RIA Technology Integration: The True Opportunity Cost of Inefficiency

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IMPACT POINTS

- Independent registered investment advisors (RIAs) deal with a wide range of business applications, ranging from portfolio accounting, financial planning, and customer relationship management to trading and rebalancing. Hybrid RIAs are faced with applications required to manage fee-based assets as well as those used to access the brokerage platform/broker workstation.
- RIAs estimate the average level of technology integration across business applications to be less than 50%; the majority of RIAs license individual solutions from a range of different vendors via an à-la-carte approach and install them in-house.
- On average, 3.2 support staff members are required to operate an RIA: 1.6 full-time employees support the primary financial advisors with advice-related tasks and a similar number focus on operations-related activities.
- A primary advisor at an RIA firm spends 20% more time on operations-related tasks (e.g., data reconciliation, performance reporting, fee billing, general administration) than on client acquisition and prospecting. Supporting financial advisors face a much worse situation; they are spending three times the amount of effort on operations tasks as on client acquisition and prospecting.
- RIAs see the need for technology integration. They have put increasing the level of integration among the top three spending items related to technology. The need for integration increases sharply once an RIA has surpassed US$100 million in assets.
- Moving from an average level of technology integration to a fully-integrated environment will allow an RIA firm to reallocate the equivalent of five weeks per staff member annually from operations tasks to client acquisition and prospecting. For supporting financial advisors, the reduced focus on operations tasks (-40%) leads to a tripling of time available for client acquisition and prospecting.
- In order to increase integration, RIAs have to change the way they source technology, as the à-la-carte approach often practiced by RIAs will automatically lead to inefficiencies. As RIAs lack the expertise and technology budget to conduct technology integration efforts, leveraging the pre-integrated platform offered by outsourcing providers is the most realistic way for them to obtain a fully integrated technology environment.
- RIAs that opt for an outsourced operating model need only half the operations staff of RIAs with an in-house model. They can significantly reduce the time required to perform processes like data reconciliation and fee billing. An outsourced model reduces the time it takes to send out client bills by one week.
- The outsourced model allows RIA firms to reduce the costs spent on hardware, maintenance, and data backup by 72%. Leveraging the capabilities of an outsourcing provider also means much improved data security and disaster recovery.

INTRODUCTION

The U.S. wealth management industry is dominated by firms with large technology departments and more than 10,000 financial advisors each. The business applications with which advisors at large firms like wirehouses serve their clients are well integrated, allowing advisors to work in an efficient manner. While independent registered investment advisors (RIAs) provide similar services and compete head-on against advisors from wirehouse firms, their advisor desktops do not allow them to work anywhere as efficiently as their peers at larger brokerage firms. This puts RIAs at a significant disadvantage when competing with advisors at larger firms.

Published by National Financial Partners and produced by Aite Group, this study examines the impact that technology integration and outsourcing can have on an RIA's operational efficiency and ability to compete effectively in today's market place. For this purpose, Aite Group fielded a March 2011 online survey of 146 RIAs.

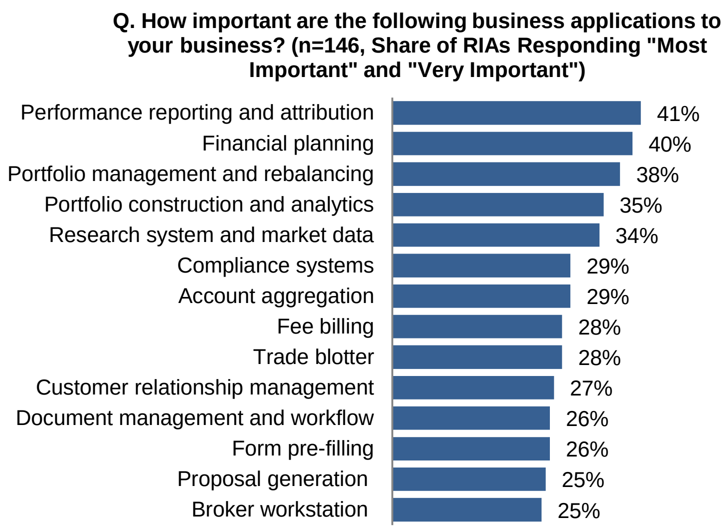
OPERATING AN RIA FIRM

Serving wealthy clients as an independent RIA entails not only providing financial solutions to wealthy individuals, but also business aspects like evaluating and licensing business applications, running a technology infrastructure, and managing an operations team. Clearly, running an independent RIA firm is a complex task. This section analyzes how independent RIAs typically handle crucial requirements, like business applications and personnel support.

BUSINESS APPLICATION REQUIREMENTS

The list of business applications required to run an independent RIA firm is long. Figure 1 shows which business applications are considered "most important" or "very important" by surveyed RIAs. It is little surprise that performance reporting was ranked as the most important application, given that the ongoing reporting of investment performance is key for any RIA demonstrating to clients that their chosen investment strategy is successful. Depending on an RIA's business model, however, certain applications are more important than others. While those RIAs that are mostly focused on providing advice will value their financial planning platform more than their trading infrastructure, RIAs that see investment management as their core proposition will feel differently.

