Welcome to the Jungle

The Next Phase of the Evolution of the Wealth Management Industry

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Introduction

The industry has just completed a rather raucous decade. Soaring U.S. equity markets, historically low inflation and an extended period of record low interest rates made it a great time to work in wealth management. Assets, revenues, and profitability exploded. Everyone prospered.

At the same time, a week did not go by without the announcement of another mergers and acquisition (M&A) transaction. Buyers paid record prices and many owners decided to sell and became wealthy in the process.

Unfortunately, in March 2022 the Federal Reserve reversed course and began to aggressively fight inflation. Markets corrected, interest rates went up and the party ended. And no one is sure what comes next, much less what this will mean for their business.

It also has been eight years since at least one of the co-authors of this report has published a study on the future of the industry. Consequently, we thought that it might be helpful to provide participants with an updated roadmap on how we believe the industry is likely to evolve.

Certainly, forecasting is an imperfect exercise and not everything that we have prophesized will occur, much less on the predicted timetable. That said, with the help of some of the industry's best thought leaders, we have gathered and compiled many ideas. We hope that industry participants will find them useful to their thinking and planning.

Acknowledgements

It took almost a year to prepare this study and the authors are extremely grateful to all of those who helped us. Indeed, so many individuals provided input that there isn't sufficient space for us to thank them all. However, we would be remiss without noting the exceptional contributions from several key people including:

Mark Tibergien gave us a great deal of his time and shared numerous ideas that helped lay the foundation for this study. For decades, his name and the term "wealth management thought leader" have been synonymous. Aside from being brilliant and an almost iconic figure in this industry, Mark is one of its nicest and most generous individuals.

Brian Hamburger has made MarketCounsel one of the industry's leading business and regulatory compliance consulting firms. Having worked with him on this study, it is easy to see why so many owners of many of the most successful wealth management firms rely on his advice. He too was generous with his time and spent many hours helping us shape this report, challenging our ideas and adding his own.

Michael Kitces, founder of Kitces.com, is the industry's top expert on practice management and his widely read online newsletter/blog regularly shapes the thinking of thousands of wealth management firm executives. He likewise was very generous with his time and his ideas. He repeatedly challenged and forced us to rethink many of our ideas, in particular on the operating models that successful wealth managers would rely on in the future.

Ray Sclafani of Clientwise provides elite coaching programs and consulting to many of the industry's best firms. After debating many of our most important ideas with him, it is unsurprising that he and his partners have helped numerous industry participants improve their revenue and profitability, the quality of their team members and enhance their enterprise value. He was kind enough to review our study and was instrumental in helping us rethink how the coming shortage of talent will impact every firm.

Chris Frieden of Alston & Bird has served as legal counsel to nearly every major M&A transaction that has occurred in this industry. His success is due in no small part to his deep understanding of the internal dynamics of wealth management businesses and how they impact the ability and likelihood of completing a transaction. He spent a great deal of time helping us understand how the market for wealth managers will likely change and the traits of the most successful future buyers and sellers.

Allan Starkie founded Knightsbridge, the preeminent executive search firm for the wealth management industry. He has helped recruit and place hundreds of executives. He was very helpful in shaping our ideas regarding what will be one of the industry's greatest future challenges – finding the necessary talent to grow.

Jon Stern is a Partner at Berkshire Global Advisors. He has for many years thoughtfully and successfully guided buyers and sellers in the industry's largest transactions. He helped shape our views on how the market for mergers and acquisitions will change going forward as well as the traits of the most successful future buyers and sellers.

David Canter is the former Head of Fidelity's RIA and Family office businesses, and former President of Bluespring Wealth Partners. Easily one of the most creative people in the industry, for more than a decade David advised the CEOs of many its largest participants. He was extraordinarily generous with his time, ideas, and advice, all of which materially improved this study.

Each of these individuals – as well as many others – were critical to the preparation of this report and provided many of its best ideas. However, any of the study's shortcomings are solely our own.

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Executive Summary

When the history of wealth management is written, the years 2012–2021 will be remembered as the industry's equivalent of a financial bacchanalia. Low inflation and a raging bull market for U.S. equities – typically the largest portfolio allocations for most clients – produced outsized inflation-adjusted investment returns. Indeed, a diversified portfolio generated an annual return net of the Consumer Price Index (CPI) of more than 10%, or nearly three times that of the preceding 10 years.

2012-2021 will be remembered as a financial bacchanalia

Owning a wealth manager is the economic equivalent of making operationally leveraged investments in the financial markets. Consequently, as client assets appreciated, the profitability of many firms tripled or even quadrupled without adding any new clients.

The normal economic rules that guide every other industry were suspended. The only thing that mattered was the market. How hard participants worked or whether their strategy – if they even had one – made sense was irrelevant. So, too, was the quality and the sophistication of the advice. Everyone prospered.

The industry was lulled to sleep.

The run-up of the markets also lulled the industry to sleep. Most participants, for all practical purposes, ceased marketing. And those who did often relied heavily on custodians to refer them to potential prospects.

But for the equity bull market, 70% of participants would have shrunk

Although the industry's assets under management increased nearly $50 trillion or almost two and a half times what they were in 2012,[1] 70% of the industry's growth came from market appreciation.[2] Indeed, one custodian found that, but for the U.S. equity bull market, about 70% of the firms that it serviced would have shrunk. Meanwhile, the average age of client bases became much older.

At the same time, a confluence of factors triggered an industry-wide M&A frenzy. The equity bull market was fueled in large part by the Federal Reserve expanding its balance sheet over several years to nearly $8.8 trillion by the end of 2021,[3] resulting in a prolonged period of record low interest rates. Debt became plentiful and cheap.

Wealth management was an inviting target for private equity (PE) firms.

[1] https://www.mckinsey.com/industries/financial-services/our-insights/from-tailwinds-to-crosscurrents-resilient-growth-in-wealth-management
[2] Ibid.
[3] Federal Reserve Board - Recent balance sheet trends

Private equity firms also raised trillions of dollars – including more than $2.2 trillion since 2016[4] – for which they needed places to invest. They took notice of the industry, and it was an inviting target. Particularly attractive was the stability of wealth manager client relationships because they generate predictable, recurring fees which allow buyers to use large amounts of leverage when acquiring these businesses.

Additionally, participant owner demographics created many transaction opportunities of size. Numerous $2 billion to $10 billion AUM participants had been founded in the early 1990s with owners who were now in their mid-60s and needed a way to monetize their ownership stakes.

Prices soared to 20 and even 30 times trailing twelve months cash flow

Under such conditions, it was unremarkable that more than a hundred acquirers suddenly emerged, buying anything and everything that was for sale.[5] Nearly 1,600 transactions were completed.[6]

Size was what mattered most. Quality quickly became an afterthought. PE firms backing these buyers had oceans of money they needed to invest if they were going to collect the associated management fees that now dominated their own profitability.

Prices soared, buyers bet heavily on a rising tide and won big.

Understandably, prices soared. In an industry that had long relied on valuation metrics of eight to twelve times trailing 12 months cash flow, multiple transactions were completed at 20 times and even some at nearly 30 times.

Buyers bet heavily on a rising tide and won big

But even at these absurd valuations, the financial markets ensured that nearly every transaction was successful. Price did not matter so long as client assets kept appreciating, papering over any mistakes. Buyers bet heavily on a rising tide and won big.

Unfortunately, the party ended when in March 2022 the Federal Reserve began to address surging inflation by raising interest rates, shrinking the money supply, and intensifying its scrutiny of bank lending. The financial markets began a correction from which nearly two years later they have yet to fully recover. Suddenly, participants woke up and wondered, “Where am I?” and “What comes next?”

[4] PE Stats Final.pdf (senate.gov)
[5] Wealth Management M&A Transaction Report (fidelity.com), Wealth Management Market Update (hl.com)
[6] https://f.hubspotusercontent30.net/hubfs/7475083/ECHELON%202021%20RIA%20M%26A%20Deal%20Report.pdf

The accuracy of any forecast depends heavily on the future performance of financial markets.

This paper tries to answer those questions. Of course, the accuracy of any forecast depends heavily on the future performance of the financial markets. No one knows what will happen and should there be a repeat of the 2012–2022 U.S. equity bull market, the normal economic rules will remain suspended. That said, in this report we are assuming that financial market returns for the next 10 to 15 years will be much closer to their historical averages.

Regardless, it is very unlikely any participant will go out of business – that is, unless they neglect their cybersecurity. The only questions are how much money they will make and their business' level of enterprise value. Additionally, it is important to recognize that change in wealth management happens slowly and occurs non-linearly.

Unlikely any participant will go out of business unless they neglect cybersecurity

However, to understand what comes next, one must first recognize where the industry is now. Although it has just completed its initial stage of consolidation, it is in many ways more discombobulated than a decade ago.

The industry remains very fragmented.

It remains very fragmented with nearly 15,000 RIAs with a median size of $412 million of AUM.[7] It is mostly made up of small generalist firms, and what participants do for clients – financial planning, investment management, tax advice, etc. – has changed very little since the industry's inception. Indeed, excluding the use of FinTech used to improve operational efficiency, little innovation has occurred.

Now, numerous large aggregators with more than $25 billion of AUM exist. But only a handful have created fully integrated businesses. Additionally, the preponderance of firms that today would be considered mid-sized (i.e., $2 billion to $10 billion of AUM) have been acquired.

Large firms make it easy for small ones to compete, and participants rely on outdated operating models.

More importantly, it is almost impossible to distinguish between the offerings of participants. Clients generally receive the same package of services for the same price, regardless of the wealth manager's size. It is as though larger firms want to make it easy for smaller ones to compete with them on equal terms.

Big firms act like they want to make it easy for small ones to compete

Further, most participants also rely on outdated operating models that make it difficult to scale their businesses. Rather than specialize by function, their operating structures effectively discourage their best

[7] https://investmentadviser.org/wp-content/uploads/2022/06/Snapshot2022.pdf

marketers from recruiting new clients once they have built their own books of business.

The industry has largely ignored cybersecurity risks, gets paid more for doing less, and is getting old.

Additionally, the industry has largely ignored cybersecurity risks, notwithstanding the direct threat that they pose to client wealth and that the SEC recently proposed a set of extensive cyber regulations that equate taking the necessary steps to protect client information and assets with meeting fiduciary duties.

More troubling, many did less for their clients over the last decade despite being paid higher fees. Indeed, more than half of all participants effectively evolved into investment-only wealth managers.

A talent shortage that will worsen over time

Advisers likewise got older and now face a talent shortage that will only get much worse over time. Today over half of all CFP holders are over 50 and only 5.6% are under 30. Nearly a third are over 60.[8] Moreover, more than one third of financial advisers are expected to retire in the next 10 years[9] and at the same time fewer college students are enrolling in finance and accounting degrees, reducing the potential pool of entry-level employees.[10]

There is a continuum of aggregators.

A continuum of aggregators exists. At one extreme, a handful of integrated businesses never lost sight of the fact that organic growth ultimately builds enterprise value. At the other end, the preponderance of aggregators are confederations of autonomous small firms that long ago stopped marketing. Trying to integrate their affiliates into a single enterprise which can grow organically and capitalize on their combined scale will be a mammoth task.

Strategy of buying as many wealth managers as possible with borrowed money now unsustainable

More importantly, the strategy of buying as many wealth managers as possible using as much borrowed money as possible is no longer sustainable. Debt is more expensive and less plentiful. One Month Libor rates are now more than five percent higher than what they averaged in 2020-2021.[11] Banks have begun shrinking their balance sheets and 40% have tightened their lending standards.[12] Indeed, some aggregators are scrambling to deleverage their balance sheets.

[8] CFP® Professional Demographics | CFP Board
[9] https://www.cerulli.com/press-releases/40-of-advisory-assets-will-transition-in-10-years-according-to-cerulli#:~:text=Within%20the%20next%2010%20years,unsure%20of%20their%20succession%20plan
[10] https://www.financialexecutives.org/FEI-Daily/March-2023/Why-Are-Students-Leaving-Accounting.aspx#:~:text=Colleges%20across%20the%20United%20States,for%20finance%20and%20accounting%20degrees
[11] https://www.global-rates.com/en/interest-rates/libor/american-dollar/historical/2020/ USD LIBOR interest rates in 2021 (global-rates.com); Current 1 month Libor - Google Search
[12] https://fred.stlouisfed.org/series/DRTSCILM

Eight differences in the future operating environment

1. There will be a renewed focus on organic growth.

There is an immense opportunity approaching

The good news for the industry is that an immense opportunity is approaching. Greater than seven million more people in the United States are between the ages of 45 and 60 than between 60 to 75.[13] Hundreds of thousands of the younger segment will look for financial advice once they have accumulated some level of material wealth.

Additionally, although the present value of the fees generated by each new client is immense, the current cost of acquiring them is a fraction of the value they create. Certainly, this is unsustainable and at some point, everyone will have to spend much more on marketing as well as do more for clients, which will lower margins. However, in the interim, there is an opportunity for participants to build gigantic amounts of incremental enterprise value.

Most participants are unprepared to capitalize

Consequently, the industry will refocus on organic growth. Unfortunately, the vast preponderance of participants is completely unprepared to take advantage of this opportunity. It is almost impossible for organizations which have not marketed for some time to suddenly begin marketing. It will take large investments in building brands and a great deal of time and work to transform cultures and create the necessary proprietary referral networks.

Additionally, many organizations have become addicted to custodial referrals for their organic growth. Such dependence is likewise unsustainable, and a large part of their future profitability is at the mercy of the custodians.

2. The industry will be much more competitive and far less genteel.

Industry will evolve from a club into a jungle

The scramble to take advantage of the upcoming tidal wave of potential new clients will change the industry — and not for the better. Longtime unspoken rules will fall to the wayside. It will be far less genteel.

Participants will share less with their peers and compete more. Participation in industry events and study groups will diminish. And the industry will evolve from what is now a giant club into a jungle.

[13] https://www.statista.com/statistics/241488/population-of-the-us-by-sex-and-age/

3. Big firms will start to act like big firms in other industries.

A key driver of these changes will be big firms capitalizing on their scale to create competitive advantages. They will expand their value propositions and do more for clients for the same fees.

Of course, the package of services provided to different clients will depend on what they pay. However, every client, regardless of size, will receive much greater value for their money. Indeed, they will demand it. Paying one percent of assets in a 5% inflation-adjusted return environment is quite different than in a 10% percent environment.

Sophisticated smaller firms will adopt niche strategies to sustain margins.

Every firm will do more for the same fees

As big firms expand their value propositions, every participant – regardless of size – will be forced to respond. Smaller firms will scramble to sustain margins. They will need to become much larger and will also affiliate with shared resource platforms that allow them to spread the fixed costs of certain services across a greater number of clients.

Sophisticated smaller firms will also adopt niche strategies, enhancing their expertise in the most complicated and important problems of targeted, narrow client groups within their geographic markets. Doing so will allow them to charge a premium for their services.

4. Talent will be in greater demand, harder to come by, and more expensive.

Trying to grow at a high organic rate will also require much additional talent. Meanwhile, nearly every participant will need to replace numerous retiring senior professionals.

Consequently, participants will battle with each other for the people they need. Labor costs will rise. And many of the new professionals in the industry will be far less capable than those whom they replace.

5. Cyber threats will increase costs, lower productivity, and aggravate everyone.

Cybercrime is an existential threat to wealth managers and their clients' wealth

Cyber attacks are existential threats to every participant and to their clients' wealth. Cybercrime will soon be a $10.5T industry, larger than the sale of all illegal drugs sold worldwide, combined.[14] Those who continue to ignore them are likely to wind up being sued, personally receive an enforcement action, and be fired by custodians.

[14] Cybercrime To Cost The World $10.5 Trillion Annually By 2025 (cybersecurityventures.com)

The SEC has recognized the magnitude of this threat and recently proposed regulations that mandate self-reporting in the event of a breach and force participants to disclose counterparty cyber risks to clients that arise from using their services.[15] Managing this risk will be costly and aggravating. Moreover, unlike most other investments, it will lower rather than enhance productivity.

6. AI-software will impact wealth managers but not for some time.

Notwithstanding the immense hype regarding the potential impact of artificial intelligence software on wealth management, it will be some time before cost-effective technology will become available. Such tools will ultimately improve participant operations, most notably when onboarding new clients.

7. M&A transactions, on average, will be smaller except for some potential aggregator mergers.

The days of making easy money from mergers and acquisitions are gone. Instead, any value created from such transactions will depend almost entirely upon what happens after the deal closes.

PE firm incentives make transactions between aggregators unlikely

Notwithstanding, the industry will continue to see high volumes of mergers and acquisition transactions completed. However, the average size of acquired firms will be much smaller over the next 10 to 15 years than in the prior decade.

There also may potentially be transactions between aggregators. That said, the financial incentives of many of their PE backers and the current condition of these entities make it unlikely such transactions will occur anytime soon. The current biological imperative of PE firms is to find places to put money to work and the last thing any want to do is to sell an aggregator that they have backed. Indeed, many already have effectively sold their stakes in these businesses to themselves, moving it from one fund to another.

Still, mergers between aggregators may occur after some of these organizations have transformed themselves into single enterprises, as well as taken the steps necessary to begin recruiting large numbers of new clients. Such transactions would allow both sets of backers to roll their stakes over into the new entity and continue to collect the associated management fees.

[15] Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies - https://www.sec.gov/files/rules/proposed/2022/33-11028.pdf

8. While prices will remain fulsome, quality in M&A will ultimately matter.

The market has finally recognized the stability of client relationships

Meanwhile, the prices for wealth managers will remain fulsome. Competition alone will ensure this. However, the market has also finally recognized the stability of client relationships creates an implied value for these types of businesses that is materially greater than their traditional valuations.

Additionally, quality will matter. Aggregator management already has its hands full integrating existing acquisitions, building brands, and transforming affiliates. Consequently, they will only consider acquiring another poorly run firm that long ago ceased marketing if they can buy it at a cheap price.

In contrast, well-run, growing wealth managers of all sizes will be in high demand. Buyers will pay much more for these organizations than their less attractive peers.

Ten traits common to the most successful industry participants over the next 10 to 15 years.

1. Have decisive owners with very long investment horizons.

Decisive owners with long investment horizons is the greatest competitive advantage

The single greatest competitive advantage for any wealth manager is having decisive owners with very long investment horizons. It will take large investments and a great deal of patience to capitalize on the upcoming immense organic growth opportunity. And decisions made today will determine outcomes for the next 10 to 15 years.

2. Do whatever is necessary to capture as many new clients as possible.

Disparity between the value of clients and their acquisition cost is unsustainable

The most successful participants recognize that the current disparity between the present value generated by each new relationship versus its cost of acquisition is unsustainable. They also understand it will be the first movers that innovate and change the terms of competition that will benefit most from the upcoming organic growth opportunity.

Consequently, these organizations will do whatever is necessary to capture as many new clients as quickly as possible. Still, they will not depend on outside parties, such as custodians, to generate prospects. They recognize they control neither their participation in these programs nor the underlying economics. Instead, they will create their own Center of Influence (COI) new client referral networks to recruit new clients.

3. Reengineer their operating models to better use their talent.

Successful organizations will also reengineer their operating models to better use their talent. Instead of “athlete”-based structures – which compensate their best marketers on the size of their books and disincentivize them from getting new clients once they are full – these participants will specialize by function.

Shifting operating models is essential but risky

Shifting to this operating model will accelerate organic growth rates as much as four to five-fold while capitalizing on existing excess client servicing capacity which virtually every wealth manager possesses. However, implementing such a change will be extremely challenging and creates a risk of blowing a firm up.

More specifically, key employees currently effectively control client relationships, and this is the source of their bargaining power with their employer. Unilaterally shifting to a specialization-by-function operating structure would institutionalize relationships, stripping this power away. Understandably, it would likely trigger the departure of many key employees and their clients.

