The Death Of Referrals And The Future Of Business Development For Financial Advisors

kitces.com/blog/death-of-referral-marketing-for-financial-advisorsin-investment-news-2016-financial-performance-study/

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Executive Summary

It is "accepted wisdom" that the best way to grow an advisory firm is through referrals. Of course, that means brand new financial advisors have to hustle harder to get their first few clients – because they don't have anyone to refer them – but even for those in their early years, once there's a critical mass of clients on board who can refer, it's supposed to be smooth sailing from there.

Except that it isn't anymore. In the latest Investment News 2016 benchmarking study of the Financial Performance of financial advisors, it turns out that referrals aren't the primary driver of AUM growth for RIAs anymore. Not client referrals, nor professional referrals, nor even both combined. Instead, it's now all about external business development and marketing strategies instead.

Notably, though, while advisory firms are driving more growth from non-referral strategies, and are indicating plans to ramp up non-referral business development even more in the coming years, there's little consensus about what the 'best' marketing strategies are. From community involvement to participating on non-profit boards and hosting networking events, advisory firms are trying out a wide range of activities. In fact, the only common thread is about what seems least likely to work, which is traditional 'advertising' strategies (whether print, radio, or online).

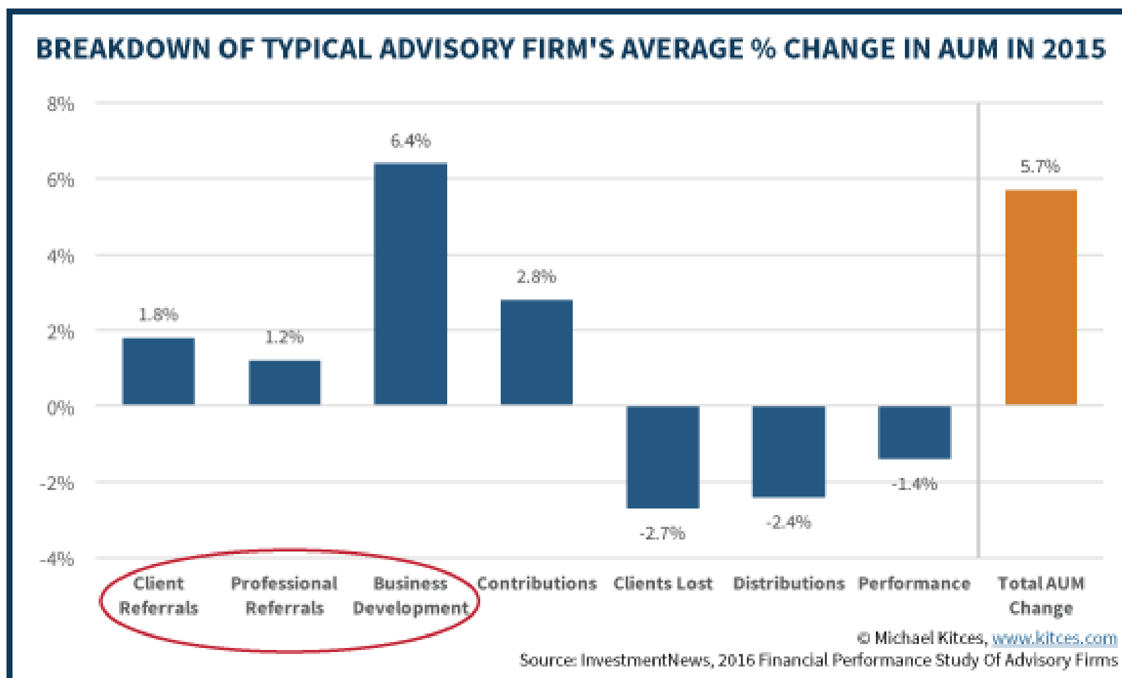
Nonetheless, the shift away from referrals appears to be on, in what may be driven by the underlying challenge that there just aren't very many "unattached" clients left to be referred in the first place. Because while independent advisors often like to talk about "taking clients away" from large firms like banks and wirehouses, the data shows that 3/4ths of new financial advisor clients are actually self-directed investors who decided for the first time to work with an advisor.