Figure 1: Business Applications Deemed "Most Important" or "Very Important" by RIAs



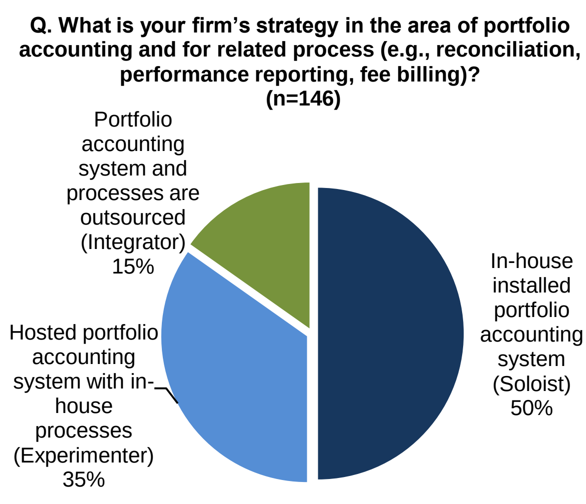
Source: Aite Group Survey of 146 Registered Investment Advisors, March 2011

All in all, Figure 1 clearly demonstrates that there is no single most important business application; rather, a broad spectrum of applications is required for running an RIA firm. A central role of an RIA platform is played by the portfolio-accounting system, which is the basis of many crucial processes, like performance reporting and fee billing. This core infrastructure component provides an up-to-date copy of the client positions held at the custodians used by the firm. Especially in a multi-custodial environment, the portfolio-accounting system is the only place where an integral view across all client assets managed by the RIA is available. A regular data reconciliation process will ensure that the portfolio-accounting representation of the custodial records are kept up-to-date such that accurate performance and billing processes can be run based on that data set.

There are several implementation strategies in the area of portfolio accounting. In rough terms, they can be segmented into the following three approaches:

- **Soloist:** RIA firms install the portfolio-accounting software in-house on their own servers. In this model, RIA firms take on the responsibility for updating data (e.g., security master) and performing processes like data reconciliation and performance reporting. Firms also have to make sure their technology infrastructure (i.e., hardware and applications) is available during business hours, and keep system downtime to a minimum. As shown in Figure 2, half of all surveyed RIAs follow this model.
- **Experimenter:** Instead of installing the portfolio-accounting application on the firm's own servers, RIAs can take advantage of the hosting services provided by software vendors and outsourcing providers. In this model, RIAs delegate the burden of managing the software (and parts of the hardware), but continue to be responsible for processes like performance reporting and fee billing. Thirty-five percent of respondents have implemented this model.
- **Integrator:** This approach is an extension of the ASP model in that the business application is hosted and the RIA firm delegates certain operational processes, like the production of performance reports or client fee statements, to a specialist outsourcing provider. About 15% of RIAs have opted for this model.

Figure 2: Deployment Method of Portfolio-Accounting Application

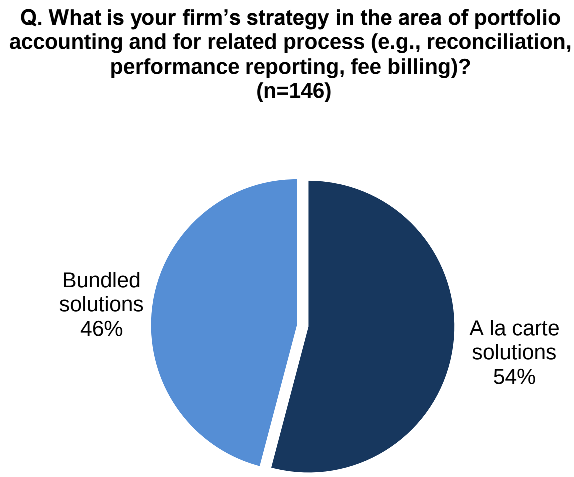


Source: Aite Group Survey of 146 Registered Investment Advisors, March 2011

While portfolio accounting is at the core, accounting systems cover only one part of an RIA's business applications requirements. As shown in Figure 1, RIAs are licensing many other applications in order to be able to serve their clients. Financial planning, rebalancing, and portfolio construction tools are among the most common.

The majority of RIAs license business applications on an à-la-carte basis (Figure 3), which means that these advisors are picking the tools with the best feature/function set within each application area rather than licensing larger, pre-integrated platforms that cover most or all of their application needs. The à-la-carte approach will result in a larger set of vendors that need to be managed, and will require a greater RIA effort to make the various technology pieces work together.

