of the large firms and the hustle advantage of smaller ones.

HOW TO ACCELERATE GROWTH

What can firms do to grow faster? We turned to correlation analysis to answer that question. If you want to grow faster (based on positive correlations with new AUM from New Clients), you should consider:

Working with smaller clients. The strongest positive correlation with growth is the AUM yield—the relationship between revenue and AUM. In an overgeneralized way, you could say that this is the average price clients pay in a firm. This AUM yield appears to explain as much as 41% of the growth rate (r-squared analysis). This is quite shocking—the more you charge, the more you grow.

Smaller client relationships can be more readily available and easier to bring into the firm for two reasons. First, these clients might require a higher level of service at the start of the relationship. Secondly, firms might not look at potential clients that are closer to their AUM minimum. These factors may seem like challenges on the surface, but the data shows that these clients can be key to growth.

Networking more. Firms with the highest percentage of their leads coming from advisor networking efforts grew the fastest. Networking isn't comfortable for many advisors, but we have seen firsthand that with a bit of coaching and the ability to network in their own way, within their own circles of influence, advisors can find success.

Investing more in marketing. As noted earlier, firms with a higher percentage of leads coming from marketing have faster growth than those with lower percentages. If you choose not to hire a marketing team (and even if you do), consider working with an outside agency to fill this role and help craft the strategy and tactics to build your brand and connect with more ideal clients.

This is not to suggest that other strategies may not work. After all, differentiation is, by definition, doing something different or differently. Still, the data seems to suggest that these three initiatives, when executed well, have a high probability of leading to growth.

There are also characteristics that may hurt growth. You should expect some headwinds to growth if you are:

An undifferentiated large firm. The strongest negative correlations with growth are total AUM for the firm and total revenue (measures of size). Relative to smaller firms, large firms generate a higher percentage of leads from custodian programs. While the opportunity is abundant, custodians charge advisors a fee for their referrals and, because the lead came in due to the custodian brand, converted leads may initially have higher loyalty to the custodian than the firm.

Chasing ever-bigger clients. One of the strongest negative correlations to growth is revenue per client. This is an important and nuanced result. As the average revenue per client grows (meaning the firm is working with larger client relationships), growth tends to slow down.

Relying solely on referrals from clients. Without a doubt, referrals are the best way to grow—but they are not enough. A negative correlation exists between a firm's investment in marketing and the percentage of clients generated by referrals: The higher the percentage of leads that come from referrals, the lower the marketing budget (including staff) relative to revenue. In other words, referrals are great, but you also need to actively market and network.

Caution is due when interpreting these results. Our data is strong, but not infallible due to sample size and sample bias.

BlackRock has resources to help with your growth plan.
Please visit Advisor Center to take the next step.

METHODOLOGY

Correlation analysis is a valuable tool for examining a linear relationship between two variables, helping us determine whether they move together in the same direction (positive correlation) or in opposite directions (negative correlation). In this report, we use two key metrics:

- Pearson Correlation Coefficient: This measures the strength and direction of a linear relationship between two variables. It ranges from -1 to +1, where +1 indicates a perfect positive relationship, -1 indicates a perfect negative relationship, and 0 indicates no linear relationship.
- Coefficient of Determination (R-squared): This explains the proportion of variance in one variable that is predictable from the other variable. It is calculated as the square of the Pearson correlation coefficient.

A correlation coefficient close to +1 or -1 denotes a strong association between the variables, while a coefficient near 0 suggests a weak relationship or no relationship. It's important to remember that correlation does not imply causation. For example, a correlation between revenue growth and average basis points charged on assets does not mean one causes the other; another variable, such as firm size, might influence this relationship.

In finance and accounting, significance levels for correlation and regression analysis are often lower compared to fields such as medicine or biology. This is due to the more subjective and variable nature of financial data. The interpretation of what is considered significant is thus subject to the analyst's judgment.

GLOSSARY

Firm Sizes

Small – Firms with less than 500 million ($500M) in Assets Under Management (AUM)
Medium (mid-size) - Firms with from 500 million ($500M) to one billion ($1B) in AUM
Large - Firms with more than one billion ($1B) in AUM

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