Yet with competition for self-directed investors tougher than ever, not only because there are fewer of them (as more and more have adopted advisor relationships with the growth of the AUM model in the past 15 years), but also because they're now being solicited by everything from "digital" robo-advisors to the financial planning and wealth management divisions of Schwab, Fidelity, and Vanguard. Which means in the future, financial advisors may have to figure out how to not just bring in referrals, but do outbound marketing to persuade a client already working with an advisor to switch to them instead… a tough challenge, given the ongoing crisis of differentiation amongst most financial advisors today!

Professional And Client Referrals Vs (Other) Business Development Strategies

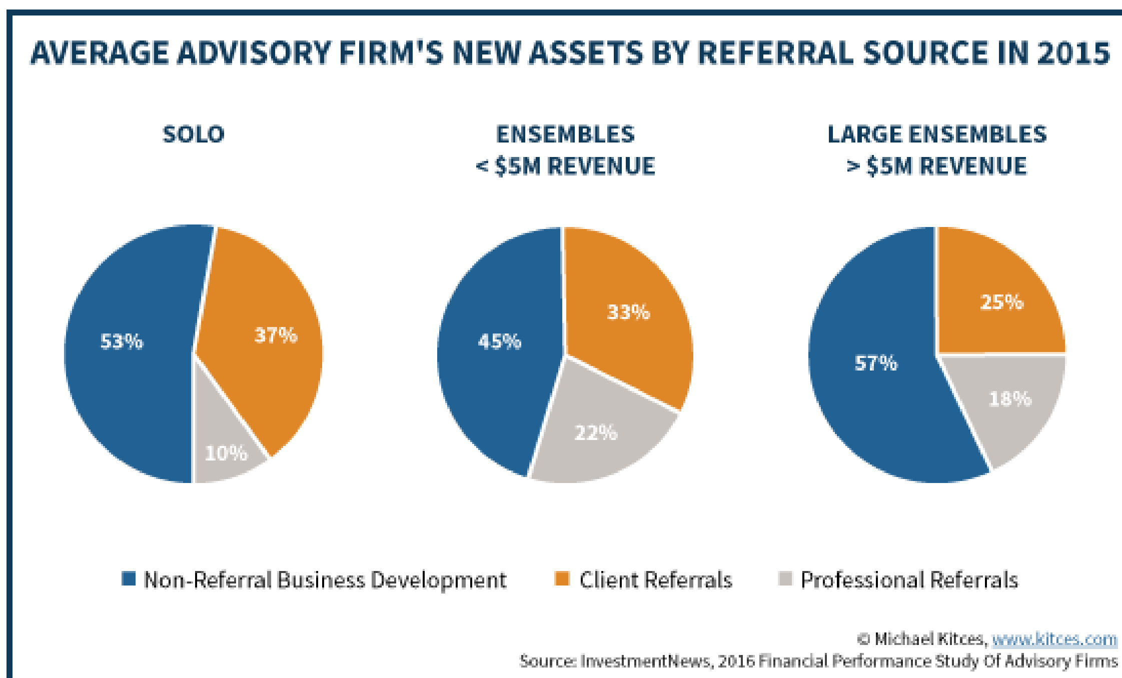
In the latest Investment News 2016 Financial Performance benchmarking study, a stunning new trend has emerged when it comes to growing an advisory firm: for the first time, *non-referral* business development is now driving materially more AUM growth than all client and professional referrals, combined.

Specifically, in its breakout of where growth is coming from across all the firms studied, the Investment News study found that the average advisory firm grew 1.8% of AUM from client referrals, another 1.2% from professional referrals, but a whopping 6.4% from other business development strategies!



In other words, despite the accepted wisdom that the best advisory firms grow via referrals – particularly from existing clients – the data actually shows that referrals are no longer the primary driving force for growth!