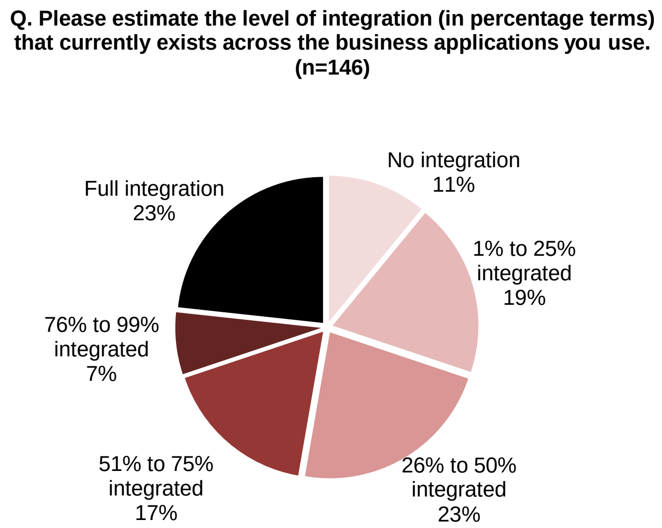
Figure 3: Approach for Sourcing Business Applications



Source: Aite Group Survey of 146 Registered Investment Advisors, March 2011

Given that RIAs often don't have dedicated technology staff or the means to conduct large-scale technology projects, it is little surprise that their technology environments are characterized by a low level of integration. On average, RIAs report that less than 50% of their business applications are integrated with each other (Figure 4), and less than a quarter of respondents can claim having a fully integrated platform.

Figure 4: Level of Integration Across Business Applications



Source: Aite Group Survey of 146 Registered Investment Advisors, March 2011

RIAs might not always have chosen the a-la-carte over the platform approach, but over time, many small technology decisions have led to a low level of integration and process inefficiencies. Those independent advisors that conduct fee- and commission-business—the so-called hybrid RIAs—are certainly in a trickier situation than are fee-only RIAs. Distinct technology platforms are typically used for each type of business, a broker workstation provided by their broker/dealer firm and advice tools and a portfolio-accounting system licensed directly from technology vendors or sourced from custodians. Unless their broker/dealer firm can provide a level of integration across both lines of business, achieving operational scale is extremely difficult for hybrid RIAs.

PERSONNEL REQUIREMENTS

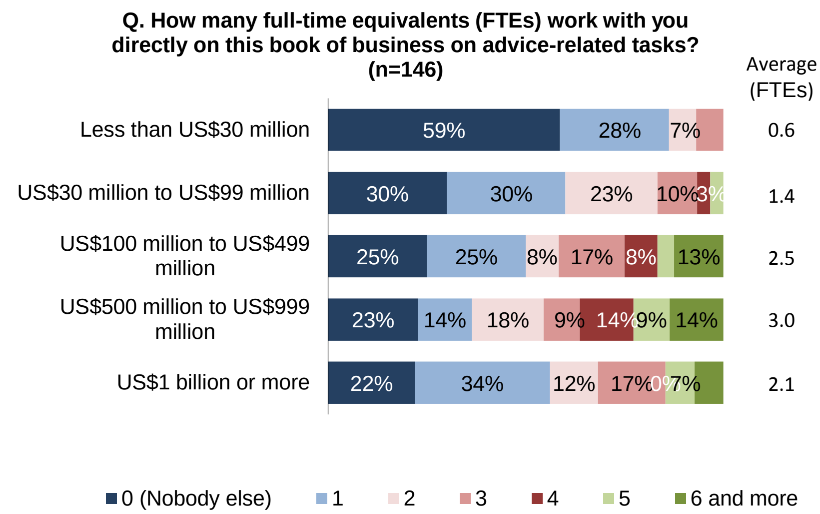
Burdened with a low level of technology integration and process inefficiencies, RIAs have to hire staff in order to support them in serving clients. There are two types of support staff:

1. The first type focuses on helping the primary financial advisor in advice-related tasks like financial planning, responding to client requests, and cold calling.
2. The second is predominantly occupied with operations activities like data reconciliation/exception handling, and fee billing.

As shown in Figure 5 and Figure 6, the amount of support staff employed by an RIA firm depends heavily on the size of the firm. While each RIA has an average of 1.6 full-time equivalents (FTEs) focused on advice-related tasks, and a similar number focused on operations-oriented activities, this number goes up to 2.5 FTEs for each type of support staff at RIAs with assets between US$100 million and US$500 million. For 25% of RIA firms of this asset size, however, the number of FTEs supporting advice-related activities is 4 or higher. On the operations side, close to 30% of

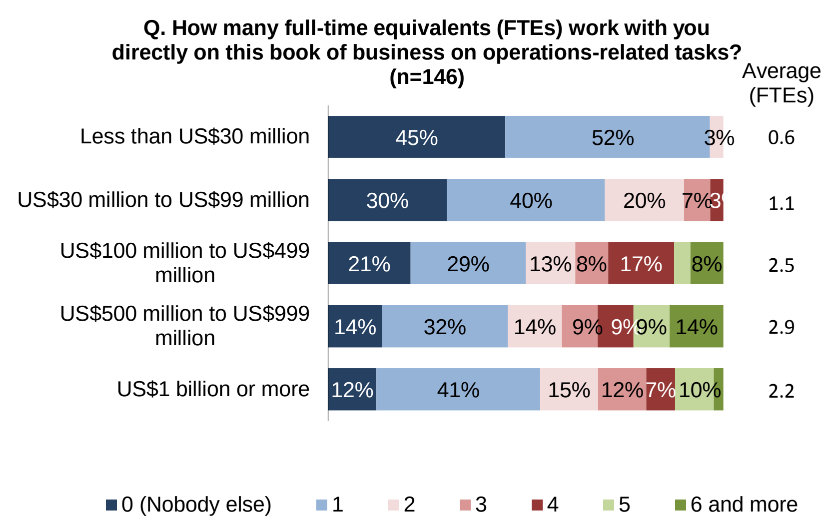
RIAs with assets of between US$100 million to US$500 million have 4 FTEs or more supporting this area.

