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The Billion Dollar Equation

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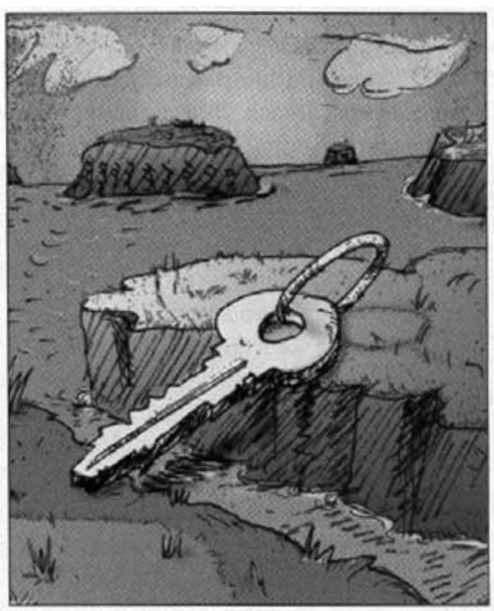
The Billion-Dollar Equation

Skill, service plus separate accounts are key for advisors managing a billion.

By Sydney LeBlanc

A billion dollars under management-for many advisors, it's the stuff of which dreams are made. But for more than a few, it has become reality. Even with the higher asset levels being gathered by advisors today, it's hard to imagine how to approach the billion-dollar mark, much less break through it. According to Barnaby Grist, director of business development at Schwab Institutional, an estimated 400 to 450 advisory firms have achieved this lofty level, and they seem to fall into four different categories:

- Wealth managers who work with multimillion dollar corporate executives;
- The classic money manager aiming to outperform a chosen benchmark and usually focused on a single style;
- Family offices, which provide a full slate of customized services including wealth management;
- Institutional consultants who bring unique asset allocation skills into the high-net-worth business.



With the larger assets under management, these advisors are able to use separate accounts as they were originally offered to institutions and wealthy families. As their assets grow, their capabilities also will grow, allowing clients to meet minimum investment requirements for any manager-especially those not commonly listed on popular platforms-and reap the greatest benefit from separate account management.

Most of the advisors who established these firms started out on the brokerage side of financial services and decided to go on their own with a partner or two. They left because they reached a point in their businesses where the large brokerage house could no longer support them adequately in providing customized service, or because of conflicts between product and service-centered business models.

But without exception, there is something different about the way these advisors have approached their businesses from the outset. Although a billion dollars is a significant amount of assets either to have under management or advisement, reaching that level happened as a natural result of doing business the way they thought it should be done-putting clients' needs first as an every-day, second-nature habit.

What commonalities do such advisors have? What differences? What is their secret formula? The answers to these questions mark the line in the sand for those wishing to follow in their footsteps. And the line looks a little different than one might expect.

The Commonalities

Advisors and teams who have made it to the billion-dollar asset mark have distinct characteristics in common. Most have a different mindset and approach to both their clients and their businesses. These firms share six primary commonalities:

- They define their practices differently, and reaching $1 billion was not a conscious goal.
- They focus on client satisfaction above all else.
- They've never allowed operational concerns to get in the way of client service.
- They have created businesses out of their practices, catching the market trend early and creating equity for themselves.
- They serve clients using a team approach, with no one advisor handling all aspects of any single account or household.
- They have a well-designed hierarchy of service that allows each team member's talents to be used to its best capacity.

These advisors have had a distinct vision for their

Illustration by Vasily Kafanov

practices from the start. Staffing, technology and growth decisions have all been made in terms of client service, not primarily in terms of profitability. Jack Thurman, CIMA and president of BKD Wealth Advisors in Springfield, Mo., distinguishes this level of client-centered focus by stressing the objectivity that must be associated with it. "You must have a passion to serve them and you must have complete objectivity," he notes. "If you have a passion to serve your clients, but in the back of your mind your focus is to make a whole bunch of money doing it, you mess up on the objectivity."

Operations were a concern, especially to start with, but these functions were either handed off to internal people hired to provide support or were outsourced. According to Grist, the advisors' priority was to enable them to do what they do best-earn new business and focus on client service. Technology, reporting and strategy issues were also delegated to others. As each firm grew, the detailed, day-to-day service aspects continued to be delegated or outsourced, ensuring that advisors had the time to properly nurture client relationships. Grist confirms that this is the right focus for firms who are serious about growing their businesses to bolder levels. "If you want to be 100% focused on clients, every minute spend worrying about what your reporting looks like is a minute wasted."

