

GAIN GREATER CLARITY ABOUT THE ECONOMICS OF INDEPENDENCE

Understand the fundamental economics of launching a new independent firm - from equity and compensation to leverage and margins.

OVERVIEW

Today, more financial advisors are breaking away and choosing to forge their own path as an independent registered investment advisor (RIA) or something in between.

Transitioning a financial advisory practice is not without its challenges and opportunities. Review frequently asked questions (FAQs) and learn why so many advisors are choosing the path of independence.

FAQS

What key economic factors should an advisor consider before launching a new firm?

Start with these questions:

- How are you going to capitalize your firm?
- Do you need a capital infusion on the front-end?
- Do you need to replace a forgivable loan or another financial construct you owe to your prior employer - so you will be fully free to solicit your clients?

Capitalization comes in two forms - equity or debt - and each has its merits.

- Equity means that you engage a partner that will be aligned with both the top and the bottom line of your business. Equity capital tends to be more expensive, but the partner has a vested interest in your near term performance and long-term success.
- Debt means engaging a lender. This approach delivers less expensive capital, but the provider will not typically offer the same level of partnership or proactive effort to help you pursue growth.

How is advisor compensation handled for an independent firm versus a wirehouse?

If you are an advisor at a wirehouse, you are typically compensated on a grid structure. The firm pays your expenses, and you get a mid-40s percent payout based on revenue from your book of business.

With independence, by contrast, you have almost total control over the payout, because you can dictate your expenses by building your team and choosing the resources and the platform behind you. You can use your entrepreneurial leverage to scale your business to increase payout margin and profitability.

Key Insight: Look beyond payouts to take stock of the additional value from equity in the firm, which can be considerable.

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Are there differences between how small and large firms handle compensation?

Small advisory firms, where a few key advisors own 100% of the firm, often use a framework called Earnings Before Partner Compensation, in which partners pay the business' expenses and any leftover money drops straight to earnings, becoming partner compensation.

As firms move up the growth curve, however, they generally shift to professional compensation structures for everyone, including the equity owners. Advisors might get an additional amount that is usually based on business net income.

How do firms achieve adequate operating leverage?

Operating leverage comes from taking advantage of the right internal opportunities and the right external resources, to ensure that your growth is not hamstrung by limitations.

It does not have to be expensive to achieve adequate operating leverage, and there are more options now than ever before. You can outsource or insource nearly every vertical of running a firm, which means that partners can focus on what they do best - managing their current book of business and soliciting new clients.

Also, having the right resources makes it easier to bring in new talent. You will possess an attractive organization, marketing and name brand recognition, and offer a complete suite that an advisor needs. Good operating leverage is how you go from being a practice to being a true professional.

How important is it to retain certain profit margin?

A profit margin is one indicator of the financial health and wellbeing of any business - but for many independent firms, it can be a misleading number.

For example, if you invest in a chief marketing officer or chief investment officer, your profits may be down incrementally, but the firm is now poised for significant growth. By contrast, you might see a firm with very high profit margins, but there might not be a strong infrastructure. Examples could include underspending on technology or other critical resources needed to grow. Profit margin is not a static number - context is needed on either side of those percentages.

Ready to get started on your breakaway journey? BNY Pershing can help. Visit bnypershing.com or speak to a Sales Executive at (800) 445-4467.

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