Figure 5: Number of Full-Time Support Staff Performing Advice-Related Tasks



Source: Aite Group Survey of 146 Registered Investment Advisors, March 2011

Figure 6: Number of Full-Time Support Staff Performing Operations-Related Tasks



Source: Aite Group Survey of 146 Registered Investment Advisors, March 2011

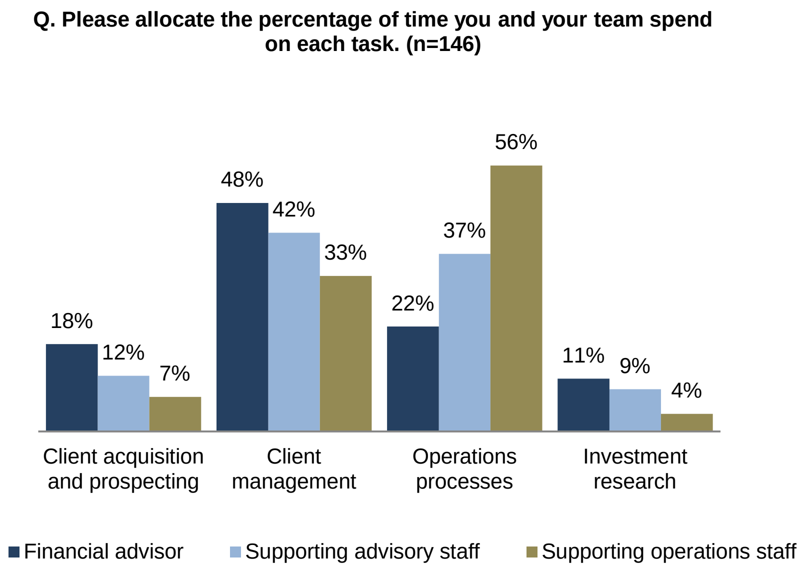
The survey has analyzed the roles these staff members play and the activities performed by them. For this purpose, we have defined four major activity categories:

- **Client acquisition and prospecting** are activities that are aimed at growing the book of business through adding clients.

- **Client management** includes all activities along the investment management process that are mostly performed for existing clients. Financial planning, proposal generation, ongoing monitoring, and trading are some of the tasks found in this category.
- **Operational processes** (e.g., data reconciliation, performance reporting, fee billing, and general administration) are tasks that do not relate to any one client case or prospect. Most of them are performed on a regular basis (e.g., monthly, quarterly).
- **Investment research** includes all tasks related to following market events and identifying investment opportunities.

It is striking how much time primary financial advisors, support staff focused on advice tasks, and support staff focused on operations tasks spend on operations-related activities. As illustrated in Figure 7, the primary advisor of an RIA firm spends 20% more time on operations-related tasks than on client acquisition and prospecting. Junior advisors (i.e., support staff focused on advice-related tasks) have a much worse situation, they spend three times the amount of time on operations tasks as compared to client acquisition and prospecting. Clearly, there is much room for improvement. The next sections will examine the level of operational improvement that technology integration and outsourcing can achieve.

Figure 7: Time Allocation of RIA Staff



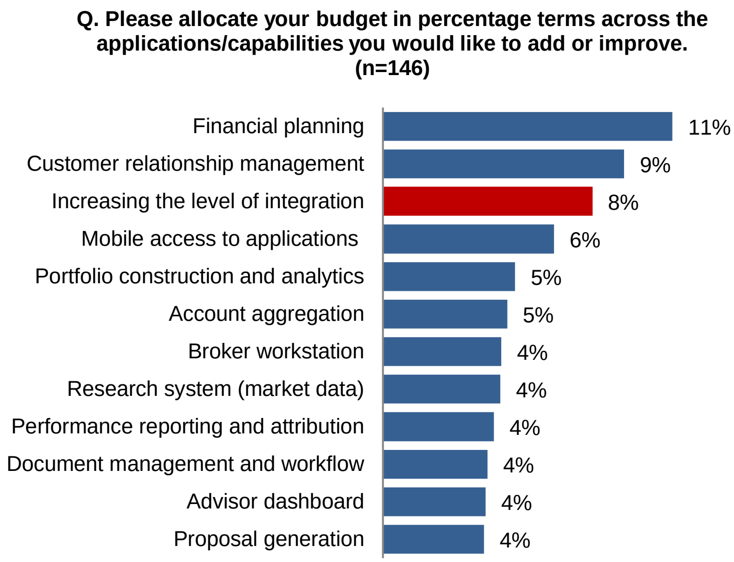
Source: Aite Group Survey of 146 Registered Investment Advisors, March 2011