Most of the firms interviewed use both Schwab and Fidelity, and some specialized vendors such as PPCA and Prima Capital, for performance attribution and manager search for their separate account portfolios.

The Business Model

In hiring more advisors while building their respective firms, they also prepared for the conversion of their practices to actual businesses. "We see an aging population of money managers, and if we have our clients associate with us personally, we're not going to be able to transition our business," explains Jane Williams, CEO of Sand Hill Advisors, in Palo Alto, Calif.

Reaching the billion-dollar mark was primarily a rite of passage for these advisors. For Thurman and his group, "We saw it as a threshold of credibility. We didn't view it as the threshold of completion, we viewed it as a starting point." After being with Merrill Lynch for 14 years, Thurman became a partner at BKD LLP, one of the ten largest CPA and advisory firms in the county, with the assignment of building the wealth management arm of the firm.

The office has 35 staff members, 22 of whom are advisors or portfolio managers. He hires the best talent he can find, looking for that same passion to serve clients. "Competency comes quickly thereafter," Thurman says. The firm has approximately $140 million in separate accounts that are either managed by Schwab's platform or by managers chosen through Prima Capital's screening process.

Williams and her partners also came from Merrill Lynch. "We wanted to be managers of portfolios," Williams explains. "That was about the time Schwab was emerging, and we saw the market really bifurcating between the discount and full-service houses and moving toward sales and product development. Our objective was to have a close relationship with our clients-a planning-based relationship, which was pretty unique at the time." Williams and her partners also had a portfolio-based philosophy.

The billion-dollar level offers Sand Hill greater scale than a $500,000 manager. "It puts us into a different mix and will, hopefully, give us more leverage with greater pricing power," explains Williams.

As CEO, Williams does most of the core work with new relationships. "We've developed a robust team approach. We've recently split our wealth managers' roles." Senior managers used to handle all aspects of the client relationship and portfolio management. Now, those functions have been separated.

With portfolio managers taking over portfolio management and implementation, investment decisions are implemented promptly, improving service to clients and allowing senior and junior wealth managers to manage the relationship. The next layer of service involves a customer service person assigned to each client relationship. "We've really leveraged what our senior wealth managers are able to do, so they are more available for new business-they're prospecting at higher levels than before."

The firm is part of Fidelity's Advisor Network, but also works very closely with Schwab and sees that relationship growing. "Schwab lines up appropriate managers and offers them to you," says Williams, "and Fidelity operates on the 'no advice' model, using a much more open framework-it's just a different capability. We use both platforms for clients, sometimes for the same client-where they wouldn't gain access to a particular manager in one group, we go to the other group."

The firm uses either separate accounts or institutional funds, depending on fees. "Separate accounts are part of our overall wealth allocation. In each class, we find contradictory numbers regarding fees (compared to institutional funds). For example, in REITs, sometimes we find an SMA alternative that's less expensive than an institutional fund, whereas in other market areas, the reverse is very decidedly true."

Richard M. Todd, CIMC and principal at Innovest Portfolio Solutions LLC in Denver, Colo., says, "We started Innovest in 1996 with three partners; we dropped our securities licenses and became completely independent. We don't sell investment products, insurance or financial plans. We don't have a fee schedule per se," Todd explains. "We look at a situation and determine what we need to make to be profitable based on the advice we're giving and the complexity of the situation."

Todd started his career at EF Hutton in 1986 and uncovered wealthy families by cold calling. He needed help servicing them, so he aligned himself with another advisor who had more experience dealing with larger accounts and who was part of the firm's consulting group. Both became uncomfortable about conflict of interest at their former firm. "Our fiduciary responsibility was to the firm and not to our clients, where it should have been. We just felt uncomfortable with that relationship," he explains.

The team doesn't want to "be all things to all people," and works in tandem with other family advisors, especially tax and legal. There are 20 people in the firm who work as a cohesive unit delivering investment advice to clients. Each client works with two or three advisors. Approximately 70% of the firm's clientele are institutions and 30% are families. Clients are surveyed every year to gauge satisfaction.

The client survey is a good idea, according to Grist. "Your true distinction point is what you actually deliver, so your clients are the only credible ambassadors for your brand."

