



# Who Will Succeed?

Cover Story

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A person who carries a cat by the tail gets knowledge that's always going to be useful." This aphorism, attributed to Mark Twain, insightfully illustrates a powerful point: Sometimes a struggle is required for real learning to occur.

Holding this down market by its proverbial tail is an important part of the evolution of the business of financial planning. Consider the circumstances of recent years. Bullish markets and the onset of the baby boomer generation have fueled practice growth across every size and segment of firm. This growth has, in turn, fueled the hiring of more staff and advisors which—given that the average advisor does not excel in the area of human capital—has created new challenges.

These trends are being experienced by firms on the forefront of practice management, so they may not have yet trickled down to, nor been recognized by, the collective body of advisors. I suspect you will find some of these trends in line with what you're experiencing. If not, be on the lookout. They are coming to an advisor near you.

There is little doubt that current and anticipated growth, the challenges of managing firms and related human capital dynamics will lead us further into uncharted waters. Our goal, then, is to ensure we have as clear a picture of the horizon as possible, as well as the navigational tools to help us stay on course.

The problem is that the people who may soon be running many firms lack their founders' entrepreneurial knack for finding new business. As baby boomer planners prepare to retire and seek to enhance the value of their firms before selling, perhaps the most important tool is the one that has been long overlooked: new compensation structures that specifically motivate employees to perform in the areas of finding, developing and nurturing new or expanded business. The idea is to stay away from the eat-what-you kill mentality and craft new structures that align compensation with individual performance in various advisor roles, including all forms of rainmaking.

In attempting to do so, planning firms indeed have a hissing cat by the tail, for this is no easy task. It is one that involves precisely defining and/or redefining roles and assigning new levels of accountability that determine advisors' income. Only after equipping future firm owners to develop new business can today's owners be assured of their firm's value at sale and be confident that what they built will outlive them.

## **Boomer Movement**

Since many advisors are also baby boomers, everyone with a voice has noted that succession planning is essential for the continuity of their practices. But most of these advisors are not ready to retire, and still others plan to die with their boots on. Thus, these advisors have not been quite as concerned about succession planning as the rest of us. However, I've noticed an interesting development behind the scenes in recent years. There is a growing lifestyle movement among the advisor population. They've worked hard and feel it's time

that they began to live a bit more and work a bit less. But they are not ready to retire or remove themselves from their practices.

This evolving movement is creating increased demand for hires to support mature advisors as they move toward a lifestyle practice model. The founder generation of advisors who now run successful firms are self driven and self made. Most began their careers with an encouragement in the form of: "Here's the phone book; now make it happen." And make it happen they did. These advisors are entrepreneurial spirits who forged their own way while, at the same time, formed an industry.

### **Not the Same**

There's just one problem: The advisors following in their footsteps have grown up in a different environment and time. These individuals have professional degrees and designations, and expect to join a service firm, not a sales force. They expect compensation to be robust, yet not at risk. And they expect it to be determined in ways beyond the generation of new business. They want career advancement tracks, standards of practice and partnership equity over time.

The risk-reward relationship is fundamentally different between founder advisors and those who follow. It seems that two groups of advisors have emerged: the entrepreneur advisor and the employee advisor. Founders, who are entrepreneur advisors, tend to believe they are hiring advisors much like themselves. They become frustrated when their hires focus on relationship management at the expense of rainmaking. Founders don't understand working this way because they are not wired this way.

A key contributor to founders' frustration is that advisor compensation is frequently tied to the top-line measures of firm AUM and revenue. As firms have grown organically, so has employee advisor compensation. Founders aren't particularly pleased by compensation increases that aren't accompanied by any material change in responsibility or performance. After all, this is not how they learned to get paid. (Interestingly, these same founders tend to forget that they designed these compensation structures in the first place.) And so a gap between the employee advisor and the entrepreneur advisor has emerged. A clear understanding of the trends that have produced this gap can help us change behavior and business models to capture the best of both worlds.

### **Finder, Binder, Minder, Grinder**

A contributing factor in the development of these trends is the different roles that advisors have come to play. These roles can be expressed in terms of a categorization of advisors that is not mine, but rather that of a respected consultant to the insurance industry who passed away in the 1990s and whose name I do not know—but to whom credit is due. Heretofore, entrepreneur advisors were the only advisors, and so they had to fill four roles to succeed: finder, binder, minder and grinder. I define these roles as follows. Finders are rainmakers, those with a penchant for business development. Binders are those with the skills to make the presentation and consummate the relationship. Minders are those who tend to the relationship, ensuring that it is successfully maintained. And grinders are those who work behind the scenes, generating the work that supports the relationship.

Many firms may not have anyone on board who wears only one of these hats; most advisors fulfill some combination of these roles. The entrepreneur (founder) advisor grew up in an industry that forced the development of all four skill sets. By contrast, employee advisors have not been trained to develop this broad skill set. To their credit, many are willing to try, though they often fail, creating a lack of confidence on their part and frustration on the part of founders. This versatility is nevertheless essential, especially at smaller firms.