THE VALUE OF AN INTEGRATED PLATFORM

THE NEED FOR INTEGRATION

As described in the previous section, the majority of RIAs use technology platforms that were assembled out of many individual solutions; they provide low levels of integration. Clearly, the inefficiencies created by this lack of integration must weigh heavily on the lean organization of an RIA firm. Indeed, when asked to prioritize technology spending, financial advisors cited increasing the level of integration across their platform as a top-three item to which they would dedicate 8% of a proposed technology budget. Figure 8 also demonstrates the broad array of technology spending priorities for RIAs, which further increases the complexity of achieving integration.

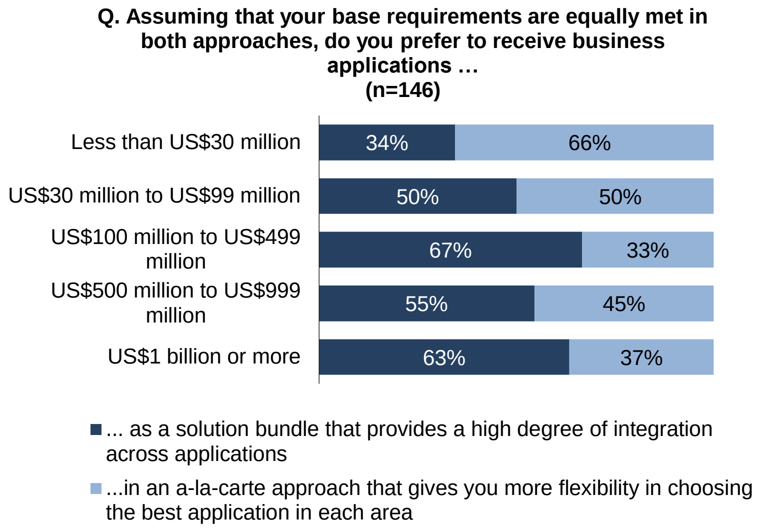
Figure 8: Technology Spending Priorities for RIAs



Source: Aite Group Survey of 146 Registered Investment Advisors, March 2011

RIAs' current choice of licensing business applications in an à-la-carte fashion is also questioned by many survey respondents. While very small RIAs (those with less than US$30 million in assets under management) seem to favor this approach—it helps them to build their technology platform one application at a time—only about one in three RIAs with assets between US$100 million and US$500 million prefer the à-la-carte approach (Figure 9). With the increased asset size comes the need to serve more clients as well as a sharp increase in operational pressure. These RIAs realize that a bundled solution will provide a greater level of integration, which, in turn, will improve operational efficiency and allow the firm to service more clients.

Figure 9: Desire for Integrated Business Applications

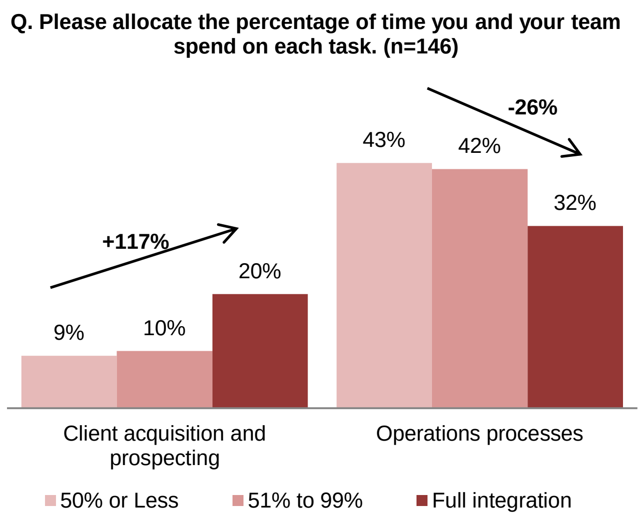


Source: Aite Group Survey of 146 Registered Investment Advisors, March 2011

BENEFITING FROM INTEGRATION

The results of segmenting firms by their level of technology integration and comparing the time each segment spends on operations tasks speaks loud and clear. By moving from a technology integration level of less than 50% to full integration, the amount of time RIA staff (i.e., primary advisor and support staff) spends on operations tasks can be reduced by more than a quarter. As shown in Figure 10, 11% of time across the firm that is shaved off operations can be directly added to client acquisition and prospecting, doubling the time allocated for this area across the firm.