Thus, the most successful participants will instead adopt a two-track approach. First, they will create compensation systems that provide marketers with a contractual material participation in the value created by each new client they recruit. Under such a structure, the most talented individuals will be capable of building immense personal wealth over time.

Second, these organizations will also accept that many existing key employees will reject any change. Consequently, they will also create parallel compensation systems that effectively grandfather in certain individuals.

4. Reset their cultures.

Recruiting clients is brutally hard

The fourth common trait of the most successful firms will be that they will reset their cultures. Recruiting new clients is brutally hard. Only those organizations obsessed with organic growth are successful in doing so. However, most wealth managers today are low stress, relaxed places to work. Shifting to the necessary growth-focused culture will impose accountability on everyone and raise everyone’s stress, causing many departures.

5. Do whatever is necessary to quickly acquire the necessary talent to grow.

The most successful participants will also do whatever is necessary to quickly acquire the talent they will require to grow their businesses.

Successful firms will poach talent from competitors

They will poach professional staff from competitors notwithstanding that they and their management will be shunned – perhaps, even despised – within the industry for doing so. However, the scarcity of available talent combined with its upcoming immense organic growth make such considerations irrelevant.

Savvy firms will also preemptively create the necessary financial incentives to retain their best people, long before any other organization tries to poach them. They recognize participants who believe they can rely on restrictive covenants to retain talent are deluding themselves.

Moreover, successful organizations want to change the labor market and drive up their competitors' costs. They understand these organizations are focused on their short-term profitability because it funds their owners' lifestyles. Forcing changes to their cost structures will limit their ability to compete for new clients.

6. Develop cost-effective, powerful brands.

Wealth manager brands are about diagnosing and solving client problems

Cost-effective, powerful brands will be the sixth trait common to the most successful participants. To date, wealth manager brands have been largely irrelevant as reflected in their inability to drive large volumes of prospects to their organizations. Certainly, Schwab and Fidelity have brands that do this. However, they spend hundreds of millions of dollars annually on marketing, outstripping what even the largest aggregators can currently afford.

Consequently, the most astute competitors will build potent, cost-effective brands that communicate expertise in diagnosing and solving their targeted audience's problems. Certainly, the management of some larger participants will have a natural inclination to go toe-to-toe with Schwab and Fidelity, ignoring both the accompanying costs and that these two organizations are unable to retain thousands of the potential new clients brought into their branches because they lack the staff with the needed expertise many prospects require.

The most successful brands will be multiple sub-brands wrapped in a national one

The smartest firms instead will focus their brands on those whom they can best serve and will incorporate the groups which such individuals affiliate with into their marketing strategies. The most successful larger participants will effectively be a collection of sub-brands wrapped in a larger national brand.

7. Embrace rather than just endure the many changes cyber threats will force.

The seventh trait of the most successful participants will be that they will embrace rather than just endure the many changes cyberthreats will force. These organizations accept that cyberthreats along with the

SEC's new regulations are going to change how they operate their businesses — and not for the better. They also recognize the immense threat that cyber poses to client wealth and wellbeing. Consequently, they will quickly make the necessary investments to upgrade their defenses and help clients better address their cyber risks.

At the same time, however, they will also use these investments as a distinguishing feature when marketing. Counterparty cyber risks must be disclosed to clients. Calculating competitors will point to the strength of their defenses when compared with their lesser-prepared peers.

Astute competitors will use cyber defenses to differentiate themselves

These participants also recognize they are now obligated to disclose to current and future clients that custodial and brokerage agreements obligate the user to bear the preponderance of the risk of cybertheft from accounts. But rather than just inform and likely scare the living daylights out of these individuals, the most successful wealth managers will instead help them to manage cyber risks and likewise use this capability as a differentiable attribute when marketing.

8. Aggressive in expanding their value propositions.

Astute competitors want clients to scrutinize the assets-under-management fee model

The eighth common trait of the most successful participants will be that they will be aggressive in expanding their value propositions. These organizations want both their competitors' existing clients as well as prospects to scrutinize the current assets-under-management fee model and demand more value for their money. These wealth managers will lead the way in doing more for clients for the same fees, distinguishing their offerings, capturing greater market share, and forcing others to follow in their wake.

Savvy smaller organizations will respond by accelerating their development of specialty expertise in the problems of narrow groups of targeted clients in their geographic regions. They will shift from just helping clients manage their wealth to playing a much larger role in helping them create and build it.

9. Much more sophisticated and discriminating buyers and sellers.

Savvy buyers will offer much more value to sellers

The ninth common trait of the most successful participants will be that they will be much more discriminating and sophisticated buyers and sellers of wealth managers. Acquirers will carefully study prospective acquisitions and focus on only those opportunities which fit within their overall strategy. They will also create compelling propositions that provide sellers with much greater value than just the amount paid at closing.

These buyers will also build relationships with prospective sellers long before they come to market. They will understand the perspectives and objectives of each of the seller's employees and be well positioned to address everyone's concerns.

Sophisticated sellers will likewise invest a great deal of time identifying and learning about those prospective buyers. They will study the incentives of each buyer's backers, research the acquirer's prior acquisitions, and determine how it interacts with its affiliates.

More importantly, astute sellers will prepare their firms for a transaction long before they come to market. They will try to preemptively address potential buyer concerns and best position the organization to be as compelling of an opportunity as possible.

Sellers will demand much greater value from their bankers

These sellers will also demand much greater value from their bankers. In many prior transactions, bankers were paid immense amounts of money to be glorified auctioneers. The most sophisticated participants will demand much more, requiring bankers hoping to represent their firms in the future to invest several years of work educating them on the details and perspectives of various sellers and to coach them on the best way to prepare their organizations for a potential transaction.

10. Management with the necessary skills, temperament, and expertise to execute.

The tenth trait common to the most successful participants will be possessing management with the necessary skills, temperament, and expertise to execute in what will be a very different future operating environment. Consequently, participant owners must determine whether current management – regardless of how successful in the past – has the skills and abilities to lead their organizations going forward.

Successful firms will be led by business operators

The most successful firms will be led by individuals who at their core are business operators, individuals who are passionate about the day-to-day details of running a wealth manager. Most participants are going to have to undergo a major transformation. This will require leadership that has the patience to effectively renegotiate agreements with many key employees as well as decisiveness in determining who should be let go. They also are going to have to build brands and sub-brands. And they are going to have to be effective recruiters who at the same time can effectively manage their firms' owners.

Unfortunately, many successful firms were largely built through acquisitions, led by individuals with great vision who took a great deal of risk. However, not all will be successful at building future enterprise value over many years.

What will the wealth management industry look like in 10 to 15 years?

Investment management offers the best template for this industry's future structure

The investment management industry offers the best template for predicting the future structure of the wealth management industry. In the late 1990s, the former industry had just completed the first stage of its consolidation and consisted of several firms with $25 billion to $200 billion of client AUM, a relatively small number of mid-sized organizations with $2 billion to $10 billion, as well as thousands of smaller enterprises.

Industry participants will wind up in three groups

Today the investment management industry has 11 firms with more than $1 trillion of AUM and 40 more with more than $200B. Two hundred and fifty other firms, each with more than $5 billion of AUM,[16] are specialist money managers, highly profitable businesses with unique investment strategies that target a small specific portion of a portfolio allocation. Also, several thousand small investment management firms or "investment counselors" are marginally profitable, generalist money managers.

Undoubtedly, the wealth management industry over the next 10 to 15 years will undergo a similar transformation into three groups. The only question is which current participants will wind up in each group.

Group I – "Mega-firms"

Our view is that the industry's "mega-firms" – i.e., those with $500 billion or more client AUM – will likely emerge from the ranks of its current aggregators. Intense competition to buy wealth managers along with the paucity of independent $2 billion to $10 billion firms will make it extraordinarily challenging for a de novo aggregator to achieve the necessary scale through acquisitions.

Many aggregators lack backers with sufficiently long investment horizons

To no surprise, many obstacles exist that aggregators must first surmount to become mega-firms. The preponderance of the industry's growth will be from adding new clients. These organizations will have to undergo a very expensive, lengthy, and challenging transformation to participate in this opportunity. However, their backers are private equity firms with funds that on average have five to seven year lives which limit their ability to take the necessary long-term perspective.

As noted earlier, a handful of aggregators are at the other end of the continuum with very different owners and are much further along in their integration processes. They are much better positioned to capture the upcoming tidal wave of new prospective clients and, by far, are the most likely to ultimately emerge as mega-firms with at least $500 billion of client AUM.

[16] Largest Money Managers 2023 - Full List | Pensions & Investments (pionline.com)

Another potential group of mega-firm candidates will be aggregators that merge. As noted earlier, this is most likely only after they have finished transforming their affiliates and begun to grow organically.

Sovereign funds will at some point disintermediate PE firms

Additionally, we believe it is likely that one of the organizations that provides PE firms with their capital – i.e., sovereign funds – will at some point disintermediate them and acquire and build an aggregator into a mega-firm, enabling it to own an intergenerational asset. Lastly, and as described below, mergers between specialist wealth managers that occur over time may likewise create very large and profitable enterprises.

Being a public company is a recipe for destroying value in wealth managers

That said, any organization that is a public company is the least likely to emerge as a mega-firm. Rather than gradually building enterprise value over 10 to 15 years, public company management must instead focus on the next quarter's earnings, a recipe for destroying value in wealth managers.

Further, as mega-firms grow, they will evolve into diversified financial institutions that compete directly with organizations like Schwab and Fidelity. They will acquire brokerages to allow them to capture additional client revenues, and many will also offer services to businesses owned by clients.

Group II - Specialist wealth managers

Some specialist wealth managers will become $100 billion+ firms

The second group of participants will be made up of specialist wealth managers. Like niche competitors in any other industry, they will have expertise highly valued by a narrow set of clients and for which they will pay a premium price. These organizations will be much larger than they are today, and over time will acquire similar firms in other geographic markets.

They also may acquire other types of specialist firms, creating large enterprises with multiple sub-niches. Some of these organizations will manage more than $100 billion of client assets.

Group III – Thousands of small generalist wealth managers

The largest number of firms will largely remain unchanged. Thousands of small generalist wealth managers will continue to provide advice to clients in their communities. However, they too will be forced to expand their offerings, driving down their margins over time.

In 10 to 15 years, these firms will be jobs and not businesses. Their owners will work harder, make less and their firms will have little to no enterprise value.

I. How did the industry get to where it is today and what does it look like?

To understand how the wealth management industry arrived where it is today, one must first closely examine the 10-year period between 2012 and 2021. It was a halcyon decade for participants. Assets under management increased to nearly $50 trillion or almost two-and-a-half times what they were in 2012.[17] There was an M&A feeding frenzy with nearly 1,600 transactions completed.[18] And for the first time in the industry's history, there are now several non-brokerages with more than $100 billion of discretionary client AUM.

An equity bull market and low inflation shaped the industry

However, as shown in Figures 1.1 & 1.2 below, there were two dominant variables that shaped the industry – U.S. equity market returns, typically the largest allocation in most client portfolios – and historically low rates of inflation. For example, the S&P 500 generated a 15.1% compounded annual return net of CPI or 170% of the average of the 50 prior years.

For those firms that charge asset-based fees, owning a wealth manager is the economic equivalent of making operationally leveraged investments in the financial markets. As markets rise, so do firm revenues, but operating expenses change only marginally. And industry participants with 50% gross operating margins see their operating profits go up and down about one-and-a-half to two times as much as the markets.

Even poorly managed firms tripled or quadrupled their profitability

Consider the impact of a decade of outsized U.S. equity returns on a wealth manager's overall economics. A 70%/30% portfolio[19] would have generated a 10.04% compounded annual rate of return net of inflation versus only 3.44% for the preceding 10-year period. Firms that operate at 40% to 50% gross margins saw their operating profits increase at an annual compounded rate of 15% to 20% per year. Wealth managers that began that 10-year period with $5 million of annual operating profits finished with $20 million to $30 million without adding any net new clients. Even poorly managed industry participants with negative organic growth rates still managed to triple or even quadruple their operating profits.[20]

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[17] https://www.mckinsey.com/industries/financial-services/our-insights/from-tailwinds-to-crosscurrents-resilient-growth-in-wealth-management

[18] https://f.hubspotusercontent30.net/hubfs/7475083/ECHELON%202021%20RIA%20M%26A%20Deal%20Report.pdf

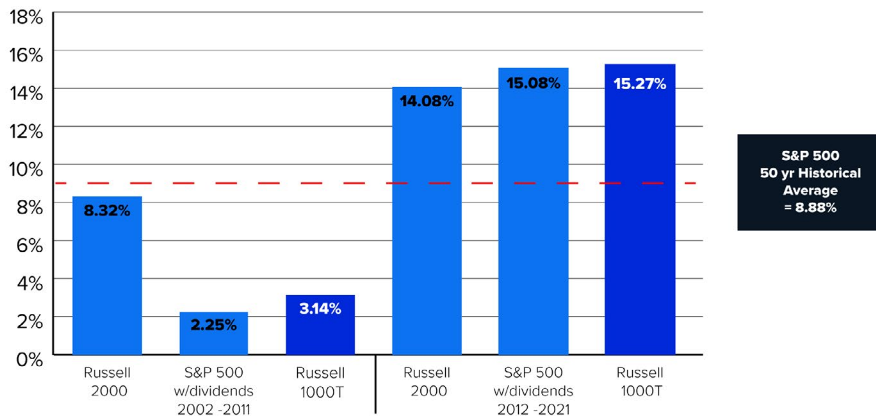
[19] For purposes of this example, we assumed a typical client portfolio that was 30% invested in the Corporate Bond Baa index and 15% in the MSCI, 10% in the Russell 2000, and 45% in the Russell 1000 equity Indices.

[20] It is important to note that for purposes of this study, we define operating profits as EBITDA before paying employees who are effectively economic owners of the firm. More specifically, the numbers described above reflect changes in the aggregate economics of wealth managers. However, many firms – as described below – rely on outdated operating models that compensate certain key employees based on a percentage of the revenue generated by their individual books of business. Such structures effectively provide these individuals with an economic ownership stake in their employers that participate as operating profits rise and fall, even though they may not have any legal ownership in the enterprise.

To be sure, 2022 saw a market correction, albeit nothing comparable to the 2008-2009 crash. And the markets have since partially recovered. Regardless, the decade-long run up in the markets has fundamentally altered the economics of most industry participants, which will impact their owners' future behavior and, in turn, how the industry will evolve over the next decade.

Figure 1.1

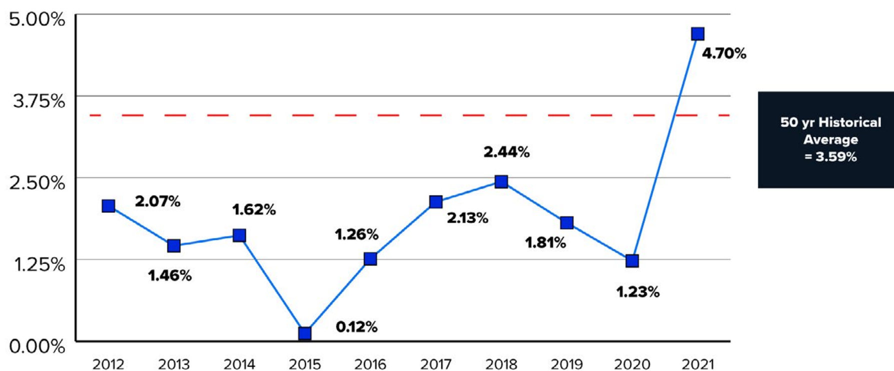
U.S. Equity Market Returns Net of CPI



Sources: https://www.1stock1.com/1stock1_785.htm; https://www.1stock1.com/1stock1_784.htm; S&P 500 Price Return, Dividend Return, and Total Return (slickcharts.com); https://www.usinflationcalculator.com/inflation/consumer-price-index-and-annual-percent-changes-from-1913-to-2008/

Figure 1.2

Average Annual CPI Was About Half of It's Historial Average



Source: https://www.usinflationcalculator.com/inflation/consumer-price-index-and-annual-percent-changes-from-1913-to-2008/

Normal economic rules were suspended.

More succinctly, a decade of aberrantly high equity returns effectively suspended the normal economic rules that govern this as well as any other industry. It did not matter whether organizations had well thought-out strategies or their management's ability to execute or even how hard they worked. The EBITDA of every wealth manager surged.

The normal economic rules were suspended

There was little incentive to improve efficiency. Organic growth also became much less important, and few industry participants invested much time or effort in building brands, developing referral networks, or even trying to capture new clients.

Everyone was successful; the only issue was how much. Indeed, many owners became wealthy – if they were so fortunate (or perhaps, so brilliant) as to sell in either 2020 or 2021.

A perfect storm for mergers & acquisitions.

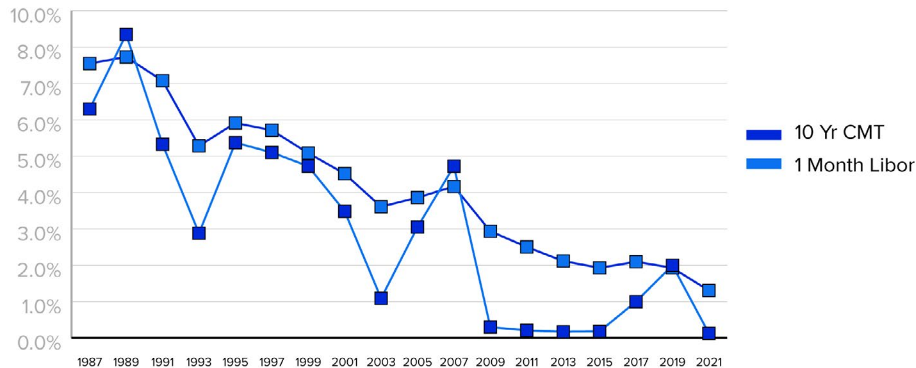
At the same time, a combination of a raging equity bull market (and what largely fueled it), PE firms awash in uninvested capital, and a generation of aging owners created the perfect storm for a wealth management M&A frenzy. The financial markets' frothiness was driven by a Federal Reserve policy of monetary expansion which commenced in the 2008-2009 financial crisis, was largely continued for most of the decade, and was also later significantly expanded in response to the Covid epidemic.

Debt was plentiful and cheap. Banks grew their balance sheets, increasing their commercial loan portfolios from about $1.3 trillion in the beginning of 2012 to more than $3 trillion by May 2020.[21] At the same time, the Federal Reserve's expansion of its balance sheet to nearly $8.8 trillion by the end of 2021[22] led to record low interest rates and the average one-month LIBOR rate for 2020-2021 was only 0.35%.[23]

[21] https://fred.stlouisfed.org/series/BUSLOANS
[22] Federal Reserve Board - Recent balance sheet trends
[23] https://www.macrotrends.net/1433/historical-libor-rates-chart

Figure 1.3

Interest Rates Were Historically Low



Source: LIBOR Rates - 30 year Historical Chart | Macreo Trends; https://www.macrotrends.net/2016/10-year-treasury-bond-rate-yeild-chart

Investing money was more important than generating strong returns

Meanwhile, PE firms raised record amounts of money, including more than $2.2 trillion since 2016,[24] as sovereign wealth and pension funds increased their allocations to private equity, leading to far too much money chasing far too few opportunities. More importantly, the management fees generated by this ocean of capital were staggering and altered the behavior of PE firms. It became much more important to them to find places to invest their funds and collect the associated management fees than it was to generate strong investment returns.

Wealth management was an inviting target to PE firms.

Wealth management was an inviting target

The wealth management industry was an inviting target to them for several reasons. First, the stability of client relationships – and the associated advisory fees that generate participant revenues – is breathtaking. For the industry's best firms, the biggest cause of client loss is death. They average less than 3% client turnover annually, implying an average tenure of more than thirty-three years.

Second, revenue stability makes investing in wealth managers far less risky than many other types of financial service companies, and this helped persuade lenders to provide acquirers with immense amounts of leverage. Indeed, some transactions were funded with debt greater than twelve times the selling firm's EBITDA.