Innovest uses separate accounts for institutions because of the cash savings and the ability to identify the source of performance. According to Todd, "The benefit of the separate account or SMA is the ability to see inside the portfolio and really understand why performance happens, good or bad. That's going to help you be a better judge of whether a strategy or solution or manager is still viable going forward.

Within the dedicated client focus of each, certain unique market opportunities have developed based on the team's conglomerate talent and capabilities. Each firm views separate accounts as a large part of its business, but as a tool within a larger client service model. Thurman's subsidiary has built a platform customized around the needs of its clients. "We view passion as our strength and we try to serve clients on their own terms," says Thurman.

He cites a recent example of a client who sold his business for $50 million. "I knew that Goldman Sachs, Morgan Stanley Private Asset Management and JP Morgan Asset Management would all be going after this client," he explains. "I met with the client and said, 'I'm not here to sell you on anything. What's your greatest problem?'"

The client was concerned that his children were about to inherit $5 million each-he wasn't sure how they were going to deal with it and needed help. Thurman offered to develop a customized educational program. "We charged him for it, but we customized it around his challenge. Our whole perspective is to provide solutions, not to sell."

William's firm specializes in providing a deep level of financial advice to people going through transitions. "Sometimes these transitions start long before there is a money management engagement to be undertaken," explains Williams. Typical situations include counseling the less informed party in a divorce as they go through the process of dissolution, or counseling with trustees in estate resolution matters where assets are shifting.

Williams developed an affinity for working with wealthy women early on in her career. "We have a significant business with wealthy women. We've long felt women would be the repository of great wealth transfer. Sometimes it comes from parents, sometimes from a deceased spouse where the woman has to take control, an infirm spouse where a wife needs to take command, and, of course, from divorce," she says. The firm has instituted a Women's Wealth Network offering women "an inspiring and safe educational and networking space where they can achieve financial confidence."

In addition to high-net-worth individuals, the firm manages money for a variety of charitable foundations and endowments. It has about 170 clients and just over $1 billion under management. Although not a family office, the firm has a very broad service offering for clients. It runs two portfolios inhouse, a core equity and active bond. "But we are open architecture to a very great extent," Williams adds.

Innovest, according to Todd, works with families and foundations, both public and private; as expert witnesses in fiduciary cases; does retirement planning; and works on special projects for clients. "We don't want to be all things to all people, but we want to make sure we work in conjunction with their other advisors," says Todd. "We call ourselves an extension of the family, or investment committee or board."

Such phenomenal growth also breeds challenges. Thurman's firm hired Schwab to help it expand its client service platform and streamline communications with its clients. He also cites the difficulty of balancing customized service with scalability. "It's very difficult," says Thurman. "There are a lot of things we have to compromise on. We focus on customization through standardization, like the solution we offered the client who sold his business for $50 million."

Williams cites price competition as a challenge. The boards of public foundations are becoming very sophisticated. "They're looking to bargain their fees down to nothing, and it's just not a proposition you can very easily support," she offers.

Todd cites the continual challenge of offering clients value in what is delivered. "Because we're a consulting firm, we don't offer the same solution to everybody. With that business model, there are capacity issues. As we grow and continue to bring in clientele, we have to continue to bring in quality people."

"Often, success breeds arrogance," says Thurman, citing what he views as the firm's greatest challenge. "We want success to breed humility. Getting to $2 billion means tweaking 1% better out of a hundred different things-being a little more efficient on quarterly report generation, making three phone calls to a half-million-dollar client instead of two calls."

Platform providers realize they need to offer more than just a good platform. Schwab's Grist says his focus is on advisors who are trying to develop their businesses and are thinking about strategic planning. Two major themes at Schwab are generating referrals and creating the proper educational structure for employees to ensure quality client service.

As each firm is adamant about maintaining its proper focus, it continually refines its original delivery structure, adjusting to the growth challenges cited earlier. "Our momentum is good, our biggest challenge is to grow at a measured pace. I'm afraid of growing too quickly," says Williams. Narrow focus, proper deployment of personnel and capabilities, custom managed account solutions and a unique service –based vision are what catapulted these firms to the billion-dollar level. The same ingredients offer them much promise for the future.

Financial writer and former wealth manager Lisa Gray contributed research and interviews for this article.