Figure 10: Effect of Technology Integration on Time Allocation of All RIA Staff

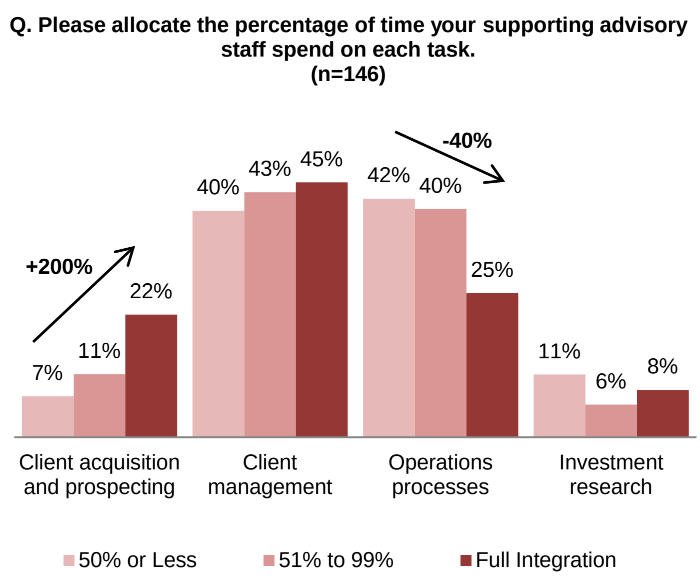


Source: Aite Group Survey of 146 Registered Investment Advisors, March 2011

Expressed in time spent in each area, this increase in efficiency translates into each staff member at an RIA firm being able to spend an additional half day per week on client acquisition, and reducing their effort spent on operations tasks by the same amount of time. Over the course of a year, this time shift ads up to five weeks per staff member. Across the entire firm, an RIA with a total staff of 4 (including the primary financial advisor) would reduce the time spent on operations by 21 weeks annually. Once an RIA firm has grown to a total staff of 8 or more, which applies to about one in four RIAs with assets of between US$100 million and US$500 million, moving to a fully integrated technology environment will free up the equivalent of a full-time employee from operations tasks, allowing the firm to use this resource for client acquisition and prospecting. Given the great benefit for an RIA firm of this size, it is therefore no surprise that this group of RIAs is more interested in bundled solutions than in sourcing technology components in a piecemeal approach (Figure 9).

With a fully integrated technology environment, a principal financial advisor at an RIA firm can allocate more time to client acquisition and prospecting (21%) than to operations-oriented tasks (20%). While this is a desirable improvement for the advisor, the benefits for support staff are much greater, as support staff carry most of the operations workload. This is especially true for staff members that support financial advisors, who are hired to help with client-facing talks and prospecting, and spend on average 42% of their time helping out on the operations side. They see their time spent on client acquisition and prospecting triple while at the same time cutting the time spent on operations functions by 40% (Figure 11). In addition, they are also able to increase by 10% the time spent on the management of existing clients.

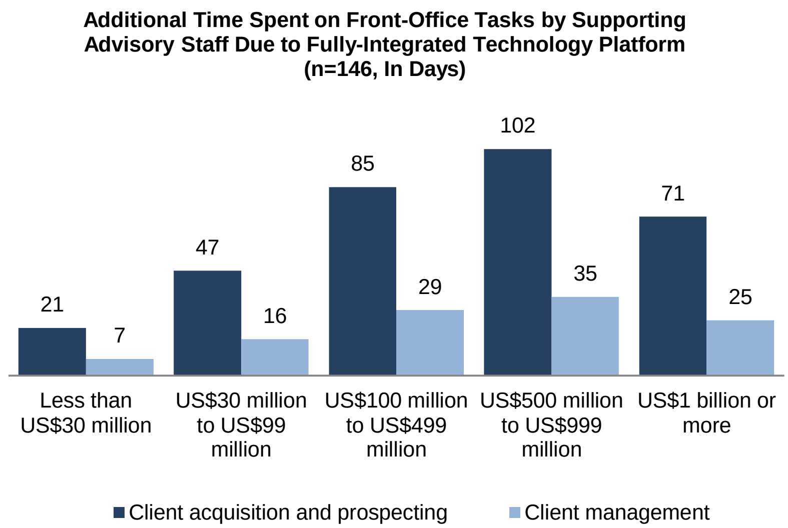
Figure 11: Effect of Technology Integration on Time Allocation of Supporting Financial Advisor



Source: Aite Group Survey of 146 Registered Investment Advisors, March 2011

The full impact of these improvements becomes clearer when one considers the number of supporting advisors that work at an RIA firm. Figure 12 shows the amount of reallocated time due to increased operational efficiencies (i.e., moving from a less-than-50%-integrated technology platform to full integration) across all supporting advisors based on the average number of FTEs in this category for each firm size (Figure 5).

Figure 12: Reallocation of Time by Supporting Financial Advisor due to Technology Integration



Source: Aite Group Survey of 146 Registered Investment Advisors, March 2011

Let’s take RIA firms with assets of between US$100 million and US$500 million as an example: These firms employ on average 2.5 supporting advisors. Due to the increase in operational efficiency provided by a fully integrated technology platform, this group of employees sees an aggregated 114 days—or almost a 0.5 FTE shift—from operations tasks to client acquisition and prospecting (85 days) and client management (29 days). Another example: While supporting advisors at firms with low levels of technology integration are able to spend 42 days on prospecting and acquiring new clients, this number increases to 127 days for those that have fully integrated technology platforms available; further, the number of days spent on client management increases from 235 days to 264 days.