Lastly, many larger wealth managers were founded in the early 1990s by individuals who at the time were in their mid-thirties and now were in their mid-sixties.

[24] PE Stats Final.pdf (senate.gov)

They needed to monetize their ownership stakes, creating numerous potential transaction opportunities.

Betting heavily on a rising tide.

Prices were inflated to levels previously unimaginable

These factors helped significantly increase both the number of PE-backed wealth management firm aggregators and the prices they were willing to pay. In 2012, there were only a handful of such buyers and transactions were typically priced at eight to twelve times trailing 12 months EBITDA. By 2020, there were more than 100 aggregators. [25]

They bet heavily on a rising tide and won big. So long as the equity markets continued to inflate assets and firm revenues, acquisitions would be successful regardless of price. Size – and not quality – drove outcomes. And a combination of intense competition for acquisitions, plentiful cheap debt, and PE firms awash in money inflated prices to levels previously unimaginable.

Actual cash flows were ignored, and instead "Adjusted EBITDA" was used

Indeed, buyers contorted themselves to justify higher and higher prices. Many ignored the actual cash flows generated by the seller and instead the term "Adjusted EBITDA" – a euphemism for what the business might make if its revenues continue to grow indefinitely at an astronomically high rate – became commonplace.[26] Larger wealth managers were often acquired at prices exceeding 20 times trailing twelve months EBITDA. There were even transactions priced at nearly 30 times.

At the same time, a slew of the industry's best firms put themselves up for sale. Certainly, for decades many owners had told clients and outsiders they would never sell, nor could they be tempted to do so because of how much cash flow was thrown off by the business. However, the opportunity to monetize it at 20 times EBITDA or more was simply too inviting to forgo.

What does the industry look like today?

The industry remains incredibly fragmented

Notwithstanding this decade-long M&A frenzy, the industry remains incredibly fragmented. Although there are numerous large aggregators with $25 billion to $200 billion of assets under management, there still are nearly 15,000 RIAs that have a median AUM of about $412 million.[27]

There has also been a convergence in how different types of businesses that provide financial advice describe themselves. More specifically, virtually every financial advisor uses the label "wealth manager."

[25] Wealth Management M&A Transaction Report (fidelity.com), Wealth Management Market Update (hl.com)
[26] One aggregator also uses the term Adjusted EBITDA when describing its profitability and defines it as what EBITDA would have been if one did not deduct a large portion of its cost of acquiring firms.
[27] https://investmentadviser.org/wp-content/uploads/2022/06/Snapshot2022.pdf

Brokers/registered reps and insurance agents who still sell products and collect commissions, as well as collect fees, now refer to themselves as “fee-based” wealth managers, making it almost impossible for potential clients to distinguish them from traditional “fee-only” fiduciary advisory firms.

However, what is different from only a decade ago is that there are now far fewer firms that previously would have been considered “large” (i.e., with $2 billion to $10 billion of AUM) but that today would be considered “medium-sized.” The preponderance of such “medium-sized” firms have been acquired and the difference between the big and the small (for much of the industry) is now much greater.

The industry has been sleepwalking.

Much of the industry became somnambulant

At the same time, the raging equity bull market also caused a large part of the industry to become complacent, even somnambulant. Many firms effectively stopped marketing. Why care about organic growth when your EBITDA is growing 15% to 20% per year without having to add new clients?

Indeed, 70% of the industry’s growth was from asset inflation[28] and a major custodian analyzed the firms it served and found that the AUM of more than 70% were contracting net of market appreciation. One major aggregator’s assets under management would have shrunk materially but for market appreciation and its ability to complete additional acquisitions.

Few participants have felt an urgency to grow organically

None of this is remarkable looking back over the industry’s three-decade history. When it began, there were more prospective clients than wealth managers could take on. Only gradually over time did the industry’s capacity catch up with the demand for the service, but the primary source of new clients for most firms remained referrals from existing clients. And the industry’s culture has long emphasized quality-of-life over profitability. Even in less frothy markets, few participants have felt an urgency to grow organically.

Minimal change and/or innovation.

Moreover, excluding FinTech largely used to improve efficiency, the industry has had little innovation since its inception. Wealth managers largely do today what they did 30 years ago, except that most firms now also provide tax and insurance advice.

The operating models of most wealth managers have also not materially improved. For example, a key contributor to the scarcity of the industry’s organic growth is that most participants rely on “athlete”-based operating models that effectively discourage their

[28] https://www.mckinsey.com/industries/financial-services/our-insights/from-tailwinds-to-crosscurrents-resilient-growth-in-wealth-management

most capable marketers from recruiting new clients.

More specifically, a small number of individuals fill multiple roles. They recruit the firm's new clients and then service them. They are also largely compensated based on the size of their books. However, inevitably at some point they have more clients than they can service and, given how they are paid, cease any marketing.

Current operating models are self-inflicted wounds

"Athlete"-based operating models are the industry's equivalent of a self-inflicted wound.

This widely used operating structure is the industry's equivalent of a self-inflicted wound. Recruiting new clients is hard and uncertain, and most firms have only a handful of people capable of doing this.

Success is conditioned on referral relationships which they have developed over many years. It also involves enduring rejection and disappointment and demands exceptional persistence.

Indeed, it requires a certain type of personality and drive, lacking in most current employees at wealth management firms. By relying on an athlete-based operating model, these organizations discourage the limited number of their employees capable of marketing from doing so and effectively create a brake on their ability to scale their enterprises.

Most employees are incapable of recruiting clients

Although some firms continued to add clients, much organic growth was from custodial referrals.

Of course, there were small numbers of participants that have continued to add clients and improved their business models. Some newer firms also built subscription programs targeting younger clients, years before they accumulated a great deal of capital.

That said, a major source of whatever organic growth the industry did achieve was from custodial referral programs. Immense numbers of potential clients walk into custodial branches every day. However, these organizations lack sufficient high quality financial advisory staff necessary to retain many of these prospects as clients. Consequently, the custodians instead refer them to independent RIAs in exchange for a perpetual participation in the revenue generated from the relationship. In 2020, Schwab alone made 7,000 such referrals that became clients of wealth managers.[29]

Many firms provided less value while collecting higher fees

Providing less value while getting paid higher fees.

More problematic, inflated equity market returns also allowed many wealth managers to become complacent and provide less value over time while getting paid higher fees. They became less involved

[29] https://www.riaintel.com/article/2aucu4e2wyzpnfv355yps/wealth-management/schwab-and-td-ameritrade-merge-advisor-referral-networks-cut-number-of-rias-in-new-program

Few clients scrutinized the value they were receiving for the fees paid.

in their clients' lives. Meetings were often delightful and only rarely uncomfortable. Investment performance blew through any projections in financial plans, making it almost a certainty that clients would meet their goals. Advisors were heroes, and few clients bothered to scrutinize what they were receiving for the fees that they paid. Indeed, many industry participants forgot what allowed them to succeed back when the industry was in its formulative stages.

Certainly, there was also a very small subset of the industry that recognized the unsustainability of this approach. Some even expanded their services to provide greater value. Regardless, according to one estimate, more than half of all industry participants today have evolved into de facto investment-only wealth managers.

Offerings have become homogenized.

Wealth management firm offerings have also become homogenized to the point that it is almost impossible for prospective clients to distinguish between them. Nearly every firm offers "wealth management" services – i.e., a combination of financial planning, investment management, tax advice and insurance advice.

Of course, every participant tries to claim some degree of uniqueness as well as expertise. But prospects are largely left to select wealth managers based on the charm and charisma of their staff and not the breadth, quality, and price of their offering.

Large firms do not act like big competitors

This homogenization is directly attributable to the fact that large firms in this industry do not act like large firms in others. They fail to take advantage of their size and scale and provide larger packages of services for the same price. These organizations instead allow smaller industry participants to compete with them on equal terms. For prospective clients, it is almost impossible to distinguish between the value propositions of firms with $500 million of AUM and those of with $100 billion of AUM.

A much older industry.

Another equally important byproduct of the raging equity bull market was that the industry got much older. Revenue growth from market appreciation does not require additional staffing. Indeed, adding staff without commensurate organic growth only reduces profitability. Consequently, industry-wide revenues increased at nearly twice the rate of staffing.[30]

There is no pool of available trained professionals

More importantly, there is no pool of qualified, experienced individuals just waiting to be hired. Today over half of all CFP holders are now

[30] https://www.nasdaq.com/articles/recruiting-for-the-right-roles%3A-the-future-of-wealth-management-hiring-is-here

37% of financial advisers are expected to retire in the next ten years

over 50 and only 5.6% are under 30. Nearly a third are over 60.[31] Approximately 37% of financial advisers are expected to retire in the next 10 years, creating an immense demand for qualified staff, in particular senior professionals[32]. Simultaneously, colleges across the United States have seen a 17% decline in the number of students enrolling for finance and accounting degrees, reducing the potential pool of entry-level employees.[33]

Largely ignoring cyber security risks.

Additionally, most industry participants continue to ignore the potentially existential threat that cybercriminals pose to their businesses. Soon to be both the world's largest criminal enterprise as well as the source of the greatest transfer of wealth in human history,[34] cybercrime is changing how virtually every other industry operates. It has also created such an immense demand for cybersecurity staff that there are currently more than 700,000 unfilled positions in the United States alone.[35]

Most participants approach cyber threats as though it is still 1993

More importantly, the SEC, recently proposed expanded regulations that more clearly define the cybersecurity obligations of industry participants. Although for nearly two decades wealth managers have been obligated to protect client information from potential identity theft, the recently proposed SEC rules[36] require much greater disclosure, self-reporting of breaches and equate having "adequate" cybersecurity procedures and policies with meeting fiduciary duties.

Notwithstanding, a survey conducted earlier this year for the industry's leading technology conference found that more than three quarters of participants had literally done nothing to address these risks.

They and many others continue to approach cyber threats as though it is still 1993 and not 2023.

Aggregators face multiple challenges.

Aggregators are paying for the sins of their earlier success

Aggregators now face a much more complicated operating environment and are effectively paying for some of the sins of their earlier, rapid success. A byproduct of the frenzied scramble to complete transactions as fast as possible and without regard to their quality or potential long-term fit is that many – but not all –

[31] CFP® Professional Demographics | CFP Board
[32] https://www.cerulli.com/press-releases/40-of-advisory-assets-will-transition-in-10-years-according-to-cerulli#:~:text=Within%20the%20next%2010%20years,unsure%20of%20their%20succession%20plan
[33] https://www.financialexecutives.org/FEI-Daily/March-2023/Why-Are-Students-Leaving-Accounting.aspx#:~:text=Colleges%20across%20the%20United%20States,for%20finance%20and%20accounting%20degrees
[34] https://foreignpolicy.com/2012/07/09/nsa-chief-cybercrime-constitutes-the-greatest-transfer-of-wealth-in-history/
[35] https://www.forbes.com/sites/forbestechcouncil/2023/03/01/why-overcoming-the-cybersecurity-labor-shortage-matters-to-company-success/?sh=36ce9dc7766b
[36] Cybersecurity Risk Management for Investment Advisers, Registered Investment Companies, and Business Development Companies - https://www.sec.gov/files/rules/proposed/2022/33-11028.pdf

aggregators today are not really businesses but rather confederations of businesses. Some affiliates have their own brands and most operate semi-independently. Indeed, these aggregators have realized only the costs of scale and none of its potential benefits.

Most aggregators have done little to integrate acquisitions

To be sure, it is important to recognize that there is a continuum. At one end, a handful of organizations were much more discriminating in what they bought and began integrating their purchases almost immediately after closing. These participants also have continued to focus on organic growth, albeit most of their success has been through new clients generated by custodial referral programs.

At the other end, there is the largest group of aggregators and they have done little to nothing to integrate their acquisitions. Moreover, many of their partner firms have been largely dead in the water for a long time when it comes to recruiting new clients. They have aging clients that they need to replace. Over time, these people will consume greater amounts of their capital, causing wealth manager fees, revenues, and, even more so, profitability to diminish.

The preponderance of the former owners of these affiliates are “retired-on-active-duty,” only occasionally stopping by the office and infinitely more focused on enjoying their personal lifestyle than growing the business. And most of the firm’s other professionals are incapable of recruiting new clients.

A key part of the bargain was that affiliates would remain “autonomous”

More problematic, such behavior pre-dated the firm’s acquisition, and a key part of the bargain was that affiliates would remain “autonomous,” continuing to largely operate as they had in the past. And although an aggregator’s voting rights allow it to unilaterally impose changes, doing so will permanently and adversely alter the relationship between it and its affiliates, potentially leading to the loss of key employees and clients.

In the center of the continuum, there are several aggregators that have begun integrating their acquisitions. However, they are far from having single enterprises and generally have had anemic organic growth.

Debt is more expensive and less plentiful.

Meanwhile, the billions of dollars borrowed by aggregators to finance their buying sprees has become much more costly and additional debt is less plentiful. One month Libor rates are more than five percentage points higher than what they averaged in 2020-2021. Bank commercial loan balances have shrunk more than 10% from only a year ago[37] and greater than 40% of banks have tightened their commercial and industrial lending standards.[38]

[37] https://fred.stlouisfed.org/series/BUSLOANS
[38] https://fred.stlouisfed.org/series/DRTSCILM

All of this has left many aggregators scrambling to refinance their debt. Some have even been forced to recapitalize their balance sheets, and one publicly traded aggregator was taken private.

Aggregators cannot acquire their way out of their problems

Moreover, simply trying to grow their way out of their problems through acquisitions is less likely to succeed because there are far fewer potential sellers of any material size left to buy and there are more than 100 potential buyers. Completing large volumes of deals of any size will be difficult, much less at prices that make economic sense for buyers.

The next 10 to 15 years should be "interesting times."

More succinctly, the wealth management industry is about to embark on what will be an interesting and challenging period in its history. Although it is very large and profitable, it is also relatively old and quite fragmented and has large numbers of old clients.

Many participants have done almost no marketing for a very long time. Others are dependent on obtaining new clients from custodians. And few industry participants currently materially distinguish their service offerings from those of their competitors.

Many aggregators are struggling to adjust to higher funding costs, and there are fewer medium-sized acquisition opportunities. And the equity bull market that papered over the faults of prior acquisitions appears unlikely to reoccur over the next 10 to 15 years.

"Interesting times" lie ahead for the industry

Recruiting additional talent has become one of the greatest challenges faced by industry participants of all sizes. There is a shortage of qualified professionals that will be further exacerbated by a wave of upcoming retirements.

Most troubling, many industry participants play a much smaller role in their clients' lives than in the past. With certainty, clients will soon closely scrutinize whether the value that they receive is commensurate with the fees that they pay.

To be sure, wealth managers continue to generate immense cash flow and working as one will remain one of the greatest careers in financial services. Owners and employees will continue to be well paid, and they will make a material difference in their clients' lives. Moreover, as we will discuss in the next chapter, there will be hundreds of thousands of new client acquisition opportunities over the next 10 to 15 years.

However, most firms will be incapable of capitalizing on this opportunity, and the industry's current state suggests that it is about

to undergo a complicated and challenging evolution that evokes an ancient curse. Clearly, working in wealth management over the next 10 to 15 years will most certainly be “interesting times.”

II. What will be different going forward?

The accuracy of any prediction regarding the future of the wealth management industry is highly dependent upon investment returns because — as noted earlier — owning a wealth manager is economically analogous to making operationally leveraged investments in the financial markets. Consequently, should U.S. equity market returns be comparable to 2012-2021, the normal economic rules that apply to all industries will remain suspended for wealth management. Everyone will continue to grow and flourish, regardless of competency or work ethic.

In contrast, should there be a major extended market correction that generates minimally positive or even negative investment returns for a long time, the industry's evolution will accelerate. Economics will quickly force many changes onto participants.

In this study we are assuming that financial markets will revert closer to their long-term averages. Should this come to pass, strategy and innovation will matter. So, too, will working hard, marketing, branding, and the ability to effectively manage and grow a company.

Remotely likely anyone goes out of business – unless they neglect cyber

That said, it is important to begin by noting that it is only remotely likely that any industry participant will go out of business over the next 10 to 15 years – that is, provided (as detailed below) they take the necessary steps to protect against cyber threats. Indeed, the massive run up of the financial markets and the accompanying appreciation of wealth manager client assets and firm revenues ensures that most participants will continue to be profitable for the foreseeable future. The only questions are how much money their owners will make, and whether their businesses ultimately will have any material enterprise value.

Change occurs slowly and non-linearly.

Everything in wealth management moves slower than in other financial services industries

It is likewise essential to emphasize that everything in wealth management moves much more slowly than it does in other financial service industries. Recruiting and onboarding clients takes infinitely longer than with investment managers. So, too, does brand building. Because participants throw off immense amounts of consistent cash flow, competitive pressures that drive rapid changes in other industries have a lesser, more gradual impact on this one. And, regardless of size, mergers and acquisitions transactions take *forever.*

Consequently, the industry only gradually evolves and in a non-linear manner. Changes initially occur very slowly as wealth managers usually wait for others to lead prior to altering their businesses models. That said, shortly thereafter, they are often quickly implemented and adopted industrywide.

For example, for decades wealth managers manually rebalanced client portfolios, something that literally took days of work to complete. Although new technology emerged that automated this function, the associated set-up process was very involved and time consuming. Consequently, only a handful of leading firms initially adopted it. However, a few years later it became a standard aspect of nearly every wealth manager technology stack.

In this chapter we will lay out our forecast of how the industry operating environment will differ over the next 10 to 15 years from its prior period. We believe that the historical pattern of non-linear change will repeat itself. Things will remain largely the same for a while and then, suddenly, much will change.

Should our assumptions prove to be correct, there will be eight major differences:

1. Organic growth will once again become a major focal point.

Recruiting clients was what historically created enterprise value

A big reason why firms of all sizes will soon expand their value propositions is that organic growth will again be a focal point for most of the industry.[39] For most of its history, recruiting clients was what created both profitability and enterprise value.

However, and as noted earlier, the decade-long roaring U.S. equity bull market made recruiting new clients largely an afterthought for many industry participants. The market was everyone's biggest client, and it required little work and resources to sit back and watch EBITDA grow as the markets skyrocketed.

Moreover, there is a gap between when clients are acquired and when they begin to contribute to profitability. A great deal of work and resources are involved in the onboarding process, and firms are lucky to break even on a new client during the first 18 months of the relationship.

Present value of each new client is immense

The present value of each client relationship is immense versus their cost of acquisition.

That said, the present value of each new client relationship is immense. The advisory fees paid for many years are often the same or larger, notwithstanding – at least for now – that a disproportionately greater amount of work is done for the client in the initial phase of the relationship. Additionally, those new clients who are still accumulating

[39] The term "organic growth" refers to recruiting new clients. Although it has been widely used for many years throughout the industry, we felt it was important to define it upfront because at least one prominent aggregator – which had acquired a large number of firms that years ago had largely had quit marketing and had generated negative rates of organic growth for many years – decided in somewhat Orwellian fashion to redefine the term to include additional acquisitions of wealth managers.

capital have a particularly large present value because their fees will increase over time from both greater savings and appreciation on existing assets.

More importantly, the current cost of acquiring new clients is a fraction of the value that they create. Although there is some competition for them, the present value of the fees from a new relationship are often 20 to 30 times greater than the marginal costs of recruiting the client.

Current cost of client acquisition is a fraction of their value

Consequently, the preponderance of the industry will refocus on adding new clients. Every participant faces a combination of cost inflation, aging clients who will consume more of their capital over time, and potentially less robust financial market returns, making organic growth essential to maintaining, much less increasing, profitability and enterprise value.

Organic growth will be a particular emphasis of many aggregators. A combination of higher debt funding costs and having to compete with large numbers of other aggregators for transactions – that on average will be much smaller than earlier ones – will make the economics of an acquisition-based growth strategy less attractive than in earlier years.