While a mindfulness concerning these different roles and their various matrices is crucial to achieving the long-term goals of building firm value and succession planning—indeed, the two are inextricably linked—they also apply to situations that are far more imminent. Many founder advisors aren't going to be leaving their firms all at once. Instead, as exemplars of the lifestyle movement, they'll be gradually putting in less and less time at the office. After all, this phenomenon is already upon us, driving a growing need for support advisors who will eventually become succession advisors. At the same time, ensemble firms are growing, both in size and number, causing an increase in advisor hires to support this growth. In the past five years, all practice models (solo, silo and ensemble) have grown faster than the talent pool of qualified job candidates. The result is an industry with more firms looking for advisors than there are candidates, and that's before we account for the fact that a limited percentage of available candidates are desirable hires. Thus, a battleground for advisor talent has emerged.

### **Finding the Future**

The challenge of recruiting future owners while having to compete tooth and nail for talent comes as firms have taken on one of three

basic practice models. Ensemble firms tend to be more attractive to advisors seeking a professional firm environment, and generally have more time, people and financial resources to devote to recruiting and compensation. Solos don't have the size or scale, but do have unlimited flexibility in how they design culture, compensation and equity participation. Silos present themselves as firms, but tend to act as a number of individuals under one roof. They often end up attracting less qualified candidates. On the behalf of clients in recent months, I've spoken with five advisor candidates, each of whom was engaged in a thoughtful search for the right firm. They knew they were a commodity in short supply and were embracing the rules of a free market. All five had multiple job offers with which my clients had to compete. It seems the real winners in the talent war are the candidates who can command higher compensation.

I am not suggesting that service advisors are earning too much. Rather, I am suggesting that position design and compensation structures drive behavior and so should be created with that in mind. If rainmaking is a desired behavior for a senior advisor, then some component of variable pay (though not all or you're back to eat-what-you-kill) should be based on new business development. If relationship management and referrals are the desired behavior for a service advisor, then compensation should be structured to reward performance in these areas. Interestingly, the majority of firms compensate service advisors, whether they are titled accordingly or not, based on assets managed, and do not use performance-based standards, such as meeting service delivery standards, as a function of pay.

Compensation structures of the future will be less top line and more robust. They will be designed to correlate compensation with performance across multiple dimensions of behavior. So let's look at how compensation structures might be addressed or altered to account for the three advisor roles critical to initiating, managing, sustaining and servicing client relationships.

- **Finders.** Advisors who find clients and develop new referral sources from square one without a scintilla of help are, of course, quite valuable. And their compensation should reflect this. As rainmakers (finders) tend to be founders, conventions for compensating non-founder rainmakers tend to be lacking and thus wide open to definition.

Two methodologies are emerging. One centers on aligning the risk-reward relationships via an incentive compensation model—the greater the risk, the greater the reward. In whatever form it takes, this approach generally provides a small base salary—perhaps as low as \$60,000—with incentive compensation that is virtually unlimited and tied directly to performance. The more "finding" that takes place, the more income increases.

The second emerging methodology is a higher base compensation (often required to retain quality rainmaker talent), topped by an opportunity for incentive compensation. In this approach, base salary is a more significant component of total pay. Less compensation is at risk in this approach, but in most of the scenarios that work, there is a minimum performance hurdle (e.g., new AUM or new client revenue) that must be cleared to ensure job retention. The base salary is higher, but so are the expectations.

Designing compensation structures for finders is exceedingly complex. In most firms, finders perform multiple functions in addition to rainmaking. In a small but growing number of firms that have or are creating a pure rainmaking role, the methods for compensation vary depending on circumstances and goals. More often than not, there is a combination of roles, responsibilities and compensation structures to ensure best alignment with firms' goals. For example, in one situation, base salary itself was tied to performance, with the base being reset annually according to historical performance. In other words, if a finder gathered \$25 million in AUM over the prior two-year period, these assets became the basis for the coming year's salary, calculated as one percent of \$25 million, or \$250,000, then halved to produce a salary of \$125,000.

Additionally, the salary resets each year based on performance during the most recent two-year period. Performance goals for each year increase 10% and incentive bonuses do not trigger until the minimum goals have been reached. This hybrid structure encourages rainmaking this year and serves two purposes for the advisor: It ensures that this year's compensation goals are met, allowing access to incentive pools, and it assures growth in next year's salary based on the two-year performance average.

The most suitable compensation structure for rainmakers depends on the nature of their role. Is it a rainmaking role or a hybrid role? In either case, it is essential that new revenue generated exceeds compensation paid, otherwise the rainmaking compensation is a drain on firm performance and value.