By moving to a fully integrated technology environment, RIAs’ support staff, in particular those hired to perform advice-related tasks, will be able to focus on the tasks for which they were hired rather than fight the inefficient technology setup. Refocusing the workload of supporting advisors from operations to lead generation will not only put the money spent on personnel to better use, but will also have a direct impact on the firm’s growth.

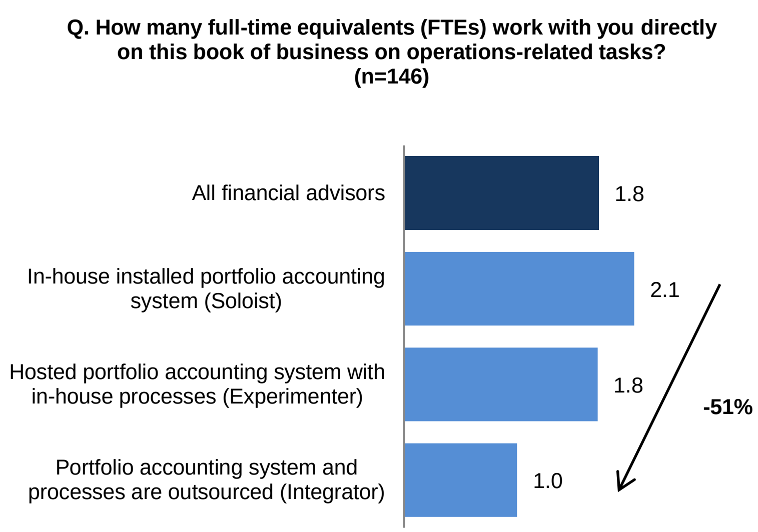
THE VALUE OF OUTSOURCING

Integrating business applications can be a daunting task for RIAs, which typically lack the technology expertise or technology budgets available to conduct the necessary IT projects. Leveraging a pre-integrated outsourcing platform is the most realistic approach to obtaining a fully integrated technology environment, and provides the added benefit of reducing the operational burden and required time to complete some of a firm's key processes. The following section will examine the benefits of an outsourced model. In order to measure the impact of an outsourced operation, we segmented survey responses by the firm's general operating model (Figure 2).

REDUCING IN-HOUSE OPERATIONS

Figure 13 examines the average number of operations staff required for each operating model. RIAs that have an all-in-house approach (i.e., have a locally installed portfolio-accounting system and are maintaining the responsibility for processes like data reconciliation in-house) need on average a little more than 2 FTEs to perform the various operations tasks. One in four RIAs with an all-in-house model, however, require 3 or more FTEs supporting operations. In contrast, RIAs that have outsourced their portfolio-accounting system and related processes require on average 1 FTE; only 5% of RIAs require more than 2 FTEs. Through outsourcing, RIAs have the ability to keep the number of employees focused on operations tasks to a minimum, while at the same time being able to benefit from a pre-integrated platform.

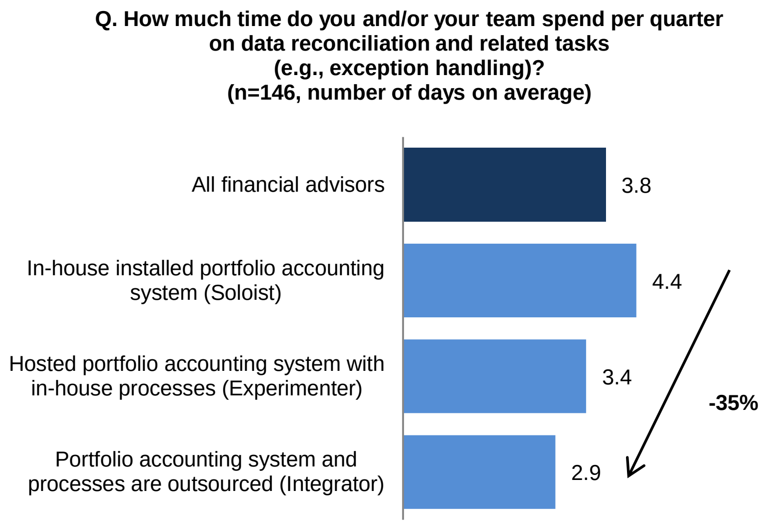
Figure 13: The Impact of Outsourcing on Staff Requirements



Source: Aite Group Survey of 146 Registered Investment Advisors, March 2011

Leveraging the operations firepower of an outsourcing provider will lead to a reduction of the amount of work spent on key processes. For example, the amount of time spent by the RIA firm's staff on data reconciliation and exception handling can be reduced by 35% (Figure 14). As a result of increased efficiency, reconciled data is available sooner and subsequent processes can be completed more quickly. This becomes visible when one considers the amount of time it takes to send out client fee statements. In an all-outsourced environment, fee statements can be sent out almost a week sooner than they can in an all-in-house setup (i.e., a reduction of around 50%), which will result in a faster client payment. Fee billing is just one process that benefits from greater process efficiencies. Performance reporting and portfolio rebalancing are among others.