Plenty of new potential clients to pursue.

There are seven million more people 45 to 60 than 60-75

The good news for those who want to grow is that there will be plenty of prospective clients to pursue. Notwithstanding the hype about the size and importance of the Boomer generation, there is an even larger population of people now in their mid-40s and 50s than who are between 60 and 75.

As shown in the Figure 2.1 below, there are 62 million people in the United States who are between 45 and 60 and only about 55 million between 60 and 75. Many of the younger category over time will soon need a wealth manager.[40]

Impossible for firms that have ignored marketing to suddenly pivot and begin recruiting clients

The bad news is that it will be impossible for any organization that has largely ignored marketing to suddenly pivot and begin recruiting large volumes of new clients. It requires substantial investments back into the business and commitment to change cultures and operating structures.

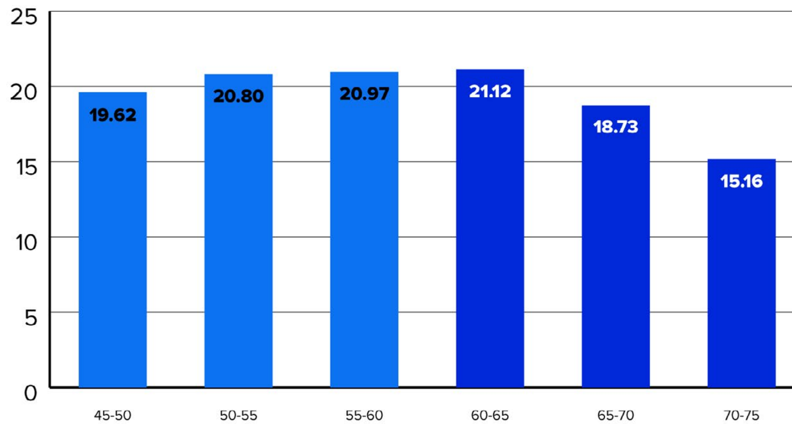
At the same time, competition for not just new clients, but also existing clients, will be much greater than in earlier years. Larger wealth managers need greater volumes of new clients to sustain organic growth rates. There are also a host of new competitors now versus a decade ago. Virtually every bank today has a wealth management arm, as does every insurance company.

[40] https://www.statista.com/statistics/241488/population-of-the-us-by-sex-and-age/

Figure 2.1

Seven Million More Americans Ages 45-60 than 60-75

U.S. Population by Age (millions)



Source: Population of U.S. by sex and age 2022 | Statista

There are also numerous robo-advisers competing for wealth management clients. One major bank is even using ChatGPT to develop a more sophisticated and personal way to provide low-cost, online advice.[41]

41 https://www.cnbc.com/2023/05/25/jpmorgan-develops-ai-investment-advisor.html

Will There Be an Immense Intergenerational Transfer of Wealth?

The potential upcoming intergenerational transfer of wealth and the ability of industry participants to capture it has been the subject of much debate. Indeed, by one projection, $72.6 trillion dollars is forecasted to transition between generations over the next 20 years.[42]

However, these numbers are based on current life expectancy projections and – as pointed out by Dr. Laura Carstensen, the Director of the Stanford Longevity Center in her seminal work *"A Long Bright Future"*[43] – nearly 70 percent of the longevity increases to date have resulted from declines in infant mortality rates. Factors such as better diet, exercise, new medicines, and healthier lifestyles and their impact on life expectancy are only just beginning to be realized and are not reflected in these numbers.

By her estimate, nearly half of those individuals who today are 60 or older will live to be 100. Her research has also found a very high correlation between wealth and longevity, meaning that those with money will likely be the overwhelming majority of those who will live longer.

More succinctly, should her forecasts prove true, a great portion of the wealth being held by Boomers and expected to transfer to their children will be consumed. Moreover, whatever amounts that are transferred in the next 10 to 15 years likely will be far less than currently projected.

[42] https://www.cerulli.com/press-releases/cerulli-anticipates-84-trillion-in-wealth-transfers-through-2045
[43] Carstensen, Laura L., PhD. A Long Bright Future, Random House, New York, 2011.

2. The industry will be much more competitive and far less genteel.

The industry has been somewhat of a club

For most of its history, the wealth management industry has been somewhat of a club. Many owners are friends with each other. They regularly meet and share their best ideas and confidential information. Indeed, they often see themselves as being in the "profession" of wealth management and not the "business" of wealth management.

This viewpoint is attributable in large part to how the industry began and that few participants had to raise capital to start their companies. The explosion in demand for advice in the early to mid-1990s stemming from companies rapidly shifting away from traditional to defined contribution pensions created conditions that allowed almost anyone to hang out a shingle and begin recruiting large numbers of clients. Most achieved profitability within about six months, and in short order were large enough to enable their owners to finance a very comfortable lifestyle.

Many founders were missionaries instead of business people

Moreover, many founders viewed what they did much more as a vocation than a job. They were missionaries and not businesspeople, dedicated to protecting people from unscrupulous brokers and somewhat unconcerned about how much money they might make.

Had these firms instead been required to raise outside capital, it would have forced a certain discipline upon them. Management would have been required to focus on maximizing profitability and enterprise value. Because of the immense long-term economic value of client relationships, short-term profitability and the quality of the owners' personal lifestyle would have been sacrificed to make the necessary investments to recruit and retain as many clients as possible.

Certainly, there are a relatively small number of participants that did not raise capital but still took this approach. And today, some of them are the industry's most successful independent firms.

Financial capital and the need to grow organically will change the industry's culture.

Many unspoken industry rules will dissipate

However, large amounts of capital have now come into the wealth management industry and participants will need to grow at high rates to generate sufficient returns on these investments. The resulting competition will change the industry's culture and not for the better. Many long-time, unspoken rules – maintaining one's work/life balance is paramount, one never poaches employees or clients from other firms, there are plenty of prospective clients to go around for everybody, etc. – will dissipate.

Going forward, wealth management will look much more like a jungle than a club. Participants will compete for new and existing clients.

There will be even more ferocious competition for talent, including existing employees. Short-term profitability will become less important than long-term enterprise value. And the industry will become far less genteel and polite.

3. Big firms will start to act like big competitors in other industries.

Participants market themselves not on what they do but on how well they do it

A key driver in changing the industry's culture will be that big firms will begin to act like big competitors in other industries. More specifically, one of the more remarkable current aspects of the wealth management industry is that most participants market themselves not on what they do or what it costs but instead on how well they do it. Nearly every firm's value proposition is a similar package of financial planning, investment, and risk management services and the costs of such services do not vary widely between participants. Instead, differentiation is tied to the perceived quality of professional staff and the depth of their concern for clients.

Certainly, some organizations that target ultra-high net worth clients and profess to be multi-family offices may offer a larger menu of potential services. However, from the client's perspective, one largely pays the same for the same services.

This will change. In virtually every other industry, large firms bundle products and services and provide rebates to their best customers. Airlines have frequent flyer mile programs as well as other awards. Hotels provide points that can be used to pay for future stays. Cable and telecom companies offer packages of different channels, services, and free phones. Even food delivery services now provide rebates to repeat clients.

These programs tie customers to them and make it much harder for smaller organizations to compete. For example, in 1995 there were 96 airlines. Today there are only 63 and four provide 84% of all domestic air travel.[44] And many of their smaller competitors pay them to participate in their frequent flyer programs.

Large firms will do more for clients for what they pay now or less

Larger wealth management firms will similarly capitalize on their scale, expand their service offerings, and do more for clients for what they pay now or even less. Such additional services will be like those currently provided by family offices, but they will be customized to meet the specific needs of high-net-worth clients instead of ultra-high-net-worth.[45]

[44] https://www.ncbi.nlm.nih.gov/pmc/articles/PMC7489892/#:~:text=In%20the%20US%2C%20the%20four,international%20market%20of%20the%20US.

[45] For purposes of this paper, we have defined ultra-high-net-worth clients as having $50 million or more of liquid assets.

Of course, the services provided will depend on the size of clients and the fees they pay. Emerging affluent clients and very small high-net-worth clients that pay relatively low fees will receive far less than clients who pay $30,000 per year or more. Regardless, value propositions will be expanded for all clients.

Large firms will initially add high intellectual capital / low marginal cost services.

High intellectual capital /low marginal cost services will be added first

Moreover, large firm value propositions likely will only gradually expand and initially they will do so in a way that does not materially reduce their profitability. As part of this, they will add high intellectual capital / low marginal cost services that require only small numbers of additional professionals whose cost can be spread across large numbers of clients. Such potential services may include career and business consulting, personal real estate advice and management, banking relationship management, philanthropic advice, and much more comprehensive tax and insurance advice.

Smaller firms will be forced to similarly expand what they do for clients. However, given the high associated fixed costs, it will be likely many will only be able to do so by affiliating with large service platforms. They will remain independent but will achieve the necessary size and scale through shared resources.

Firms will eventually include services that clients currently pay separately for

In response, larger firms over time will further expand their bundled offerings without increasing the fees they charge to include lower cost, high volume/low margin services that clients must now separately pay for – such as bill payment and receivables management, personal cybersecurity and cyberprivacy services, and tax return preparation – as well as some more expensive, one-time services such as estate and trust document preparation.

They also will upgrade their technology platforms to allow them to help clients track important financial information needed to determine property tax basis, household employment taxes, sales and use taxes, personal property taxes, and estate and gift taxes, as well as provide more comprehensive financial reporting including ongoing balance sheets, net worth statements, and regular cash flow analyses.

Large firms recognize it will be hard for small ones to match their offerings.

Certainly, adding these services and enhancing technology platforms will reduce profitability. However, larger firms recognize that it will be even more challenging for smaller competitors to match these offerings without obliterating their profitability and, thus, the lifestyle of their owners.

As these changes become industrywide, smaller competitors will have to reengineer their business models and get much larger or accept that they will make a lot less money over time. They will also specialize, developing expertise in the most important, complicated

problems shared by small numbers of individuals in a particular geographic market. Although they, too, will have to do more for clients they will be able to charge a premium price given the enhanced expertise provided as part of their services.

Bigger firms will expand their value propositions far sooner than most industry participants expect.

It is our view that bigger firms will begin taking these steps far sooner than many industry participants might currently expect. Indeed, a small number of larger organizations have begun to do so.

Clients will soon demand more value for their fees.

This will be due in no small part because both current and prospective clients will demand it. More specifically, the insane run up of the equity markets from 2012-2022 led, or perhaps misled, many wealth managers into significantly reducing the value that they provide. Clients were happy and the fees they were paying were trivial when compared to the investment returns that were being generated. And so long as this persisted, they were not going anywhere.

However, the world going forward will likely be quite different. A one percent fee looks much larger in a five percent inflation-adjusted return environment than it does in a 10% one. And as the gloves come off in the industry, existing and prospective clients will be increasingly solicited by other firms offering to do more for less. Clients will scrutinize more closely what they get for what they pay and demand more.

4. Talent will be in greater demand, harder to come by, and more expensive.

Participants face several talent recruitment headwinds

Meanwhile, nearly every participant will be trying to find additional talent, long the bane of wealth managers. However, they face several headwinds. As noted earlier, more than a third of financial advisers are expected to retire in the next 10 years and fewer college students are seeking finance and accounting degrees.

Firms hoping to grow organically will need to first replace retiring employees

Additionally, firms hoping to grow organically will need to not only replace those who are retiring but also somehow find advisers who can also recruit new clients. Notably, the personality types of many entry-level employees generally are very different from those who are retiring. Most of the latter are entrepreneurs or entrepreneurial employees. They were comfortable with helping to build a business, functioning in an unstructured environment and marketing and networking with referral sources.

The new entrants are often much more employees than entrepreneurs. While intelligent and technically capable, they often are most comfortable in structured environments with clearly defined

responsibilities. They also are far less comfortable selling themselves and their expertise than selling the brand of their employer.

Consequently, participants hoping to grow organically are largely left with two alternatives:

(i) recruit senior individuals from other types of financial services companies and retrain them over time to become wealth managers or

(ii) poach talent from competitors.

The battle for talent has already begun

Additionally, notwithstanding their shortcomings and shortage, the battle for talent has already begun and is accelerating with certain large participants trying to recruit large volumes of new people as part of their growth plans. For example, JPMorgan recently announced that it intends on doubling the number of financial advisors in its private bank.[46]

Moreover, consistent with any supply/demand imbalance, talent – both new and existing – will soon be much more expensive. Labor costs will rise, and operating margins will decline.

5. Cyber threats will increase costs, lower productivity, and aggravate everyone.[47]

Cyber threats and what wealth managers will be forced to do in response to them will have an outsized impact on industry participants. Cybercrime will soon exceed $10.5T annually and be larger than the sale of all illegal drugs worldwide, combined.[48] It has been described as the largest wealth transfer in human history, and Warren Buffett stated that it is the “number one” threat to mankind.[49]

Cybersecurity poses an existential threat to all firms

Cybersecurity is an existential threat to every wealth management firm, regardless of size. A combination of financial and regulatory liability creates heretofore unseen risks for these enterprises and a significant breach resulting in the theft of material amounts of client assets and/or information could literally put a firm out of business.

More specifically, the wealth manager would be financially liable for any losses and undoubtedly be sued. It likely also would be effectively uninsured, given the standard terms of most cyber insurance policies.

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[46] Which Private Banks and Wealth Managers Are Looking to Hire (businessinsider.com)

[47] Two of the co-authors of this study published a seven-part series that examines in detail the cyberthreats faced by industry participants and what they will need to do to address them. They can be accessed at https://www.fa-mag.com/news/cybercriminals-are-coming-to-get-your-clients--assets-and-information-73935.html

[48] Cybercrime To Cost The World $10.5 Trillion Annually By 2025 (cybersecurityventures.com)

[49] https://www.businessinsider.com/warren-buffett-cybersecurity-berkshire-hathaway-meeting-2017-5

Why Is There Such a Shortage of Qualified Wealth Management Professionals?

The industry has no large pool of trained and experienced but unemployed individuals available for hire because of how it suddenly came into existence in the late 1980s and early 1990s. As noted earlier, in response to the explosion in the demand for advice, the resulting vacuum was filled by a cottage industry of tiny proprietorships. Only over many years did they become sustainable businesses and even the largest ones were still quite small on an absolute basis.

None were large enough to have the kinds of recruiting and training programs typically found in other financial services industries. Industry participants did not regularly hire large numbers of entry-level professionals with the expectation that some might wind up working somewhere else. Instead, most firms minimized the size of their staff.

In contrast, the large brokerages for many years had large recruiting and training programs. However, they focused on recruiting salespeople and not financial advisors. Granted, these organizations in recent years have tried to repackage their legions of brokers into wealth managers. But large numbers of those who were able to make this transition have gone out on their own, joining independent broker dealers or converting to fee-only wealth managers. Regardless, notwithstanding their size and cost, these training programs have generated very little additional potential talent whom industry participants might recruit.

A breach could literally put a firm out of business

The firm's brand also would be irreparably damaged. Not only the organization but likely also the organization's leadership could be subject to an enforcement action. Disclosure to current and future prospective clients would include the various cyber risks customers must assume when using the firm's services, as well as the amount and type of information and assets that were previously stolen and that it and management were sanctioned for breaching their fiduciary duties.

Add to this, the custodial firms that the wealth manager uses will likely fire the wealth manager and its clients. Industry participants with inadequate cybersecurity create a moral hazard for these larger, deep pocketed organizations – a hazard they are not willing to bear. The breached firm's clients likely will be notified that, due to their advisor's inadequate cybersecurity, they must find another custodian to hold their assets.

Good luck keeping existing clients – much less attracting new ones – under such circumstances.

Cybercriminals want to steal client information and assets

Wealth managers are compelling targets for cybercriminals.

Unfortunately, wealth managers are compelling targets for cybercriminals for two reasons.

They have access to billions of dollars of client assets. They also possess large amounts of client information that could be used to steal identities, and identity theft in the United States is already a $52B annual business impacting 42 million people.[50]

Sophisticated nation-state cybergangs target wealth managers

Trying to breach wealth managers are organizations that include large, sophisticated nation-state backed cybergangs operating in countries such as China, Russia, Iran, and North Korea. They have immense resources and processing power. Many are led by moonlighting individuals who by day are military cyberwarfare or intelligence officers and have been able to breach blockchain, cloud services and even the CIA and DOD.

There are also thousands of much smaller cybercrime enterprises operating in every country of the world including the United States. Although they lack the infrastructure and resources of their larger counterparts, they too are very technically sophisticated.

SEC regulations make wealth managers responsible for cyberbreaches.

The SEC first became concerned about potential cyberattacks on its registrants more than two decades ago and published rules requiring

[50] 2022 Identity Fraud Study: The Virtual Battleground | Javelin (javelinstrategy.com)

that they protect client information.[51] These rules were expanded 10 years ago with Regulation S-ID.[52]

Proposed wealth manager cybersecurity regulations will require industry participants to have cybersecurity policies and procedures that are "adequate" to protect client information and assets, and the new rules effectively hold wealth managers liable should they be beached. They also mandate that firms self-report almost immediately after such occurrences.

Many executives naively believe cybersecurity is a technology issue

The rules likewise impose detailed disclosure obligations on industry participants regarding the cyber risks that clients bear by using their services. They also mandate that all current and future clients be informed of any cyberbreaches, what caused them, and the resulting damage.

The combination of cyberthreats and the resulting potential regulatory and financial liability will force wealth managers to change how they run their businesses. Unfortunately, many industry executives naively assume these threats can be addressed simply by acquiring better technology.

However, cybersecurity is an exercise in risk management and not elimination. It requires multiple layers of defense, each focused on where individuals and technology connect, and it is human behavior that is most determinative of the strength of cyber defenses.

Wealth managers will have to take the same steps as big accounting and law firms.

Going forward, every industry participant will have to take steps like those that most major law and accounting firms have already adopted to protect against both external and internal cyberthreats. Wealth managers will be forced to shift to closed systems, accessible only by company owned and managed devices that are, at best, cumbersome to use. Access to and downloads of client information by employees will be carefully controlled.

Costs will go up, productivity will go down & headaches will abound

Industry participants will have to compartmentalize and segment client information to preclude the loss of large amounts of data from a single breach. Vendor cybersecurity will be carefully examined and they – including cleaning staff – will be barred from accessing company systems and certain areas of firm offices.

Wealth managers also will have to change who can execute transactions in client accounts and how they are done. Significantly more diligence will be conducted before approving any such transactions. And participants will have to become involved in the

[51] https://www.sec.gov/rules/final/34-42974.htm
[52] https://www.ecfr.gov/current/title-17/chapter-II/part-248/subpart-C

personal cybersecurity of both their employees and their clients.

Accomplishing this will require large investments in technology, training, and time. Wealth managers will also have to add staff that possess the requisite cybersecurity expertise. Costs will go up and productivity will go down and headaches will abound.

6. AI-software will impact wealth managers but not for some time.

There has long been speculation whether AI-software driven platforms eventually may be able to replace wealth managers. The technology, theoretically, would be able to anticipate and understand client needs at a level comparable to or even better than that of an experienced industry professional but at only a fraction of the cost.

AI technology will not replace wealth managers anytime in the next 10 to 15 years.

Perhaps this may occur at some point in the future, but not in the next 10 to 15 years. That said, wealth managers will most certainly eventually adopt AI-based technologies.

Indeed, many firms have begun to use AI-based technologies to better evaluate the quality of potential client leads. But this technology is still in its early stages. Moreover, given that client recruitment in the industry has been and will continue to be driven for the foreseeable future by referrals, such technology at least to date has not materially improved its users' organic growth rates.

AI technology will significantly shorten the time involved in onboarding new clients.

AI-technology will eventually improve efficiency

That said, AI-based technology will at some point significantly shorten the time and process involved onboarding clients. This will be a major improvement to operating efficiency because it is that process that consumes a disproportionate amount of wealth manager time and resources. The new technology will make it much easier for new clients to gather, provide, and organize their personal information.