- **Binders.** These are the in-between people who have an ability to manage client relationships and, though they may not be able to generate client business from square one—that is, without a referral—they are nevertheless good with clients and can close new business without a full-fledged rainmaker in the room. In a growing number of instances, rainmakers identify and engage

prospective clients in discussions that lead to a relationship and then turn these clients over to the binders.

In the vast majority of firms, finders, senior level minders (relationship managers) or non-rainmaking partners are filling this role. The appropriate incentive compensation might be a onetime bonus for a onetime function, based on a percentage of the assets or revenue generated by the client relationship, with little or no year-over-year payment.

- **Minders.** These are relationship managers and service advisors who manage and maintain client relationships.

Minder-base compensation strategies vary depending on the business model of their firms and their responsibilities. Base salary is a growing standard for this function, and incentive compensation is frequently driven by top-line measurements such as assets or revenue managed. So, with growth in assets or revenue, minders' compensation can—and often does—increase without any direct correlation to their individual performance.

To effectively compensate minders, a firm should determine whether it wants to encourage or require passive or even active rainmaking from minders. If it doesn't, key behaviors and compensation triggers may include client retention, implementation of service-model standards, continuing education/professional development, community involvement and other client- and firm-building activities that don't directly create new business, but which play an important role in the profitability of the firm. Passive rainmaking would include activities that directly support growth without being on the front lines, such as client referrals, soliciting new assets from current clients and engaging in marketing activities such as client events and writing articles. Minders' compensation structures should recognize the different behaviors desired of them.

Compensation of minders varies widely depending on the roles they fill. A growing number of minders receive a base salary and some form of bonus compensation. Too often, bonuses are discretionary or ineffectively based (e.g., a percentage of top-line AUM). If assets increase in value for no reason attributable to these advisors (market growth, firm or founders' rainmaking), then they are rewarded for the behavior of others, much to the chagrin of founders. Behavior that requires initiative generally warrants higher compensation, reflected either in salary or incentive pay, than behavior that does not. An area in which an awareness of this distinction can pay off is referrals.

A structure that reflects these dynamics and gives advisors strong incentives would be salary plus a bonus opportunity of up to 10%, linked to retention of the clients they serve, with compensation over and above that for referrals leading to new clients. This additional compensation could be five percent of new first-year revenue. Extending this bonus beyond the first year has a tendency to weaken incentive to take action to bring in new funds because this causes a compensation annuity to build up. Keep in mind that managing a practice, people and compensation is not a tidy business. Rarely are circumstances as simple as the examples presented, so the alignment of incentive compensation isn't as simple either.

The need to consider development roles and ways to compensate them grows more pressing as founders prepare for retirement or start taking more time off as participants in the lifestyle movement. Two years ago, a client of mine set a goal of three months off per year and of working a lighter week the other nine months.

He wanted to sustain his income while spending more time with his wife, grandchildren and golfing buddies (not necessarily in that order). Not only has he succeeded, but he has also increased his income and the value of his practice.

His lifestyle inclinations prompted him to take action to build his business beyond its dependence on him. While taking part in the lifestyle movement, this mature solo addressed succession planning. As expected from those that founded and formed this industry, he and others like him will do what needs to be done—at their own pace and on their own terms.

Given the clear need for change, we are redesigning models to recognize and reward the four advisor functions differently while treating them as being equally important to a firm's success. This is not always easy. The founder of a client firm managing more than \$1 billion in assets said to me, "I don't know why they don't bring in new business. Anyone can learn how to do it; I did." What I had to explain to my client was that he did not learn to be a rainmaker.

### **Linking Behavior to Strategy**

Instead, he had the talent and was forced to develop it. The advisors he has hired are extremely intelligent and skilled in managing client relationships; they just don't seem to have the talent to create new ones. I put it to him this way: "You can try to force them to become

rainmakers, but it'll be a bit like trying to teach a pig French. It won't work and it will frustrate the pig." I believe he got the point that you can't force talent. Instead, you find talent and then nurture it.

Beyond that, then, what can you do? You can provide incentives in much the same way that more corporate boards are linking executives' incentive compensation to behavior that achieves the intended business strategy. For planning firms concerned about the scaled-down hours and impending retirement of lifestyle-model senior principals, the business strategy, of course, is to develop rainmaking skills in those who will be occupying advisors' offices. Recruiting them with these skills already in place is prohibitively expensive. Those with records of landing new business are scarce and, if you can find them, they command astronomical sums. So the answer for most firms is to develop these skills from within. And nothing encourages the behaviors necessary for learning and change like effectively targeted incentive compensation.

With the emergence of the lifestyle movement, talent wars and employee advisors, it is clear that the strategies used to build firms of the past are not likely to work in the future.

As you think about how to build your business in the days and years ahead, heed the words of Robert P. Vanderpoel, the legendary financial editor who observed that a successful businessman will hold on to the old just as long as it is good, and grab the new just as soon as it is better. Just make sure that you're not still holding the cat by the tail now that it's out of the bag.

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