And notably, the shift to growing clientele through non-referral business development is happening across all firm sizes. For "Solo" firms, this isn't entirely surprising, as those firms tend to be newer, and may not even *have* enough clients to refer (nor have been in practice long enough to generate professional referrals); thus, a greater volume of business development happens by default. As the firm grows and the number of clients and established professional relationships instead, the relative mix of growth shifts, and client and professional referrals are a greater share. For the largest firms, though, non-referral business development accelerates again, becoming far more than "just" referral-based growth.



The fact that business development is materially greater than both client and professional referrals *combined* for large ensembles is especially notable, given the sheer volume that actually entails. Overall, the median growth from

non-referral business development efforts amongst large firms was $66M of new AUM (and much more for the largest firms). And this is also notable because the largest super ensembles are still only spending the roughly-2%-of-revenues on marketing as other smaller advisory firms. However, given their size, the median 1.7% marketing spend by super ensembles equates to over $400,000/year on marketing, and that size of a marketing spend appears to be scaling very effectively (allowing the largest firms to produce a greater business development growth result for a comparable percentage-of-revenue marketing spend).

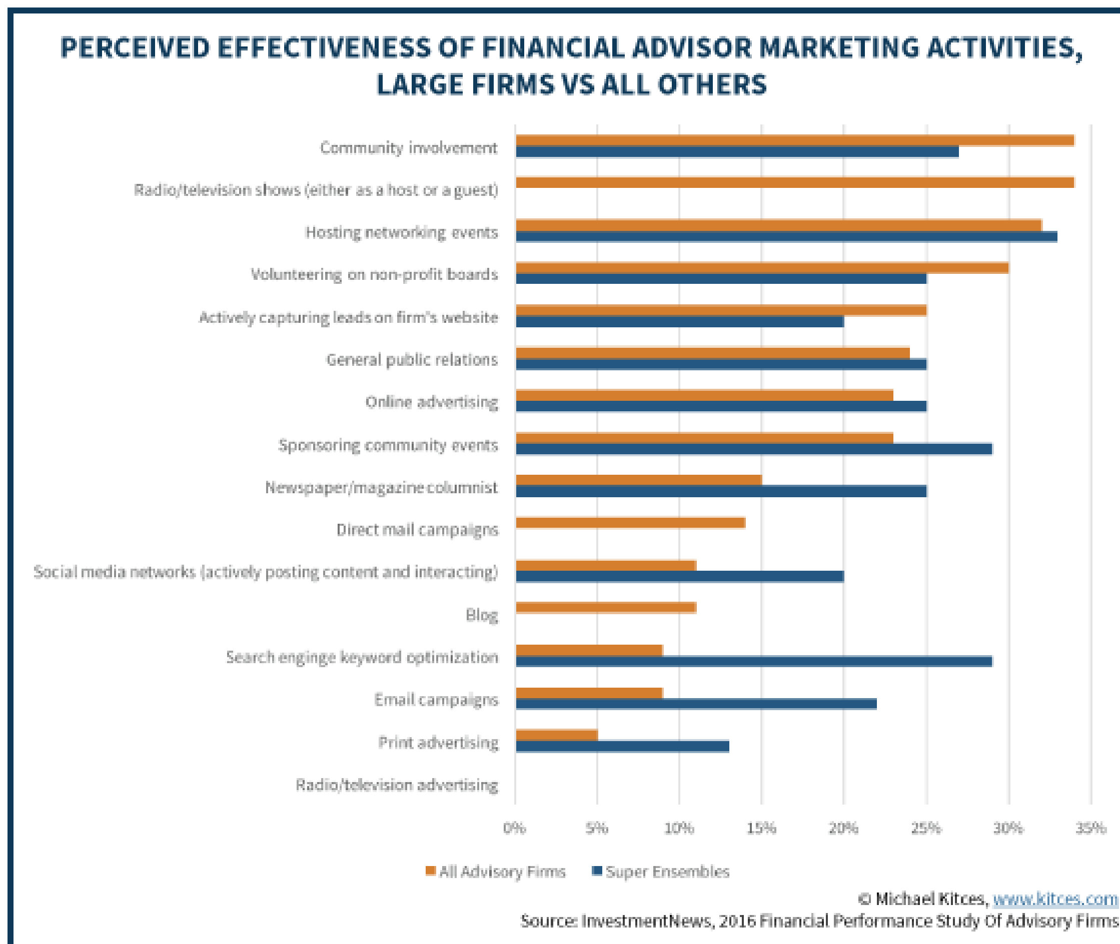
Business Development And Marketing Methods that Work (Or Not)