However, it is unlikely that such technology will be available, much less cost effective, in the near term. AI-software development is still relatively new and to date has been breathtakingly expensive.
For example, Microsoft spent nearly $10B to develop its OpenAI platform and spends about $1B per year to maintain it.[53] Certainly, as new uses of AI technologies develop over time, these costs will come down. But it will probably still be several years before they will be at a level that will induce industry participants to adopt them.

[53] https://www.bloomberg.com/news/articles/2023-01-23/microsoft-makes-multibillion-dollar-investment-in-openai#xj4y7vzkg

AI software requires access to client data that only Schwab and Fidelity possess.

Far more problematic, AI software requires access to immense amounts of data to work effectively. Platforms such as ChatGPT and OpenAI have access to and can analyze literally everything on the Internet. At the same time, the only material data sets on the personal financial behavior of millions of wealth management firm clients are closely held by organizations like Schwab and Fidelity.

Unlikely Schwab or Fidelity will share information to improve competitor efficiency

They will likely use it to develop potential wealth management artificial intelligence-based technologies. But what they may be willing to share that would enhance the efficiency of their competitors is unclear.

Moreover, AI software is most effective when it constantly updates itself based on greater and greater amounts of data. For it to be useful it would need to be able to access client data from thousands of wealth managers at once. Hence, developing AI-based technologies without the help of the custodians would require large numbers of industry participants that compete with one another for clients to agree to work together, a challenging task to somehow arrange.

More importantly, protecting this client data from cybercriminals would be daunting. Core to any cybersecurity strategy is the compartmentalization of information. It limits the data hackers can obtain from a single breach and effectively forces them to separately hack into an organization multiple times and in numerous ways to

acquire large volumes of client information. With an AI system using a shared database, this critical layer of cybersecurity protection would be eliminated.

Narrower AI-driven tools will enhance wealth manager efficiency.

That said, over time simpler, narrower AI-driven tools will be developed that will enhance wealth manager efficiency. They will focus on discrete onboarding tasks – e.g., automatically collecting and aggregating information, as well as which questions a client should be asked based on certain public information about them. This data will further automate the financial planning process as well as help generate investment recommendations.

Almost everyone has a complicated relationship with money

Regardless, what AI-based wealth management tools will not do is replace wealth managers. Indeed, they will instead place greater emphasis on the true value that they provide.

Nearly everyone has a very complicated and emotional relationship with their money that often interferes with rational decision making. Core to wealth management is helping clients manage this relationship and make the right decisions given the specific problems

they are trying to solve. And the most important ingredients needed to do this are financial advisors who possess a combination of experience, training, and judgment that they have developed over many years.

7. M&A transactions on average will be smaller except for some potential aggregator mergers.

Even large aggregators are relatively tiny when compared with the overall market

As noted earlier, the industry remains extremely fragmented with nearly 15,000 RIAs. At the same time, even aggregators with as much as $100 billion to $200 billion of assets under management are still relatively tiny when compared with the $57 trillion size of the overall market for U.S. wealth management.[54] To achieve material, sustainable long-term scale, they will have to be five to ten times larger.

PE firms are also awash in capital they need to invest. Indeed, that industry has more than $1T of dry powder, and wealth management will continue to provide a compelling opportunity to put it to work.[55] Lastly and most importantly, many owners are old, and it is demographics that ultimately drive deals in this industry.

M&A activity will remain vigorous but with smaller transactions

For all these reasons, wealth management M&A activity will remain vigorous. However, the average size of acquisitions will be much smaller. Last year 291 transactions were completed.[56]
Another 117 were completed in the first half of 2023.[57] At the same time, a third fewer transactions last year involved firms with $1+ billion in AUM than in the prior year.[58]

This trend will likely accelerate as the mid-sized portion of the industry is further hollowed out. Most $2B to $10B AUM wealth managers were founded in the early to mid-1990s and many of them have already been gobbled up by aggregators. The preponderance of the remaining participants are largely newer, smaller firms.

Aggregators could and should, but are unlikely to merge, because of PE firm owners' financial incentives.

From a purely economically rational standpoint there could also be transactions between aggregators. There are more than 100 such firms. But only a handful have taken the necessary steps to create integrated enterprises and doing so is a precondition to capture the benefits of scale.

In other industries, aggregators typically defer additional acquisitions

[54] https://www.statista.com/outlook/fmo/wealth-management/united-states#:~:text=Wealth%20Management%20%2D%20United%20States&text=Financial%20Advisory%20dominates%20the%20market,US%2483.19tn%20by%202027
[55] PE Stats Final.pdf (senate.gov)
[56] Q4 2022 Wealth Management M&A Transaction Report | Fidelity Institutional
[57] Fidelity Wealth Management M&A Transaction Report | Fidelity Institutional
[58] Q4 2022 Wealth Management M&A Transaction Report | Fidelity Institutional

until they have completed integrating their existing affiliates. Others would sell themselves to competitors that are better at the integration process.

However, that is unlikely to happen in this industry because of the financial incentives of the owners of PE firms. Rationalizing an aggregator into a single enterprise is a costly and messy process, and it will take many years to fully realize the associated benefits. Most PE funds operate with much shorter (five to seven year) investment horizons.

PE firms want to invest more money instead of selling aggregators

More importantly, (and as noted earlier), private equity firms today are more often money managers than investment businesses. It is management fees and not carried interests in investments which dominate their owners' personal financial outcomes. But to get management fees – and more importantly, more funds to invest in the future that will pay them additional management fees – they need to find places to invest more dollars in companies like aggregators rather than sell them.

PE firms have sold their aggregators to themselves.

Indeed, in repeated instances PE firms have effectively sold their ownership stakes in aggregators to themselves, transferring it from one fund to another. Doing so allowed the first fund and its investors to "realize" the value of its investment, while at the same time enabling the PE firm to put even greater amounts of money to work and continue to collect large investment management fees from the latter fund.

Shifting stakes from one fund to another creates bigger management fees

Private equity firm fund investors to date have not objected to such financial machinations because their investments have done extraordinarily well, in no small part due to the massive run up the U.S. equity markets from 2012-2021. Additionally, as part of such recapitalizations, another PE firm is typically brought in as a co-investor at a very high valuation. Its inclusion effectively ratifies the price at which the first PE firm's newer fund is paying to buy the stake in the aggregator from its older fund. And so long as the value of the underlying aggregator continues to appreciate at a high rate, similar recapitalizations can be done every four or five years, allowing a PE firm to collect greater and greater management fees over time.

Moreover, there still are many potential (albeit, smaller) acquisitions yet to be consummated in the wealth management industry. Completing them will allow PE firms to invest more money in their existing aggregators.

Rationalization among aggregators unlikely in the near term

Thus, the normal rationalization process that occurs among aggregators in other industries likely will be delayed in this one for some time. It likely will only commence when the economics

of continuing to own an unrationalized aggregator become too unattractive for PE firms to justify to their investors.

What might cause this to happen would be if the profitability of their affiliates begins to decline. As noted earlier, certain aggregators own many firms that stopped adding new clients years ago. Unless they find a way to get them to start growing organically or are once again bailed out by hearty financial markets that inflate client assets at a rate that is faster than they are consumed, these firms and their profitability will at some point shrink.[59]

Indeed, the risk of shrinking partner firms is one of the reasons many aggregators have begun emphasizing organic growth to their affiliates. Unfortunately, unless these partner firms are first transformed as part of an enterprise-wide integration process, they are unlikely to succeed at doing so.

8. While prices will remain fulsome, quality in M&A will ultimately matter.

As described earlier, as the M&A frenzy for wealth managers neared its zenith from 2018-2021, prices for firms exploded. Valuations for firms often exceeded 20 times EBITDA on a trailing 12-month basis and at times approached 30 times. An abundance of low-cost debt and a willingness by lenders to provide funding in certain instances as great as 12 times the selling company's EBITDA helped fuel these prices.

Prices will remain higher than their historical averages

Although interest rates are now much higher and bank lending standards have significantly tightened, making it much harder for such high valuations to continue, we believe there are three reasons that prices for wealth managers will remain materially higher than their historical averages (i.e., eight to twelve times trailing 12 months cash flow) for the foreseeable future.

First, the run up in the financial markets has given potential sellers significantly more bargaining power. Industry participants that paid their owners $400,000 to $500,000 per year a decade ago now generate more than $2,000,000 of cash flow annually. And when one is effectively sitting in front of a firehose that, at least in the near term is throwing off $100 bills, there is far less urgency to sell even if profitability begins to decline over time.

Competition amongst buyers alone will force them to pay more

There are also – as noted earlier – a sundry of potential buyers

[59] Most aggregators own a preferred stake in the cash flow of their partner firms and often point to that as protecting them from the decline in profitability of affiliates. But retaining employees necessary to run the company and service existing clients requires a level of compensation that is irrelevant to the firm's capital structure and cash flow rights. At some point aggregators will have to accept making much less from these firms.

and competition alone will force them to pay more. Add to that, the preponderance of transactions will likely involve "tuck-ins" – i.e., an affiliate of a wealth manager acquires a smaller firm and integrates it into its business. Such transactions usually generate cost savings that historically have only benefited the acquirer. Going forward, competition will force buyers to share these consolidation benefits with sellers.

Lastly and most importantly, it appears that the market has finally recognized the intrinsic value of the remarkable stability of wealth manager client relationships. So long as client retention levels remain at their historical levels, traditional eight to twelve times EBITDA valuation metrics do not fully reflect the risk/reward benefits of owning such a business.

Quality will affect pricing.

Pricing will no longer be uniformly high

That said, pricing will no longer be uniformly high. Instead, buyers will differentiate based on quality. More specifically, one of the more bizarre aspects of the industry's recent consolidation has been that size, and not quality, largely drove how firms were priced in transactions. Certainly, there is a bit of a "chicken and the egg" aspect to size – i.e., if a firm was not of at least a certain quality, it could not achieve scale.

Buyers intentionally ignored qualitative factors

But as the frothing M&A frenzy peaked from 2016-2021, factors such as the depth and quality of successor staff, a firm's recent track record in recruiting new clients, and the quality of its management were largely irrelevant in determining prices. Instead, they were based mostly on how much cash flow was generated by the organization. Indeed, many buyers intentionally ignored qualitative factors in their quest to close acquisitions.

To be clear, we are not suggesting this behavior was irrational, given the raging U.S. equity bull market. However, without a similar run-up in the markets over the next decade, pricing metrics will have to change. What aggregators pay for wealth managers will be tied to the seller's quality.

What aggregators will ultimately pay for acquisitions will be tied to the seller's quality.

Certainly – and as noted earlier – there are some PE firms so focused on putting money to work that they will continue to deemphasize their aggregator's integration process and instead focus on buying more wealth managers regardless of quality.

However, this approach is unsustainable. Aggregators are now large enterprises. Their management already has their hands full overseeing and integrating their existing partner firms while at the same time

trying to find ways to reignite their new client recruitment efforts. It is non-sensical for them is to buy more poorly run firms, further complicating their lives while not materially increasing their enterprise value.

“Acquire anything” strategies are unsustainable

At some point in the next three to five years the number of firms relying on “acquire anything” strategies will dissipate, and all buyers will more closely scrutinize potential acquisitions. Small firms that are systematically and regularly adding new clients, almost by definition, are better-run businesses. They will be highly sought after, and the prices paid for them will reflect this.

Additionally, larger firms that have demonstrated an ability to not only consistently grow organically but also to acquire and effectively integrate acquisitions will be even more highly valued. Indeed, any wealth manager that has demonstrated this competency will be highly sought after.

III. Ten traits common to the most successful future firms.

Ahead of the industry is a breathtaking opportunity. Hundreds of thousands of new potential clients over the next 10 to 15 years will need to engage a financial adviser. And – at least for now – each one that a wealth manager adds will materially increase its enterprise value.

Certainly, there also will still be many acquisition opportunities. However, capturing a large portion of the upcoming tidal wave of prospects will be by far the biggest opportunity to build enterprise value.

Most participants are not prepared for a high rate of organic growth

Unfortunately, most participants are not well positioned currently. As noted earlier, the glorious decade-long raging equity bull market along with record low interest rates created a temporary window to capture value through financial engineering. It distracted them and now nearly every participant to some degree must transform their business if they hope to fully participate in the upcoming massive new client recruitment opportunity.

To be sure, the level of transformation required varies widely between firms. However, we believe that when everything is said and done, there will be 10 common traits shared by the industry's most successful firms:

Industry is more disorganized than only a decade ago

1. They will have decisive owners with very long investment horizons.

The industry today can be best described as somewhat chaotic. Although it has completed its first stage of consolidation, in many ways it is even more disorganized than it was only a decade ago.

Large numbers of big enterprises are nothing more than collections of smaller ones which are little changed. Many, if not most, participants are stalled, asleep at the wheel. Others continue to operate mostly on inertia and without any discernable strategy. Indeed, except for acquisitions, there is minimal competition between participants. And at times it appears as though firms of all sizes are doing whatever they can to not distinguish themselves from their smaller competitors.

Even the best positioned firms are far from where they need to be

Moreover, even the best positioned participants are far from where they need to be to fully take advantage of the upcoming opportunity for organic growth. Some rely almost entirely on outside parties, such as custodians, for new client generation and/or have relatively antiquated operating models.

Others are still a long way from digesting earlier acquisitions. And every firm will soon face a critical shortage of talent.

Most important competitive advantage is decisive owners with very long investment horizons.

Consequently, the single most important competitive advantage possessed by the industry's most successful firms will be having decisive owners with very long investment horizons. They will think in terms of decades and not years, be indifferent to short-term profitability, and understand that success in this industry only comes slowly.

Future winners will soon formulate and implement long-term strategies

Future successful participants are soon going to formulate and implement long-term strategies, make the necessary investments, and restructure their businesses as soon as possible so that they can take advantage of what will be a limited time, land grab opportunity.

Strategies that are implemented today will determine outcomes over the next 10 to 15 years. First movers who innovate and force the industry to change how it operates and competes – including in terms of value propositions, culture, branding, and talent recruitment – will prosper and capture a disproportionate number of new clients and, thus, the incremental enterprise value created in this industry.

The quick and easy ways to make money are now gone.

Certainly, the run up of the equity markets from 2012-2021 combined with an extended period of historically low interest rates suspended this calculus. However, the quick and easy ways to make money are now gone.

More specifically, had equity markets instead generated closer to their historical returns rather than more than 15% annually as they did from 2012-2021, the EBITDA of most industry participants would be only a quarter to one third of what it is today. Some firms would no longer even be profitable.

Legions of potential buyers competing for the same firms have changed the economics of M&A.

Legions of buyers have changed the economics of M&A

Similarly, legions of potential buyers competing for the same firms have also changed the economics of acquiring wealth managers. Now what happens after a transaction closes is the most determinative of how much (if any) value is created.

Thus, the most successful aggregators will only pursue acquisitions that fit within a very long-term investment strategy and that are either growing businesses with capable successors in place, offer material operating cost savings through consolidation, or have owners who are

willing to bear much more risk in exchange for greater upside when selling their companies.

To be sure, maintaining this discipline will be challenging given that that there still are many PE firms awash in uninvested capital and whose behavior may not change for some time. Some will remain far more concerned about putting money to work to generate management fees than the potential investment returns. They also will continue to try to use financial engineering to extract value. Their indifference to the quality of potential sellers may likewise persist and some may even continue to fantasize about "adjusted EBITDA" when pricing potential acquisitions.

A handful of aggregators are much more valuable companies than their peers

However, over time their more disciplined brethren will prevail. They already are. A small number of the industry's aggregators are far more valuable companies than their similarly-sized peers.

Many small participants have decisive owners with long-term investment horizons.

It is also important to note that having decisive owners with very long investment horizons is by no means limited to large firms. The owners of a handful of small to midsized firms recognize that, although their operating environment is about to become more complicated and arduous, the industry is still in its early stages and opportunity abounds.

Successful small firms will innovate and create enhanced expertise

They will innovate by creating new, enhanced expertise for solving certain critical problems shared by small groups of potential clients. They will also build brands that communicate this expertise to their target audiences, enabling them to recruit prospects who are willing to pay a premium price for their services. Decisions made today by these owners will ensure that they prosper well into the future.

2. They will capture as many new clients as possible as quickly as possible.

Ignoring organic growth was at best irrational

When the history of the wealth management industry is written, one of its more striking aspects will be how many participants for a period lost sight of the immense economic value of each additional client relationship versus its acquisition cost. Certainly, during a decade-long roaring equity bull market and a flood of aggregators racing around trying to buy up every wealth manager offered for sale at increasingly higher prices, attention was drawn away from organic growth. But regardless of how understandable it may have been, it most certainly was not economically rational.

Each new client creates hundreds of thousands of dollars of incremental enterprise value.

More specifically, the fees from clients – especially those who are still accumulating capital – generate a staggering level of enterprise value for a wealth manager. Although the profitability of client relationships in their first 18 months is often negligible or even slightly negative, thereafter the cost of servicing them falls precipitously, and advisory fees thereafter typically have a marginal contribution rate of about 80%.

Consider the following new example 45-year-old client:

A 45-year-old $2 million client creates more than $600,000 of value

- Has $2 million of investable assets.
- Pays fees of 1% annually for the first $5 million of AUM & 0.50% for any additional AUM.
- Saves an additional $100,000 per year for the next 20 years.
- Thereafter draws down at an annual rate of 7% for the remaining 13 years of the relationship.
- Generates a 5.5% average annual after-tax return for the first 20 years.
- Thereafter, it averages 4% after-tax annually.

The client would pay in aggregate $1.7 million in fees, marginally contribute $1.35 million to EBITDA and – assuming a 5% discount rate – would generate a net present value of nearly $600,000. And this relationship would be considered a smaller new one for most wealth managers!

The cost of getting clients is a fraction of their value.

Cost of directly acquiring clients is trivial compared with their value

More importantly, the cost of acquiring the relationship is a fraction of that amount. Industry participants may host erstwhile marketing events and invest time in cultivating relationships with centers of influence (COI), such as professional organizations, law and accounting firms, and social groups, in hope that they will generate potential client referrals. And although such activities typically generate only very small numbers of referrals, the cost of these activities is trivial compared with the incremental value created by a single additional client.

To be sure, we are not suggesting that there is a large pool of untapped clients looking for wealth managers. Eligible candidates are regularly solicited by multiple firms. However, even with competition, the gap between the costs of recruitment and the value they generate is immense.

Markets are too efficient for client acquisition costs to persist

Certainly, this cannot persist. Markets are too efficient to allow someone to acquire streams of cash flow worth hundreds of thousands of dollars without having to spend comparable amounts.

Wealth manager marketing and sales costs at some point will soar. More importantly, as detailed below, participants are going to have to do much more for clients in the future. Combined, they will significantly lower the NPV of each relationship.

Why The Industry Stopped Focusing on Organic Growth.

Given the immense value created by each additional new client, an obvious question is why so many participants ignored it and instead focused on acquisitions. The answer is unclear but is likely tied to four reasons.

First, it takes a long time to recruit new clients. A wealth manager must convince a referral source to place its credibility on the line by recommending the firm. Then it effectively must persuade someone to trust them with their life savings and to allow them to play a major role in many of their most important decisions. Building such relationships does not happen quickly.

In contrast, a single acquisition can be a game changing event for a wealth management firm. It is accompanied by a block of clients and a group of employees, materially increasing the size of the acquirer.

New clients are not immediately profitable, but acquisitions could be.

Second (and as described earlier), new clients are not immediately profitable. There is an involved onboarding process, requiring a large amount of time and resources. In contrast, most acquisitions – at least before prices for wealth managers exploded – begin contributing to the bottom line at closing. Moreover, even small acquisitions much more materially increase the acquirer's EBITDA than adding a handful of new clients.