Figure 14: Impact of Outsourcing on Data Reconciliation



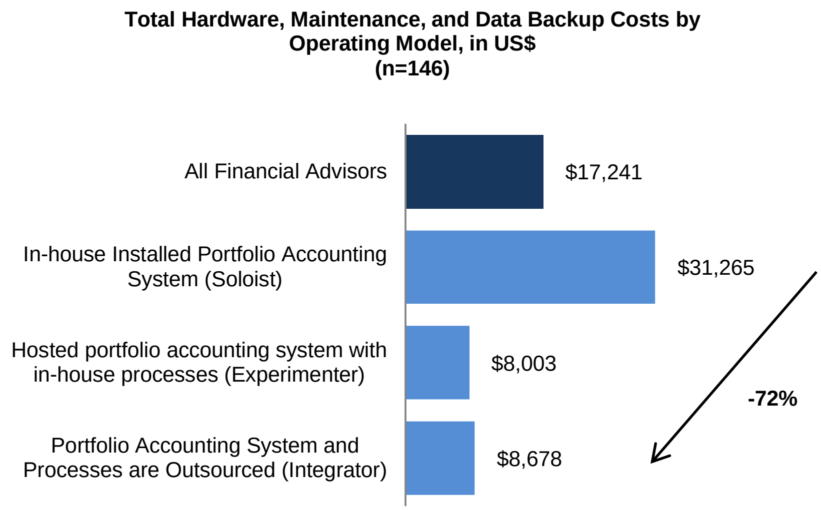
Source: Aite Group Survey of 146 Registered Investment Advisors, March 2011

REDUCING HARDWARE AND DATA BACKUP COSTS

Taking advantage of business applications hosted by outsourcing providers sharply reduces the hardware requirements of an RIA firm. As shown in Figure 15, a firm with an all-in-house approach faces annual costs of US$31,265. These costs take into account hardware purchasing, maintenance, and data backup on an annual basis. Opting for application hosting or business process outsourcing will reduce these costs by almost three-quarters, to around US$8,000.

At the same time, opting for application hosting or business process outsourcing will allow an RIA firm to leverage the vendor's expert data backup and disaster recovery strategy, providing an increased protection of the firm's client data and secure access to this data. The aspect of disaster recovery in particular is often underestimated by RIA firms, and can result in the loss of some or all business data should the firm's technology infrastructure be destroyed by a catastrophe like Hurricane Katrina.

Figure 15: Impact of Outsourcing on Data Reconciliation



Source: Aite Group Survey of 146 Registered Investment Advisors, March 2011

CONCLUSION

The wealth management industry in the United States has become increasingly competitive. The independent RIA space has been one of the major beneficiaries of the recent financial crisis, with financial advisors and their clients opting for this wealth management model. Being able to take advantage of the opportunity at hand requires a scalable organization and operations. Many RIAs, however, are dealing with a hugely inefficient technology platform. Much of the reason for this situation is that many RIA firms have started out small, dedicating a minimal amount of budget to acquiring point-solutions, and adding other components to the setup as the firm has grown. The resulting lack of technology integration results in inefficient operations that require additional staff to run the business.

Once RIA firms have reached a certain size, their inefficient operations pose an increasing burden to their business. Firms with client assets of more than US$100 million have on average a 2.5-strong support staff, which is supposed to focus on helping the primary financial advisor with tasks like developing financial plans, managing requests from existing clients, and prospecting for new clients. At RIA firms that do not have fully integrated technology platforms, supporting advisors spend on average two days per week on operations tasks rather than on serving existing clients or acquiring new ones. Moving to a fully integrated technology environment reduces the time spent on operations to slightly more than one day per week, and allows supporting advisors to triple the time they spend on client acquisition and prospecting and significantly increase the time available for the management of existing clients. For RIA firms with assets between US$100 million and US$500 million, a total of 114 days across all supporting advisors is reallocated in that way. This significant shift will allow the RIA firm to serve existing clients better and to have a greater focus on leveraging growth opportunities.

Achieving integration is difficult for RIA firms because they often lack both the technology knowledge in-house and the necessary budget to hire external firms for large-scale integration efforts. Leveraging an already integrated platform offered by an outsourcing provider is the most promising avenue for achieving the goal of increasing operational efficiency. It will also allow an RIA to grow without adding operations staff at the same rate. In a model where the technology platforms and operations processes (e.g., performance reporting) are outsourced, RIA firms require less than half the operations staff than firms with an all-in-house model.

Other benefits of outsourcing operations is that processes like data reconciliation can be completed more quickly, and, as a result, reduce the amount of time it takes the firm to send out performance reports or client bills. A shorter billing cycle would allow the RIA firm to receive client payments more quickly. In addition to operational efficiency, improved data security and reduced hardware spending are benefits of an outsourced operating model.

Familiarity with their current setup, while inefficient, often prevents RIA firms from moving to a more efficient environment. Unless RIAs are willing to take a fresh look at how they operate their firm, they will not be able to fully capitalize on the current growth opportunities and expand their client base in a scalable manner.

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