While a growing number of advisory firms appear to be focusing more on non-referral business development, the Investment News study also reveals that there is no clear consensus yet on what the best type of non-referral marketing strategy actually *is*.

For instance, the most popular strategies for business development appear to be driven by individual advisors of the firm, through activities like community involvement and volunteering on non-profit boards, along with more firm-wide efforts like sponsoring community events or hosting networking meetings. And in a nod to our emerging digital environment, many advisory firms have also been adopting social media, email campaigns, and trying to actively capture leads on the firm's website. However, there does at least appear to be some consensus about the least successful strategies for the typical advisor: the ones that require the most direct spending for a return on investment, including paid search engine ads, direct mail, and radio or print advertising (though a number of firms reported solid success with radio/television shows, and to a lesser extent newspaper/magazine columns as well).

Still, though, the chart above reveals that the *most* successful marketing strategy appears to be the most creative – with the highest rated strategy being the nebulous "other marketing activities", which was only implemented by 10% of firms, but dominated the most successful reported outcomes. (Unfortunately, nothing in the Investment News study reveals what these "other" marketing efforts actually were!)

Amongst the largest advisory firms, the most "winning" strategies are even less clear. Instead, it appears that almost any/every strategy is having at least "some" success, with no strategy in a clear standout position. In part, that may simply be because large firms are so large that it takes multiple business development strategies to succeed. Or it may simply be a recognition that almost any strategy can succeed, as long as the firm is large enough to put sufficient resources behind it (and large firms *do* tend to have the resources!).



Nonetheless, while the particular marketing strategies vary, the Investment News study overall found that there is a substantial uptick in firms' focus on developing new (non-referral) marketing strategies going forward.

GROWTH TACTICS THAT ADVISORY FIRMS PLAN TO IMPLEMENT IN 2017

Tactic	Past Two Years	This Year	Change
Allocate more adviser or partner time to developing new business	31%	50%	19%
Implement a new marketing strategy	23%	37%	14%
Adviser sales training	14%	20%	6%
Improve referrals through a new referral program or formalized relationship with a professional services firm	24%	29%	5%
Hire a marketing consultant	11%	14%	3%
Hire new staff	46%	38%	-8%

Note: Participants could select multiple answers

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Source: InvestmentNews, 2016 Financial Performance Study Of Advisory Firms

This dramatic shift in planned growth initiatives implies that not only are referrals no longer the leading strategy for growth, but that they're about to fall even further behind, implying perhaps that the "well" of referrals is starting to run dry for many advisory firms.

In part, this may simply be the challenge that any established firm faces as it grows an increasing number of long-term established clients. After all, the reality is that most clients who will refer do so in the first few years, when they're most enthusiastic about their new advisor relationship, and still have a personal network that has not yet been tapped. After several years, though, eventually the most happy and engaged clients who are likely to refer will have referred everyone in their network who *can* be referred… and at that point, the referrals from that group of clients will likely slow down.

Except for a large firm that's been in practice for decades, that actually means the majority of clients have already given all the referrals they're likely to! After all, for a new firm in its first 5 years, every client is still in their first 5 years. So 'everyone' is still a potential referrer. But by the 20-year mark for established firms, though, the reality is that 80% to 90% of the clients are now "long-term" clients. And even if the firm can still get a healthy referral rate from clients who haven't yet tapped their referral networks, it's simply not possible to sustain growth on 100% of the practice when only the 10% – 20% of clients who joined recently are driving the referrals.

Growth can't be sustained on 100% of a firm when only 20% of clients are new and driving referrals!