Third, the resources required to onboard each new client effectively create a governor on a wealth manager's organic growth. Although it can service large numbers of existing clients, the work involved in the

front end of a relationship effectively caps the number of new clients a wealth manager can add – that is, unless it significantly increases the size of its staff well before it has attracted the necessary number of clients to keep them fully occupied. In the interim, they can be costly and unproductive.

Acquisitions have no similar capacity limitations. Although there often is a great deal of time and work integrating them into the acquirer's organization, aggregators have demonstrated that they can acquire multiple firms simultaneously.

Recruiting the staff necessary to generate new clients is uncertain and expensive.

Lastly, recruiting the staff necessary to generate new clients is an uncertain and expensive process. There is no easy way to identify who can capture new clients. Success at one organization only occasionally translates to another. Moreover, regardless of the number of years spent developing individuals to market the firm's services, their future success is unpredictable.

That said, what is certain is that the process for recruiting and/or developing potential marketers is very expensive. Anyone with even a marginal track record for doing so is in high demand. And it takes a long time and a lot of money to prepare an entry-level hire to be in a position where they can at least try to recruit new clients.

Organic growth from proprietary referral sources vs. custodial firms.

It is also important to note that there is an immense difference between organic growth that is generated through proprietary, COI referral sources versus from custodial referral programs. Although such programs generate material volumes of prospects, custodians control them, and determine which firms may participate, as well as the number and types of prospects that are made available to outsiders. And – as happened recently to several long-time participants in these programs – wealth managers can be terminated at will.

Organic growth sourced through custodians is far less valuable

Equally important, it is the custodians that determine the economics of participating in these programs and likewise, their terms can be changed at will.

They currently demand a perpetual participation equal to about 25% of the revenue generated by the relationship. That participation could increase at any time.

Custodians can change the terms of referral programs at will

The NPV of custodian-referred clients is typically half of those from proprietary referral sources.

Moreover, marketing to custodial branches entails its own set of significant incremental costs that often involve paying a portion of the advisory fees to the marketers in the earlier years of the relationship. Further, the longevity of relationships resulting from client referrals in many instances is shorter than those generated from COI referrals.

Consequently, the current net present value of the fees generated from new clients captured through custodial referral programs is less than half of what wealth managers make from clients they recruit through their own COI networks. Meanwhile (and as described below), wealth managers will soon have to do a lot more for clients but for the same fees, making such new clients even less profitable.

Custodial referrals are half as valuable as ones from proprietary COI networks

To be sure, we are not in any way criticizing organizations that took advantage of custodial referral programs. Participating was an intelligent, rational, and very profitable strategy. No different than with acquisitions, a raging equity bull market caused the net present value of every new client to skyrocket, more than offsetting any associated costs of revenue sharing and marketing.

That said, their future economics will likely be far less compelling. It is almost a certainty that referrals will become much less frequent and more expensive. Moreover, aggregators will at some point become direct competitors with organizations like Schwab and Fidelity, making the likelihood of their continued participation in custodial referral programs over the long-term remote at best.

A certainty that custodial referrals will be less frequent and more costly

A more concise view on the risks of relying on custodial referrals to get clients was provided by a billionaire founder of a very successful investment management firm, who once described these programs as being analogous to using cocaine, “It might feel good but if you get addicted, it will kill you.”

3. They will restructure their operating models from "athlete-based" to "specialized by function."

A precondition for most wealth managers hoping to achieve high rates of organic growth is transforming their current operating models. As noted earlier, they currently rely on "athlete-based" structures that incentivize their firms' best marketers to recruit only those clients that they personally service over the long term.

Shifting to a specialization by function model can quintiple a firm's ability to recruit new clients

Shifting to a "specialization by function" model would quadruple to quintuple these wealth managers' ability to recruit new clients. Under it, those handful of individuals who are both capable and comfortable with building referral sources and generating new client opportunities would spend most of their time focused on marketing. Those people who are great closers would focus their time on getting prospects to sign up. And those professionals whose talents are best suited for servicing clients would do that full time.

Shifting to this operating model would also materially enhance a firm's profitability over time because nearly every participant today can service far more existing clients than they currently have.[60] But by relying on an athlete-centric operating model, they lack the means to generate them. Shifting those individuals who are the most capable marketers to focus solely on doing this would increase a firm's organic growth by a step function.

Implementing a "specialization-by-function" operating model will be very challenging.

Many capable marketers are currently paid a lot of money to not do much

That said, implementing this operating model will be very challenging. It will disrupt what current staff do, how they are paid, and their power over the organization. Individuals who are capable marketers and have large books of business currently get paid extraordinarily well for not doing that much and have little incentive to help grow the firm.

Although under a specialization-by-function structure they could make much more money, they most certainly will have to work a lot harder. They also no longer will have their "own clients" and will only get paid if they continue to generate new ones.

Also, closers will not have their "own clients." They, too, could be paid well but only if they regularly and consistently persuade additional new clients to sign up. And those responsible for servicing existing clients will suddenly find themselves at the low end of the firm's economic totem pole. They will work in teams servicing clients, making a nice living but nothing like the athletes currently get paid and much less than marketers and closers.

[60] It is important to distinguish between the servicing of clients and the onboarding process. A firm with 500 clients could not suddenly add 100 more given the work involved. However, once onboarded, they could easily service 1,000 additional ones or even more.

Shifting operating models would trigger a realignment of power

Trying to shift to a specialization-by-function model could lead to the equivalent of a prison riot.

Far more problematic, this shift would also trigger a realignment of the balance of power within the organization that many key employees would not welcome. More specifically, the economic ownership in most wealth managers is very different than that of its legal ownership. The former is tied to the relationships with clients and who controls them.

Individuals who recruit clients often control them

In these organizations, the individuals who recruit clients effectively control the firm's ability to retain them. The threat of leaving, and that clients might ultimately follow them, is the source of these employees' bargaining power with their employer. Understandably, they will fight tooth and nail against any attempts to change the current operating model.

Consequently, implementing a shift to a new operating model will require a very complicated negotiation with certain employees or create the risk equivalent to a prison riot, potentially resulting in lost marketers and clients. But without changing their operating models, wealth managers will be incapable of scaling their businesses and capitalizing on the coming wave of new potential clients.

Marketers currently are undercompensated for the value that they create.

In fairness to them, talented marketers under current compensation models currently receive only a fraction of the value they create for their employers. Moreover, they are only paid over many years and cannot control what their organization does in the interim.

The most successful industry participants over the next 10 to 15 years will be those that recognize this dilemma. They will both fundamentally redesign their compensation models, and, in some instances, create parallel operating and compensation systems within their organizations.

Participants could pay their best marketers much more

For example, just adding 40 new clients of the size in the example above creates nearly $25 million (I.e., $600,000 × 40) of marginal enterprise value. Successful firms will be more than happy to share a large chunk (i.e., ≈ $ 4 million) of this value with a marketer through equity-based compensation systems that contractually allow them to participate over time.

Certainly, to suggest that highly productive marketers make as much as $4 million per year could cause many current firm owners to become apoplectic. From their perspective, the marketers are only able to recruit new clients because of the firm's brand, infrastructure, and other staff. However, successful participants will be far less

Paying successful marketers millions of dollars is a bargain compared to custodial referrals

emotional and self-interested and will focus only on the incremental marginal enterprise value they can capture by motivating their best marketers.

Moreover, it is important to note that paying successful marketers such compensation is still a bargain when compared with participating in custodial referral programs. For the kind of client included in the example above, a wealth manager would have to pay the custodian revenues that on an NPV basis would total about $8 to $9 million. And these amounts are in addition to the other costs that the wealth manager incurs from marketing to custodial branches.

Parallel operating systems to allow "sleeping dogs to lie."

Many marketers will fight changing operating models

At the same time, successful participants will also recognize that, regardless of compensation structure, many of their more established marketers will be disinterested in shifting to a new operating model. Hence, successful firms also in certain instances will "allow sleeping dogs to lie" and not change how their current best marketers operate or are paid. Instead, they will create parallel "specialization-by-function" structures staffed by other individuals.

Certainly, doing so will be quite costly and complicated. It also will be disruptive. However, this approach will allow participants to balance the ability to capture large volumes of new clients without creating the risk of blowing their firms up.

4. They will reset their organizations' cultures.

For many organizations, equally important to revamping their operating models will be resetting their cultures. As described earlier, large numbers of industry participants stopped worrying about client recruitment during the decade long U.S. equity bull market. Indeed, even firms that previously had high rates of organic growth became distracted, either because they were doing acquisitions or were acquired themselves.

It is hard to understate the challenge faced by these organizations if they hope to generate significant organic growth in the future. Currently, working at one of these firms is comfortable and easy. Servicing clients does not involve a great deal of work or stress. Some wealth managers still even close early on Fridays so their employees can have longer weekends.

Only organizations obsessed with organic growth are good at recruiting clients

However (as described earlier), recruiting clients is brutally hard work. It takes years of cultivating referral sources, often with little feedback or success and lots of rejection. It is stressful and challenging.
Only those organizations obsessed with organic growth are good at doing this. Every part of the firm is focused on getting new clients. Everyone is held accountable, generating no small amounts of stress

and expectations. The firm's stars are those individuals who make growth happen. And everyone else has a lower status.

The scope of such a required cultural change will be very hard to implement in many organizations unless they bring in lateral hires with the necessary energy and drive. And more than a few current employees will likely decide to leave.

Accomplishing the necessary cultural shift will be an even bigger challenge for some aggregators.

Accomplishing such a cultural shift will be an even bigger challenge for some aggregators. As noted earlier, in the madcap rush to complete deals, many became indifferent as to whether or not the companies they acquired had long ago stopped marketing. For all practical purposes, the management of many affiliates is far more focused on their lifestyle than their business.

Fundamental bargain between aggregators and affiliates was that little would change

Additionally, even with acquisitions of companies that had historically high rates of organic growth, the transaction bought out the founders – the same individuals who historically recruited most of the firm's new clients. Many have retired.

Moreover, the fundamental bargain often made by the aggregators with their affiliates was that little would change. There was no expectation that other employees would replace founders as the drivers of organic growth. Now these buyers must somehow find a way to effectively renege on their understandings with their partner firms and reset their cultures without suffering a potential mass exodus of employees and clients.

5. Do what is necessary to keep talent and to get more as quickly as possible.

Nearly every firm will need more talent

Further complicating the challenges faced by participants is that changing operating models and organizational culture on their own will not create sufficient capacity to fully capitalize on the immense opportunity to add large numbers of new clients at their current low cost of acquisition. Moreover, nearly every firm will also have to replace retiring senior professionals. Consequently, the most successful firms will do whatever is necessary to keep their talent and obtain more as quickly as possible.

This will be no small undertaking given that talented employees are in short supply. As described earlier, there is no pool of unemployed, experienced professionals waiting to be hired. Rather, wealth managers have only three choices – i.e.,

(i) recruit seasoned professionals from other types of businesses, such as accounting and law firms, and train them to be wealth managers;

(ii) hire, train, and develop entry-level staff; or

(iii) poach talent from competitors.

Unfortunately, the two former strategies will take far too much time to accomplish.

Successful firms are going to "run up the Jolly Roger" and poach their competitors' best people.

Instead, the most successful participants will steal the talent they need from other wealth management firms. They are going to effectively "run up the Jolly Roger" and go after the best people working for their competitors.

Granted, this will cause a cultural shock to the industry and those who do so will be widely despised. Additionally, firms of all sizes will attempt to enforce restrictive covenants and use the threat of litigation to discourage lateral hires from their organizations.

Successful firms will "run up the Jolly Roger" and poach employees

Notwithstanding, the most successful industry participants will create carefully designed staffing strategies developed in conjunction with their strategic plans. However, rather than just determining positions of need, they will identify those specific individuals whom the firm plans on poaching and from where they will get them.

The first rule in the jungle is to not get eaten.

Further, regardless of whether you are a predator, the first rule in the jungle is to not get eaten. Consequently, the most successful firms will carefully assess their own key talent and take the necessary preemptive steps to prevent them from being poached. They will receive higher pay and equity, and their compensation packages will include significant deferred payments, increasing their cost of switching firms.

Certainly, this activity will significantly inflate labor costs. But for the industry's most savvy participants, it will be a welcome event. They recognize that competitors are anchored on compensation structures designed to boost short-term profitability and that assume minimal new client recruitment. Their owners like the status quo and want it

Firms that believe they can rely on restrictive covenants to protect themselves are deluded.

Any firm that believes it can rely on non-compete agreements to retain its best talent is deluding itself for several reasons. First, in many states their enforceability is limited and often is conditioned on the individual owning material amounts of equity, not a widespread practice in the industry.

More importantly, in most states it is extraordinarily hard to enforce a longer-than-two-year non-compete on employees and that is a blink of an eye in this industry. And many successors would welcome the opportunity to take some time off before joining a new firm.

Additionally, non-compete restrictions often can only apply to specific activities that directly compete with the current employer. It would be required to prove how it is directly damaged by what the former employee does for the other organization. Consequently, shrewd predators can hire someone they want by using a forgivable loan, send them off on a brief sabbatical and then find other ways to put them to work – such as brand building and developing referral relationships – until their restrictive covenants expire.

Further, most clients only occasionally meet with their advisor after they are fully onboarded. Indeed, so infrequently that it limits the ability of a firm to recreate relationships with them within a two-year period covered by restrictive covenants. Indeed, many clients often do not even notice for some time that their advisor has left the firm. And at the two-year point, they are open game.

to continue indefinitely; they have little interest in reinvesting in their businesses or people. Consequently, their best employees are ripe for poaching.

Most firms' best employees are ripe for poaching

Indeed, the most aggressive industry participants will intentionally try to change their competitors' cost structures. Even if they fail to recruit a targeted employee, that individual will get paid more, and the firm will likely have to increase the pay of many other similar employees. This, in turn, will limit that organization's ability to invest in branding and other marketing activities as well to steal employees from its competitors.

Certainly, higher labor costs along with expanded value propositions will over time reduce the net incremental value of each new client. Additionally, there will likely be a significant lag between hiring additional staff and when the required investment will pay off. However, the current disparity between the value that each new client creates and what it costs to acquire is sufficiently large enough to more than justify taking these risks.

6. Build powerful brands, quickly and cost-effectively.

Talent, culture, and more efficient operating models alone will be insufficient to fully capitalize on the upcoming wave of new client opportunities. The most successful participants will also build powerful brands, quickly and cost effectively.

Wealth manager brands to date have been largely irrelevant

Unfortunately, wealth manager brands to date have largely been irrelevant. Of course, many industry participants already have "rebranded" themselves from their founders' names to something which reflects their value proposition, and some aggregators have added their names to those of their affiliates. Several organizations have also developed compelling marketing materials and websites, as well as communication strategies.

However, these so-called brands are largely irrelevant because they do not drive material volumes of potential clients to their organizations. Indeed, only a handful of wealth managers are widely known even within their own geographic market.

By comparison, Schwab's brand draws thousands of prospects into its branches, far more than it can possibly capture. Consequently, it refers more than 14,000 of them each year to outside wealth managers.[61]

[61] https://www.riaintel.com/article/2aucu4e2wyzpnfv355yps/wealth-management/schwab-and-td-ameritrade-merge-advisor-referral-networks-cut-number-of-rias-in-new-program

Most new clients have been sourced through client referrals.

Moreover, the vast preponderance of new clients for most industry participants is currently sourced from referrals by existing clients. And it is the personality and magnetism of an individual advisor and not the firm's brand that persuades most of them to use its services.

Most new clients are referred by existing clients

Although wealth managers will continue to generate such referrals, they most often occur in the early part of a relationship, typically within 18 months of the client first signing up. Hence, those industry participants who effectively stopped marketing for a long time will likely see far fewer such opportunities.

The challenge for industry participants is to find a cost-effective way to build a brand that on its own will generate prospects without bankrupting the company. In 2021 alone Schwab spent $485 million on marketing and branding.[62] Not even an aggregator with $200 billion of client assets under management can afford to match that.

Wealth manager brands are about the ability to diagnose and solve client problems.

The first step in building cost effective brands is recognizing that they are about a firm's ability to diagnose and solve client problems and not how good it is at giving financial advice. Money is merely a means to an end, and the end is about what clients want to use their money to accomplish in their lives. Wealth managers use their personal judgment and experience, along with financial expertise, to help clients to first diagnose their problems and only after that is accomplished then they organize their finances to solve them and meet their goals.

Wealth managers must be realistic about their expertise

At the same time, wealth managers must be realistic and self-aware as to the expertise they truly possess, and they must recognize they cannot be all things to everyone. For example, an organization that is incredibly knowledgeable about the unique problems and challenges faced by female executives working on Wall Street is unlikely to likewise have the same degree of insight about those faced by an individual who owns a used car dealership. Additionally, the problems of individuals also often vary by geographic market – i.e., being a business owner in a rural area of the Midwest is very different than that of one in a big city, such as New York or Los Angeles.

Successful firms will use expert media as part of their branding strategies.

Successful branding strategies will have many components including communicating the firm's unique expertise through expert media

[62] https://www.statista.com/statistics/934524/spending-advertising-market-development-charles-schwab/#:~:text=The%20total%20spent%20on%20advertising,compared%20to%20the%20previous%20year

– i.e., thought-leadership articles in publications such as trade and consumer magazines and websites that targeted potential prospects regularly read. The articles will examine specific problems that these individuals face, especially those that are widely shared but not widely discussed.

Astute firms will target the groups by which prospects affiliate

They will also involve targeting the groups used by prospects to affiliate. An aspect of human nature is that individuals who share similar problems tend to join the same groups. Using these organizations – through presentations at and participation in their events – is a cost-effective way to communicate the wealth manager's expertise to their membership.

Undoubtedly, making all of this happen will require innovation and initiative on the part of key employees. It also will involve a great deal of time and cost more than a little money. That said, when correctly done, it can generate large volumes of prospects.

Additionally, because wealth management brands are based on client problems, even smaller industry participants can build cost-effective brands. They need only to communicate their unique expertise to a relatively small, targeted audience of prospects within their geographic markets, and doing so does not require a great deal of resources.

Aggregators face greater branding challenges.

Some aggregators will have the inclination to go toe-to-toe with Schwab

In contrast, many aggregators face far greater challenges when it comes to branding. Some will have the natural inclination to go toe-to-toe with custodians and attempt to wrap a single national brand around its affiliates. Perhaps their goal will be to create the perception of a consistent, compelling experience for potential clients, regardless of geographic location and their backgrounds.

With enough spending, they may succeed in attracting large numbers of prospects. However, many of them will be unlikely to sign up for the firm's services. As demonstrated by the custodial referral programs, it is the ability of a wealth manager to diagnose and address a prospect's specific problems and not the organization's brand that is most determinative of whether they become clients.

Additionally, aggregators generally acquired collections of small to mid-sized firms, each with their own limited brands within their communities and that historically targeted different types of clients. Trying to suddenly homogenize the perception of these organizations could potentially reduce rather than enhance their ability to grow organically.

Further, long-time major differentiators between many of their partner firms and their competitors are that the latter were part of larger

organizations (such as Merrill Lynch and Morgan Stanley) and that smaller enterprises are perceived as more capable of providing customized, personal service. Wrapping a single national brand around an aggregator's affiliates could diminish this advantage.

Successful aggregator brands will be similar to that of major law and accounting firms

Successful aggregator branding strategies will be a national brand with multiple sub brands.

Instead, the most successful aggregator branding strategies will likely rely on a combination of a national brand with multiple sub-brands. They will communicate both the safety and consistency of the organizations' quality of advice and service while at the same time highlighting their affiliates' insight and expertise in solving certain client problems.

A comparable strategy can be found in the approach of other large professional organizations, such as law and accounting firms to branding. Although they are well-known and well-respected organizations with reputations for attracting some of the best legal or accounting talent in the country, they also increasingly point to the expertise they provide in addressing specific types of certain problems.

For example, the law firm Skadden Arps emphasizes its 34 different practice areas in five different geographical regions. Deloitte points to its expertise in 25 different aspects of 25 different industries.