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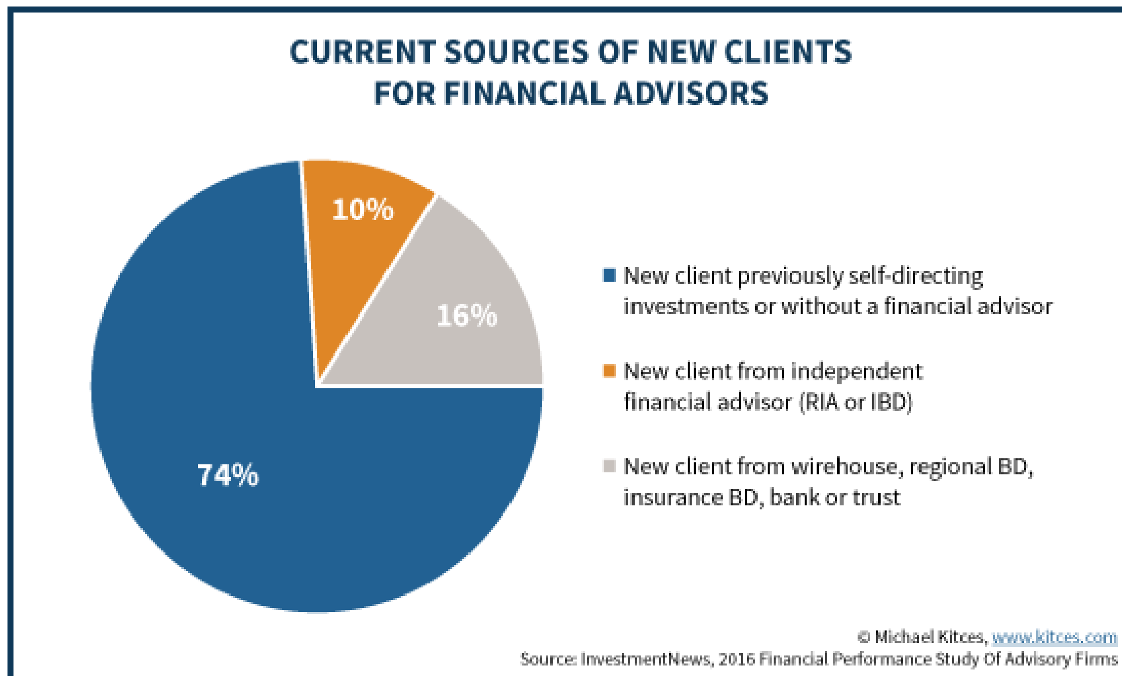
Is There A Shortage Of Potential Clients For Future Growth?

While it's possible that the slowdown in referral activity amongst larger advisory firms is nothing more than a struggle in maintaining referral-based growth rates from an ever-larger number of long-term (and likely tapped out) clients, the question also arises as to whether advisors are simply reaching the point that there aren't enough new clients *to* get in the first place. Especially since the Investment News data doesn't show *any* level of advisory firms, large or small, getting especially good growth rates from client and professional referrals at this point. And similar to the recent FA Insight study, overall advisory firm growth appears to be slowing across the board.

The question of how many potential new clients are even available *to* be referred matters because, despite the popular notion in the independent advisor community that their clients are typically coming from large firms (e.g.,

wirehouses), the Investment News study finds that in reality 74% of new clients for advisory firms come from self-directed investors who decide to finally start working with an advisor. Only 16% of new clients for advisory firms are actually coming from a bank or wirehouse, and only 10% are taken away from a competing RIA or an advisor at an independent broker-dealer.



What this means is that at least up until now, the fight for clients has actually largely been a fight for self-directed investors who decide that they no longer want to be Do-It-Yourself (DIY) investors and instead are ready to delegate to an advisor. Or perhaps are one of the few who have had a new/sudden wealth event, creating more money for themselves than what they want to manage themselves.

Yet given the slowing organic growth rates in advisory firms for the past several years – now made more evident with last year's flat market – it's not entirely clear how many "unattached" self-directed investors are really left out there.