Those wanting a single national brand will have to change their affiliates' value propositions

Aggregators face difficult choices in developing brands.

More succinctly, aggregators face difficult choices in developing brands. Those wanting to create a single national brand for their affiliates will first have to change the value proposition of these entities to that of a generic offering appropriate and compelling to only certain prospective clients. Alternatively, aggregators can build sub-brands based on their affiliates' pre-existing expertise and then wrap these sub-brands in a larger organizational brand.

With the former strategy, these organizations are electing to go head-to-head against organizations such as Schwab, Fidelity, Merrill Lynch, and Morgan Stanley. They should plan on spending hundreds of millions of dollars in marketing and advertising and effectively drag their affiliates along with them.

Sub-brands are dependent upon the initiative and ingenuity of affiliate employees

At the same time, the latter strategy may be even more challenging because of the number of different sub-brands that will have to be developed. It will also be as dependent upon the initiative and ingenuity of the individuals working at partner firms to build these sub-brands as much as it will be on the funding provided by the aggregator.

7. Embrace rather than just endure the many changes that cyber threats will force.

Firms will be responsible for how clients and employees operate personally online

As noted earlier, cybersecurity is going to change the world of wealth managers. They are going to have to spend immense amounts of money on less accessible and more cumbersome information systems. They must function in a broader, more complex regulatory regime. They are going to have to change how they execute transactions, annoying both clients and employees alike. They are going to add cybersecurity staff who will somehow be far less popular than those who work in compliance. And they also will discover that they effectively are responsible for how their employees and clients personally operate online.

Certainly, many firms will seriously address these new cybersecurity obligations only after a peer has suffered a catastrophic event. Then they will scramble, hoping to sufficiently upgrade their own cyber defenses before they too are victimized.

Successful firms will view cyber changes as both inevitable and an opportunity.

In contrast, the most successful industry participants will view the changes driven by cyberthreats and regulators as both inevitable and an opportunity. They recognize that it is inevitable that at some point their organization will be breached and that they are now liable. As a former Director of the FBI once stated, "There are only two kinds of companies: those that have been hacked and those that will be."[63]

Wise firms will exceed industry best cyber practices

Consequently, they will aggressively enhance their cyber defenses to reduce the frequency of such incidents and, more importantly, the resulting damage. Like what large accounting and law firms have done, they will compartmentalize and segment their information, limiting the potential amount of data stolen in any breach. They will change their procedures for initiating transactions in client accounts, making it much harder for cybercriminals to steal client assets. And they will implement procedures and policies that will easily meet or exceed what the SEC will view as industry best practices, significantly reducing the likelihood that the breach results in an enforcement action.

"When you are being run out of town, get in front of the crowd and make it look like a parade."

Most importantly, in the words of Sally Stanford, the last great San Francisco madam, "When you are being run out of town, get in front of the crowd and make it look like a parade." More specifically, rather than just enduring what are a series of unattractive and inevitable

[63] https://wecyberup.org/there-are-only-two-types-of-companies-those-that-have-been-hacked-and-those-that-will-be/

changes, the most successful industry firms will instead capitalize on them.

For example, under the new regulations, wealth managers are required to disclose to clients the cyber risks they bear from using the firm's services and what the firm is doing about them. Savvy industry participants will flip this requirement on its head and instead use it as an opportunity to market the strength of their cyber defenses, highlighting how they protect client assets from cybertheft and differentiating the organization from its less prepared competitors.

Clients bear the preponderance of cybertheft risk from custodial accounts

Further, polls show that about 90% of the population is already very concerned about cyber threats to them, their families, and their wealth.[64] The SEC's new cyber regulations effectively also mandate that clients be informed that they bear the preponderance of the risk of cybertheft from their custodial accounts.

Although most clients will likely be stunned to learn this, the most successful industry participants will again flip this issue on its head and turn it to their advantage. They will distinguish their offering by including services that help clients to manage and reduce their personal cyber risks.

These organizations recognize that at some point every industry participant will have to fundamentally strengthen its cyber security as well as get involved in that of their clients. However, rather than waiting to be dragged into doing so, they will take advantage of these changes to increase their market share by using them to differentiate their value propositions.

8. Expand their value propositions to create competitive advantages.

Successful firms will lead the way in expanding their value propositions

Helping clients address their personal cyber risks is only a small part of how the most successful industry participants will expand their value propositions to create competitive advantages. More specifically (and as described earlier), the wisest large industry participants are going to start acting like big competitors and will do so soon. They will lead the way in using their scale to provide a much more comprehensive offering to clients at a price comparable to what clients currently pay.

Of course, what even big firms will do for clients will be tied to the fees that they pay. It is economically infeasible to provide the same level of services for clients who pay $10,000 per year or less than it is for those who pay two or three times that amount. That said, every client will receive greater value for their money.

[64] https://www.mbtmag.com/security/news/21771578/poll-90-of-americans-concerned-about-cyber-security

And anyone who pays at least $25,000 per year is going to receive an immensely broader set of services.

Expanded offerings will be similar to that of family offices

These organizations will also be the first to upgrade their internal technology, capabilities, and expertise so that they can provide offerings that in many ways will be analogous to family office services, albeit structured to meet the needs of a high-net-worth client instead of an ultra-high-net-worth one. More importantly, they will not hesitate to add and pay for services that clients currently must pay for separately.

Successful firms want clients to closely scrutinize the "assets under management" fee model.

Astute firms want clients to scrutinize the "assets under management" fee model

Their objective is to encourage current and future clients to closely scrutinize the industry's "assets under management" fee model. They hope to exploit that the value delivered to clients on an ongoing basis does not necessarily correlate with the fees they pay and use expanded value propositions to change the terms for being in this business.

Granted, doing so will, at least in the short term, reduce profitability. However, these organizations can spread a good portion of these costs across large client bases. Additionally, the industry currently has outsized operating margins compared to many other financial services businesses. Going from a 40% to 25% margin by including services that clients currently pay for is no big deal, provided it ultimately leads to much greater share of a fast-growing market.

It will be challenging for many participants to expand their offerings

Moreover, forward thinking participants recognize that providing an expanded value proposition will be quite challenging for many of their competitors. These organizations drifted during the decade long U.S. equity bull market from the traditional role of a holistic financial advisor to that of mostly an investment manager. They became complacent and felt little need to expand or enhance the value they provided. Clients were happy and wealth manager profits were growing at an astounding rate.

Now they will have to compete with organizations offering to do much more for the same price. And their existing clients will be besieged by such offers. New clients will also finally be able to distinguish between what different wealth managers provide and at what price.

Over time, every participant will be forced to expand their roles in clients' lives and oversee every aspect of their finances. However, rather than just matching the service offering, the industry's most successful smaller firms instead will anticipate them and create their own competitive advantages. As noted earlier, they will build specialized expertise geared to the problems and needs of certain narrow client groups in specific geographic regions.

They will use this expertise to simplify clients' lives, both unburdening and empowering them.

Successful firms will play a role in their client's wealth creation and not just managing it.

Successful firms will play an expanded role in wealth creation

The most successful wealth managers will also play a role in wealth creation by helping to manage the intersection between a client's career or business and wealth. More specifically, rather than just help manage the wealth that has been created, successful participants of all sizes will play expanded roles in helping clients to build and keep more of their wealth.

Moreover, given that the government is effectively (at a minimum) a 40% partner in everyone's earnings and a 23.5% partner in every enterprise, these organizations will also significantly increase their expertise in federal, state, and local tax laws. They will also develop similar expertise on international and cross-border tax issues for those clients with international careers or businesses.

Certainly, the most thoughtful wealth managers will not do the entirety of this work on their own. Much of it will be outsourced to organizations with models better suited for high volume, low margin activities, and most industry participants instead will retain the highest intellectual capital functions. Notwithstanding, the wealth manager will be responsible for the integration of its components. It will be the general contractor accountable to clients for ultimate outcomes. Undoubtedly, the idea of doing so much for clients may appear daunting, even overwhelming, for some smaller industry participants. However, shifting to a much more comprehensive and specialized advice model is both possible and is integral to participants' ability to grow and flourish.

Every firm will provide broader and more comprehensive services

Indeed, every firm will play a broader, more comprehensive role for clients, further cementing existing relationships by making clients more dependent upon them. And the savviest organizations will consistently innovate, so they can use their service offering to create competitive advantages in client recruitment.

Small Firms Will Compete by Filling Voids That Are Too Small or Specialized for Big Firms.

Although many larger firms will build sub-specialties within their businesses, smaller competitors will take advantage of voids that are too small and/or too specialized for larger participants to pursue. And there will be numerous such opportunities.

For example, although working with physicians is often viewed as a single sub-specialty, it is a far more diverse and specialized field from the perspective of wealth management. Depending upon a physician's practice area – i.e., dermatology vs. neurosurgery vs. anesthesiology – they could have widely varied personal economic models.

More specifically, many dermatologists provide cosmetic services requiring them to make large capital investments in lasers and other technology. In contrast, neurosurgeons often receive the preponderance of their aggregate compensation from owning the surgery centers where they conduct procedures, as well as from the physical therapy centers to which patients are sent after a procedure. Anesthesiologists effectively operate volume businesses where the compensation they receive is dependent upon the number of patients that they and their nurse-CRNs treat as part of other physicians' procedures. And each of these types of doctors may at some point develop new treatments or tools that if properly monetized, could materially increase their wealth.

Consequently, each type of physician requires different expertise for their unique problems and opportunities. Moreover, the aggregate numbers of each type of physician in geographic markets are often relatively small, making them an unattractive opportunity to a large firm. For example, in the Dallas-Fort Worth market – a region with nearly eight million people – there are only about 300 dermatologists.

Specialties are narrow and require deep expertise and insight.

Additionally, such differences in client economic models are not unique to physicians. Notwithstanding the current branding of many wealth managers, there is no such sub-specialty as working with "business owners." The needs of such clients vary widely and often depend upon the type of business they own. Similarly, "technology executives" is likewise too broad of a category to be considered a sub-specialty. Depending upon which aspect of technology and where they are in their careers, such clients will face very different problems that require different types of expertise.

These variances create specialization opportunities which the most successful smaller firms will capitalize on. Key to achieving this will be an ability to identify what clients need or want but is not currently being provided by other participants.

9. Become much more sophisticated and discriminating buyers & sellers of wealth management firms.

Notwithstanding the flood of potential new clients up for grabs over the next 10 to 15 years, there will still be many potentially attractive acquisition opportunities. However, the most successful participants will become much more sophisticated and discriminating buyers or sellers of firms.

The M&A market over the last decade was analogous to an online dating service.

Most buyers and sellers only first met during the sale process

Undoubtedly, the M&A market for much of the last decade was analogous to an online dating service. What potential buyers and sellers knew about each other was largely based on regulatory disclosures, websites, news articles, and what friends may have told them about the organization. Indeed, most buyers and sellers only first met after a sales process had commenced.

We believe that this will change for several reasons. Debt is now less available and more expensive. Moreover, acquirer management time is now at a premium. They already have their hands full building brands, integrating prior acquisitions, and finding ways to recruit new clients and employees. And each potential additional acquisition

brings its own set of problems.

Unless an acquirer buys a firm without conditions, outcomes highly depend on what happens later.

That said, price will still matter as there will be legions of other potential buyers. Thus, the question will not just be price but rather how the purchase is structured and the conditions and terms for receiving the post-closing payments. Indeed, sellers recognize that unless an acquirer buys the entirety of a firm at closing without conditions, their outcomes remain highly dependent upon what happens after the transaction is completed.

Smart buyers will effectively "sell" themselves to sellers

Consequently, the most successful industry participants will take a comprehensive approach to identifying and analyzing opportunities. They also will effectively "sell" themselves to those that they hope to acquire.

More specifically, rather than just chase anything and everything that might potentially be for sale, the smartest buyers will carefully research the universe of potential sellers and develop lists of wealth managers to target. Their criteria will include the age of owners because it is demographic factors and not economic factors (unless someone offers to pay an absurdly high price) that typically drive transactions in this industry. They also will consider geographic locations, historical organic growth rates, and the depth and breadth of successors.

Integral to this analysis will be identifying those sellers for which the buyer's value proposition should create the greatest incremental value and, thus, be most compelling. Although such services will vary, they will likely include unburdening the organization by providing and supporting technology platforms, compliance services, and resources for managing both firm and client cybersecurity risks.

Savvy buyers will provide tangible resources to expand value propositions

Equally important will be the tangible resources buyers provide that help sellers compete for clients by expanding their value propositions. As part of a much larger organization, every seller should be able to do much more for clients for the same fees that they currently pay. Paramount to creating this ability for sellers will be that buyers bear the preponderance of the cost of creating and providing these incremental services. Such value propositions will also include clearly defined branding strategies and resources that will benefit their partner firms, whether they will be standalone entities or integrated into the larger enterprise.

A pre-existing relationship is a significant advantage for a buyer.

After identifying those firms that they hope to target, the most successful buyers will carefully study them, their people, values,

internal dynamics, and culture. They will use this information to cultivate relationships with key management long before any sales process commences.

It takes a lot of time and work to build a relationship

This industry is built on relationships and a pre-existing one is a significant competitive advantage for a buyer. That said, building a relationship is a lengthy process that will require material resources and immense patience.

The goal is to sell the opportunity to be part of their organization, set expectations for what life will look like post-closing, and use their existing affiliates to confirm this with potential sellers. The most sophisticated buyers will include their board members in this process and have them confirm that the acquirer's management will remain stable for the foreseeable future, help articulate the acquirer's vision, define how the selling organization fits within this strategy, and why it should be compelling to participate.

Of course, some buyers – in particular, aggregators – already have "marketing" staff whose job is to call on wealth managers in the hope of identifying potential transaction opportunities. To date their role has largely been to help buyers cover more surface area and generate as many transaction opportunities of all types as possible.

Going forward, the most successful buyers will employ much more sophisticated and targeted programs. They will focus on narrow groups of firms and will pass on more potential transactions than they will pursue.

Sellers will also do their homework.

Smart sellers will compare buyers' rhetoric with their records

Wise sellers will likewise do their homework before bringing their companies to market. One key area will involve getting an insight into a potential buyer's backers and the factors that will influence their behavior. As part of this, they will carefully examine what will likely be the backers' investment horizons, given which of their funds holds the investment in the acquirer, when the investment was made, whether the funds have any remaining, uninvested capital, and the funds' likely maturity. This data will illuminate whether the acquirer will be more focused on building or preparing to sell the business, notwithstanding any potential rhetoric by its owners and management to the contrary.

Sophisticated sellers will also ask the necessary questions to understand the incentives of the buyers' management, including the terms of their retention packages. These incentives provide the best indicators of whether the management with whom the seller is negotiating will likely remain in place for the foreseeable future.

Comparing rhetoric with reality.

Equally important will be comparing the rhetoric that describes the buyer's strategy and vision with its actual track record of acquisitions. Nearly every buyer professes that it is extremely discriminating in selecting affiliates and that "only the best" are allowed to become part of their organization. Unfortunately, the reality is often quite different, and only a careful study of the buyer's previous acquisitions provides the most accurate picture.

Similarly, savvy sellers will closely study to determine if there are gaps between how a buyer describes its relationships with its affiliates and how it has operated. Buyers typically receive outsized control rights as part of a transaction, and the best indicator of its future behavior can be found in what has transpired with its management of partner firms, their governance structure, and the turnover of management at their affiliates.

Smart sellers will closely review buyer regulatory disclosures

Further, they will carefully examine the incremental services provided by the buyer that allow their affiliates to do more for their current and potential clients. Lastly, sophisticated sellers will closely review the regulatory disclosures of their affiliates to analyze the actual compliance and cybersecurity resources provided by a buyer as opposed to what it might claim that it does.

The most successful sellers will likewise study the tangible results of the buyers' value propositions including

(i) the branding of partner firms;

(ii) their post-acquisition organic growth rates;

(iii) the numbers and types of professionals these firms have added; and

(iv) the numbers and types of sub-acquisitions that have been completed.

Beware of affiliate management with cognitive dissonance or Stockholm Syndrome

Certainly, every buyer will offer to introduce potential sellers to the management of their affiliates. And inevitably, each will sing the praises of the buyer. However, discerning sellers recognize the immense power that the buyer has over each of its affiliates and that it is in their management's interests to parrot the company line. Additionally, such skepticism is also often warranted given that it is only human nature that the affiliate management may be grappling with elements of cognitive dissonance and/or Stockholm Syndrome.

Savvy sellers will demand more from bankers.

Acquiring such deep insight into multiple potential buyers will be no small undertaking. However, the most thoughtful firms will be guided by bankers, long before they ever come to market. More specifically,

one of the more absurd aspects of the recent M&A frenzy was that many bankers were paid immense amounts of money to be glorified auctioneers. They typically first became involved only after the seller had decided to go to market. Even worse, their value largely consisted of preparing some marketing materials, making introductions, and evaluating bids.

Astute sellers will demand that bankers educate them on buyers and the market

Going forward, astute sellers will demand much more. Bankers will likewise need to build relationships with potential sellers and invest a great deal of time educating them on the market and the aspects and perspectives of potential buyers. They also will coach them on the steps that they will need to take to prepare their firms for a sales process so that they can maximize the resulting value achieved both before and after the transaction is completed.

Integral to achieving this will be the steps that sellers take to make themselves more compelling to prospective buyers. They will consider the likely perspectives of different buyers and the tangible and intangible attributes that they will likely include in their acquisition calculus. Some of the more obvious tangible ones include a firm's profitability, the quality of its client base and revenues, and its historical growth rate.

Acquirers are buying firms for what they will do in the future.

However, acquirers are buying companies for what they will do in the future and not what they are doing today. Thus their assessments will include

Acquirers are buying companies for their future

(i) the breadth and depth of the firm's management;

(ii) the organization's culture and whether every person in the organization is held accountable to clients, to the other employees, and to its values;

(iii) its culture of compliance and cybersecurity and whether there is an organizational-wide commitment to managing these risks or just an unserious, "just check the box" philosophy;

(iv) whether the seller has a demonstrated ability to complete and integrate sub-acquisitions;

(v) the firm's track record for recruiting new clients; (vi) the likely future behavior of the selling owners and their commitment to the acquirer's objectives; and

(vii) how other employees of the seller will likely view the transaction.

The most successful sellers will differentiate themselves by preparing their organizations to address these potential buyer concerns well in advance of a potential transaction. They will understand how their

firm would fit within the larger organization and the buyer's likely expectations. They will include their successors in planning a potential transaction and will allow them to participate in the proceeds. In certain instances, other more qualified professionals will have to be recruited to the firm. Compliance and cybersecurity rule violations will be considered "third rails" that no one gets near, much less ignores.

Completing a sub acquisition makes a seller more compelling

Additionally, ideally the firm will be able to complete a sub-acquisition prior to going to market, successfully merging with, or acquiring another organization. Moreover, it will have also identified and had initial discussions with several other potential smaller acquisition candidates.

10. Have management with the necessary temperament, skills, and experience to execute.

As detailed earlier, the most successful participants over the next 10 to 15 years will transform their organizations. They will have to build brands, change their operating models, reset their cultures, redefine their value propositions, recruit large numbers of new professional staff, and fundamentally redo their approach to mergers and acquisitions. However, only those firms with management who possess the necessary temperament, skills, and experience to execute this transformation will be successful.

Participant management face mammoth challenges

Consider for a moment the scope of the challenges that many participants face. They must quickly develop clear, albeit complex, strategic plans that are fundamentally different from any approach the organization has previously employed. They then must persuade the firm's owners to invest immense amounts of money back into the enterprise without any certainty of getting a return on their investment.

They must also quickly determine how to brand the firm, what it will cost, and how to measure its success or lack thereof. But prior to doing so, they must first determine the specific groups of prospective clients the firm wants to target and the capabilities and expertise the firm will need to acquire for the brand to matter.