And notably, the potential shortage of available unattached clients is only further exacerbated by the fact that such investors are already the ones most likely to be targeted by low-cost discount brokerage firms, and also are the ones being targeted most heavily by digital (i.e., robo) solutions.

Furthermore, a growing number of online and traditionally-self-directed firms are going after "DIY" investors even more directly. From the growth of Schwab Private Client, to Fidelity's Private Client Group, and the new behemoth Vanguard Personal Advisor Services, self-directed investors are not only being heavily solicited by independent financial advisors, but also by the very platforms on which they're already engaged while still self-directed!

In other words, not only may the number of available self-directed investors be dwindling, but independent advisory firms have more competition than ever in the space, including from some of the biggest brands that currently support them (e.g., Schwab, Fidelity, and Vanguard). And while there's always the potential for 'new wealth' clients, the sluggish growth of the economy means those new potential clients are only being created "so fast" in the first place.

The Future Of Business Development For Financial Advisors

Ultimately, what all of this suggests is that in the future, advisory firms may increasingly have to survive by competing more directly against other advisory firms to pull clients away from them – a world that is not conducive to traditional 'referrals', given that clients tend to be 'sticky' and have a lot of inertia and aren't likely to ask for a referral

when they're already reasonably comfortable with a current advisor.

In fact, the data from the Investment News study suggests that this may already be happening, given slowing growth rates, lackluster growth from referrals, and the ongoing recognition of a "crisis of differentiation" for the typical advisor. Which doesn't bode well for most advisory firms in the future; in a world where so many struggle just to explain why a prospective client should go with them over another (independent) advisory firm, the odds of peeling clients away from another advisory firm look bleak. Especially for small independent firms, where even being a fiduciary isn't much of a differentiator anymore in a post-DoL fiduciary world.

Nonetheless, firms that want to grow in the future will have little choice but to figure out how to navigate a landscape where (passive) referrals aren't the optimal (or even an effective) strategy anymore.

So how will advisory firms compete for new client business in the future?

Realistically, large firms will try to compete on the strength of their regional or even national brand. In fact, the Investment News study already found that the largest advisory firms were slightly *more* likely to be growing by taking away clients from other independent firms. This trend will likely only continue, especially in a world where consumers can't really evaluate the quality of one advisory firm to another up front (you don't "know" until you've experienced it), and therefore must rely on external perceived factors like the firm's brand and recognition in the community.

In turn, smaller advisory firms will increasingly be forced towards having a niche or specialization to attract clients away from better-known competitors. Because the reality is that if you're a divorce specialist, you can get a client away from their existing advisor, if that client is going *through* a divorce and feels they need more help. Or if you specialize in doctors selling their medical practice, you can get that doctor away from another advisor when they actually need help to do the big transaction. In other words, niches that fit around high-stakes financial problems may be able to pull away clients, because the clients have a substantial need, and the solutions are specialized enough that the client may not be confident their current advisor has all the answers.

Ironically, in this context, referrals could even make a resurgence as a growth model of the future, because specialization and known expertise actually *is* conducive to inbound referrals. But the only advisors who would garner referrals in that future are the ones who get referred based on their niche or specialization, not merely because their client referred a friend or family member (who, in all likelihood, will already have an advisor of his/her own by then!).

The bottom line, though, is simply to recognize that the industry benchmarking data is now showing that despite the conventional wisdom of the effectiveness of referrals, that relying on referrals – typically from unattached do-it-yourself clients who are looking for their (first) advisor – may no longer be sustainable as a growth strategy (unless perhaps refined as a focused niche referral strategy). And to the extent that many advisors still report that the majority of their growth is from referrals, that may not be an indicator it's actually a 'best practice', but merely the result that inevitably occurs for advisors who engage in no *other* business development strategies… as evidenced by the fact that client referrals alone are now producing less than 2% organic growth rates for the typical advisory firm!

So what do you think? Are referrals dying as a source of new business? Is there a shortage of potential for new growth? How will firms generate referrals when an increasing number of advisors are independent and look the same to a prospective client? Please share your thoughts in the comments below!