Accomplishing this will require management that has vision as well as a passion for the details of the business. They also will need a deep understanding of both the organization's employees and its owners.

Diplomatic skills on par with those trying to resolve the war and factionalism in Syria and Iraq.

The same management may also need to change operating models from athlete-centric to specialization-by-function. To do this, they will need to somehow persuade individuals who currently get paid a lot of money to not do that much and who have immense power over their

employer to instead take a longer view, work much harder, and have less control in exchange for an opportunity to build material personal wealth. Accomplishing this will require diplomatic skills comparable to those individuals who are trying resolve ongoing factionalism and war in places like Syria and Iraq.

Resetting culture for some organizations will be even more problematic. At many participants, everyone is comfortable. They get paid well and do not work very hard. Moreover, the firm has long operated this way. But if it is going to capitalize on the upcoming immense opportunities for low-cost organic growth, everything will have to change. The firm will have to become focused, even obsessed, with recruiting new clients. There will be expectations, accountability, and stress for every employee.

Leadership will need deft hands and decisiveness

Implementing this change without blowing up the business will require leadership with a deft hand and deep insight into the organization. They will have to quickly determine what changes can be implemented and how quickly, which employees to replace and others that they must recruit. And they will need to accomplish this while simultaneously not permanently poisoning the firm's operating environment.

Building a more compelling value proposition without bankrupting the company.

Management must also find a way to significantly expand and enhance their organization's value proposition, providing broader and better services to clients for the same fees that they pay now, without bankrupting themselves. It will require negotiating strategic partnerships with platforms and other wealth managers, identifying and recruiting specialized talent, and finding cost effective ways to get the necessary technology to support incremental services. Moreover, they must persuade owners to accept that profitability will likely be far less for some time – no easy task given its likely impact on these individuals' lifestyles.

Quality of management will be determinative of success

They also will have to develop a fundamentally different approach to mergers and acquisitions than what succeeded in the prior decade. It will require narrow, well-thought-out acquisition strategies that will take a great deal of management's time and effort to implement. More succinctly, the demands on wealth manager management going forward are going to be quite different than in the past. It will require different skills and personalities. It also will require leadership that thinks in terms of decades instead of years.

It will be the ability to find and recruit the management teams with the skills and personalities to accomplish these many things that will determine which organizations will have the greatest success over the next 10 to 15 years.

Owners of participants will have to make hard decisions.

In all instances, owners of participants will have to step back and make hard decisions as to whether the current management team in place is equipped to guide the organization forward. This is particularly true with aggregators.

Over the past decade, the most successful aggregators employed a strategy of "buy anything and everything" using as much debt as possible. Everything else was counterproductive to capitalizing on the limited-time opportunity offered by the financial markets and the wealth management industry.

Consider the current condition of many aggregators

However, consider for a moment the current condition of many aggregators. They are confederations of wealth management firms, each with their own brand, processes, and standards. Their management must find a way to integrate and reshape their affiliates without damaging them when the underlying expectation is that they will largely continue to operate in the future as they have done so in the past.

Several aggregators are currently led by extraordinary individuals who had vision, took risks, and capitalized on an exceptional market opportunity. However, their passion is doing deals. Not all have the experience, expertise, and/or interest in the details that are required to build enterprise value over many years in a wealth manager. Their backers are going to have to determine what will be the best management team and structure for what might be a completely different future operating environment.

Business operators who are a cross between Mary Poppins and Attila the Hun

Business operators with personalities that are a cross between Mary Poppins and Attila the Hun.

They will require management who are first and foremost business operators. They are going to have to transform their organizations and their affiliates into different enterprises, a lengthy, grueling process requiring someone with a personality that is a cross between Mary Poppins and Atilla the Hun.

IV. What will the industry look like ten to fifteen years from now?

The market share of even the largest participants is de minimis

The wealth management industry is in its earlier stages of consolidation. There are thousands of RIAs. Most are generalists. Those that are adding clients largely do so based on geography and through referrals from existing clients, rather than having any unique, enhanced expertise in solving specific problems. And although there are numerous firms with greater than $25 billion of client AUM and some with more than $100 billion, their share of the $57T market for wealth management services is de minimis.

Investment management industry in the mid-1990s looked like wealth management does today.

Most of the investment management industry in early 90s were generalists

One way to think about where the industry is today and what it will look like in 10 to 15 years is to look back at the investment management industry in the 1990s. In the early part of that decade, a money manager with $2 billion to $10 billion of assets under management was considered a "mid to large" firm. Most of the industry was made up of generalist firms that described themselves as either "equity" or "fixed income" managers, euphemisms for investing in all-cap portfolios of mostly U.S. stocks or bonds. The mutual fund business was still relatively small, largely sold by brokers who charged six-to-eight-point loads. The largest money managers captured the preponderance of their assets from pension plans and endowments based on investment performance. There was also an industry of consultants who served as key gatekeepers to these organizations.

However, the rapid shift from traditional pensions to defined contribution plans in the 1980s described earlier in Chapter 2 not only spawned the formation of the wealth management industry but also revolutionized the investment management industry. By the mid-1990s, financial capital became more of a determinant of success than investment performance.

Nearly all new retirement savings capital went into 401(k) and 403(b) plans which required recordkeeping. Those organizations with the ability and willingness to pour hundreds of millions of dollars into building necessary platforms collected the preponderance of these assets.

At the same time, the mutual fund industry exploded in size as Boomers began to save more. Large organizations that had the capital to create and support mutual fund families and wholesaler marketing forces captured the preponderance of mutual fund assets.

An M&A feeding frenzy soon ensued. Large organizations with access to capital began to buy up smaller money managers and an initial

Investment management industry evolution eerily similar to wealth management

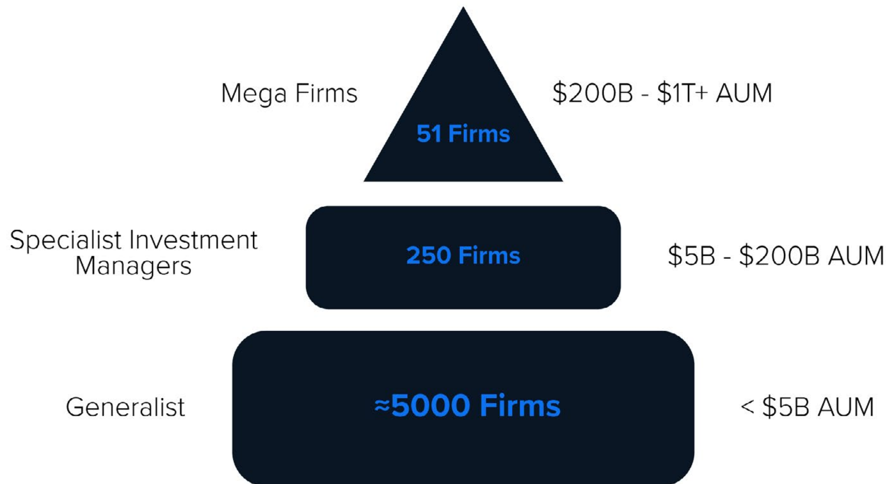
group of $100+ billion AUM firms began to emerge.

The investment management industry in the late-1990s looked eerily like wealth management today.

If this sounds eerily like the wealth management industry over the past 15 years, it should. It is the normal consolidation and rationalization that occurs in every industry.

As shown in Figure 4.1, today the investment management industry includes 11 participants with more than $1 trillion of AUM and another 40 with more than $200 billion of AUM.[65] There are also 250 additional firms that manage more than $5 billion of client assets, largely in specialized investment strategies. And although there are still thousands of smaller firms, they too either have specialized investment strategies or are "investment counselors," small, marginally profitable firms which manage money for individuals and a handful of very small institutions.

Figure 4.1
Current Structure of Investment Management Industry



Sources: Largest Money Managers 2023 - Full List | Pensions & Investments (pionline.com); https://investmentadviser.org/wp-content/uploads/2022/06/Snapshot2022.pdf

[65] Largest Money Managers 2023 - Full List | Pensions & Investments (pionline.com)

The wealth management industry will ultimately look quite like that of the investment management industry. It too will have perhaps 10 to 15 "mega-firms" with more than $1 trillion of client assets as well as many firms with more than $200 billion of AUM. It also will have large numbers of smaller – but highly profitable and valuable – specialist wealth managers with expertise in the unique problems of small groups of individuals. And there will be even greater numbers of small, far less profitable generalist firms.

The only question is which firms will wind up in which category

The only questions are how long this evolution will take, which firms will emerge from the industry's current chaos, and in what category will they land? However, it will be decisions made by owners today, as well as their management's ability to execute, that will decide their outcomes.

Group I – "mega" wealth managers.

Although there are many participants with more than $25 billion of AUM, it is unclear which are most likely to evolve into mega wealth managers. Certainly, there is a high likelihood that they will include some current aggregators, as well as potential new entrants that acquire or merge with existing aggregators. Additionally, it is unlikely that future mega-firms will include a de novo aggregator. The paucity of $2 billion to $10 billion firms yet to be acquired and immense competition to buy other firms will make it hard to achieve sufficient scale.

Current aggregator size is not indicator of future success

That said, for several reasons the current size of an aggregator is unlikely to be determinative of its future outcomes. For starters, whether the enterprise today has $30 billion of AUM or $100 billion AUM, both still have a very long way to go to eventually have between $500 billion and $1 trillion.

The most important determinant of size will be the number of new clients they can capture.

Number of net new clients will be determinative of future size

Additionally, the biggest determinant of future size will be the number of new clients that participants are able to capture over the next 10 to 15 years. Indeed, existing client bases will shrink over time as clients age and begin to consume their capital. In contrast, the upcoming wave of new clients will largely consist of younger individuals, most of whom will be capital accumulators.

However, the current ability to capture new clients varies widely. As described earlier, there is a continuum of aggregators. At one extreme, many are confederations of small firms rather than single enterprises. Integrating and transforming these businesses so that they can capitalize on the upcoming wave of new potential clients will be extraordinarily difficult and time consuming.

Many aggregator backers have insufficiently long investment horizons

More importantly, many have backers with five-to-seven-year investment horizons. They are unlikely to quickly make the necessary long-term decisions and investments because it will take a decade or longer to realize the benefits from them. Consequently, absent a change in their ownership or their current owners' investment horizons, their likelihood of evolving into mega-firms is relatively low.

Further, although the remaining aggregators are more advanced in the integration of their businesses, each still requires some level of additional transformation if it is going to capitalize on the immense, upcoming organic growth opportunity. Unfortunately, some of these organizations are also backed by investors with short investment horizons. Consequently, their chances of emerging into mega-firms will likewise depend on whether their owners take a longer view of their participation in this industry.

A handful of aggregators with visionary owners are most likely to grow to $500 billion of AUM or more.

A handful of aggregators are most likely to become mega-firms

That said, as described in Chapter 1, there are a handful of aggregators with ambitious, visionary owners. They have built their businesses from scratch and recognize the immense opportunity still ahead in this industry. They also are far along in integrating their acquisitions into their enterprises in no small part because they often are using their own money – without any associated management fees – and thus, have been far more discriminating in their purchases. Indeed, these organizations commence their integration processes almost immediately after closing. They clearly have the highest likelihood in the next 10 to 15 years of growing to at least $500 billion of AUM and perhaps more.

Three reasons why aggregators are unlikely to acquire other aggregators in the near term.

Additionally, another path that could lead to the creation of mega-firms would be for aggregators to acquire other aggregators. A single such transaction would be transformative, as much as doubling the size of the acquirer. However, there are three reasons we are skeptical of any such consolidation occurring, at least in the near term.

First, a buyer would have to pay a hefty price to acquire an aggregator, at multiples of cash flow far greater than when buying individual wealth managers. Aggregator owners are very sophisticated investors who pride themselves on getting the absolute highest price for the companies that they own. And at least for now, many have no urgency to sell.

Unclear what would be accomplished by buying unrationalixed aggregator

Further, it is unclear what an aggregator would achieve by acquiring any competitor that was willing to sell. Such organizations are unlikely to have made the necessary investments to transform their business

and instead will largely still be confederations of small firms. Buying such an aggregator will exponentially complicate the lives of the acquirer's management with little certainty of enhancing its value.

Most importantly, and as described earlier, the current "biological imperative" of PE firms is to find places to invest money so they can collect management fees. To date, many have effectively sold their ownership stakes in these businesses to themselves, shifting their investment from funds that are maturing to newer ones. The last thing PE firms want to do is to sell an aggregator they have helped build and lose the ability to continuously roll over their investments and collect the associated fees.

Mergers between aggregators will likely occur only after they are transformed

Consequently, it is far more likely that a mega-firm emerges from the merger of two or more PE-backed aggregators. But this most likely will only be between aggregators after they have transformed themselves into single businesses. Such a transaction would create opportunities for greater operating efficiencies and shared marketing benefits. It also would enable each of the PE firms involved to roll their investments into the new enterprise and continue to collect management fees.

Sovereign funds may use co-investment rights to acquire a controlling stake in an aggregator.

Additionally, at some point two other major sources of capital – sovereign funds and insurance companies – likely will back some of the industry's largest participants. In fact, many sovereigns already indirectly do so through their investments in private equity funds.

These organizations have extraordinarily long investment horizons, massive amounts of capital, and constantly try to minimize the management fees that they pay to outside managers. Indeed, organizations such as OTTP, CPP and Mubadala already regularly disintermediate PE firms through their direct investments.

They also seek opportunities to invest capital for decades. The stability of wealth manager businesses would allow them to hold an investment in an aggregator for a very long time as well as to be aggressive buyers should one be sold. Moreover, many sovereign funds condition providing funding to PE firms on having a right to co-invest equal or greater amounts in certain future transactions.

Sovereign funds will likely use co-investment rights to buy aggregators

They might elect to use this right to acquire a controlling stake in an aggregator that it will hold indefinitely and for which it will not pay management fees. They also could provide the capital and the stability that would allow an aggregator to grow into a mega-firm.

Insurance companies have very long liabilities that make them logical owners of mega-firms.

Insurance companies are also logical capital providers because many have 20-to-30-year liabilities that allow them to take a long view of their investments, and which could be offset with a stake in a large aggregator. With such a long investment horizon, an insurance company backed aggregator could take the necessary steps to build a mega-firm. Although an insurance company currently backs at least one of the current aggregators, it is likely that over time many more will consider investing in these businesses.

Public company models are particularly ill-suited for this industry.

Public company models destroy value in wealth management

Lastly, aggregator management often will speak of becoming mega-firms by taking their enterprises public and using the resulting equity currency to make acquisitions. Two large aggregators and a handful of smaller ones to date have made public offerings.[66]

However, the public company model is particularly ill-suited for this industry. As described earlier, it takes too long to build long-term, sustainable enterprise value, and public companies must be responsive to investors who often are far more focused on their next quarter's earnings than any long-term strategy. Any short-term approach is a recipe for destroying rather than building value.

Mega-firms will evolve into diversified financial institutions.

Future mega-firms will compete directly with Schwab and Fidelity

It is also important to note that those organizations which become mega-firms will likely also evolve into diversified financial institutions that will compete directly with organizations like Fidelity and Schwab. They will develop multiple business lines, acquire brokerages, and some may even offer services for the businesses of their clients.

Group II – Large numbers of highly profitable, specialist wealth managers.

The second segment of the industry in 10 to 15 years will consist of large numbers of specialist wealth managers. These organizations will have a deep expertise in the most complicated and important problems of a relatively small group of individuals. Their advice will materially improve and enhance the lives of clients.

Specialist wealth managers will materially improve client lives

Many today are small generalist wealth managers that are growing, often capturing younger clients through subscription programs. At some point they will decide to specialize in the problems of a narrow group of targeted clients.

[66] One large one – Focus Financial Partners – was recently taken private. Our view is that this transaction is an indicator of several of the changes that we have described in this study.

Such problems may be connected to a client's ability to create and build capital (i.e., their careers or businesses), specific family

challenges, philanthropic activities and objectives, or personal social goals. They also may be based on tax issues tied to how and where they have built their capital. As noted earlier, these firms will oversee every aspect of their clients' financial lives but only for a narrow group of clients.

Specialist wealth managers will continuously expand their expertise

These types of wealth managers will also continuously expand and enhance the depth of their expertise and services for their targeted clients. They recognize that unless they do so, their expertise will quickly become commoditized, losing their ability to distinguish themselves from their much larger and better funded competitors. They, likewise, will build powerful brands that communicate their expertise and experience to their target audiences.

Specialist wealth managers will be highly profitable and valuable enterprises.

Although they will be smaller than the mega firms, specialist wealth managers will be highly profitable and valuable enterprises. They also will be much larger than they are today. As described earlier, labor costs will be significantly higher, and they will have to do much more for clients, necessitating greater scale to sustain profitability.

Specialist wealth managers will be larger and more efficient

Indeed, every industry participant will have to be materially larger, or it will be far less profitable. Competitive pressures over time will force margins to shrink.

Consequently, specialist wealth managers will also have far more efficient operating models than they do today. They, too, will have shifted from operating models that rely on "athletes" to ones that specialize by function. They also will affiliate with shared service providers. Although still independent, by partnering with these organizations, these firms will capitalize on a shared scale for some of their higher fixed-cost functions such as technology, compliance, and cybersecurity.

They will have the advantage of much lower client acquisition costs.

Clients will be "pulled" to specialist wealth managers

More importantly, one of their key advantages will be that their client acquisition costs will be much less than those of non-specialist firms. The latter will have to rely on expensive marketing and advertising programs to "push" clients to their organizations. In contrast, specialist wealth manager brands will "pull" in prospects that require the firm's unique expertise in solving certain problems. And as also noted earlier, because they are helping solve very complicated and urgent problems – their clients' most critical and urgent problems – they will be willing to pay a premium price.

Like other industry participants, specialist wealth managers will grow through acquisitions of other firms. They will acquire organizations with similar specialties, expanding their geographic footprints to capture market share and increasing their scale. Some may also acquire other specialist wealth managers that target different client segments. They will become multi-specialty firms with a shared culture and commitment to clients, notwithstanding that the advice they provide may widely vary between client types.

The most successful specialist wealth managers will have more than $100 billion of AUM.

The most successful specialist wealth managers – like their counterparts today in the investment management industry – will have more than $100 billion of AUM in 10 to 15 years. These businesses will have immense enterprise value.

Group III – Thousands of small generalist wealth managers.

Generalist wealth managers will change the least

The last group of wealth managers will be the largest in number and undergo the least amount of change. Thousands of small, generalist firms will continue to operate largely as they have for the past decade, servicing existing clients and capturing the erstwhile new client referral from them.

Although many of their owners currently are paid quite well – in no small part due to the run up in the financial markets from 2012-2021 – what they earn will slowly dissipate over time. They will have to do much more for their clients. Their costs – in particular, labor – will increase. They, too, will have to affiliate with shared service platforms to achieve the necessary scale for managing some of their fixed costs.

These organizations already have relatively older client bases that will consume more of their capital and reduce (over time) the fees that they pay. More problematic, some of their younger clients may leave the firm as they age and their lives become more complicated. They will decide that they need more sophisticated and customized advice, so they will shift to a specialist wealth manager.

Small generalist wealth managers will look very similar to local bookkeeping firms.

Generalist wealth managers will be like local bookeepers

More succinctly, small generalist wealth managers will look very similar to local bookkeeping firms. Their owners will be paid salaries for their work, but they will generate few, if any, shareholder distributions. They will be glorified proprietorships that are relaxed, low stress places to work.

Many owners will fly their firms into the ground

As economic pressures rise, many owners will elect to sell. Indeed, thousands will likely do so. That said, unless they are careless with either compliance or cybersecurity, none will go out of business. Instead, their owners will make a lot less money over time than they do now.

Moreover, their companies will have little to no enterprise value. They will be jobs and not businesses. However, they will keep their owners occupied as they age, and many would prefer to fly their firms into the ground than to stop working in wealth management.