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Expense Reduction Options for RIAs in Uncertain Times

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The uncertainty of the past few weeks provides savvy wealth management firms with an opportunity to identify excess expenses and strategically reduce costs to maintain profitability as revenue remains volatile. With research and planning, firms can take advantage of the exercise to create long-term efficiencies in the business that will maintain service levels and increase productivity.

At SkyView Partners and Your Legacy Partners, we recognize that every wealth management practice is constructed differently and faces a myriad of obstacles and opportunities amidst the current global pandemic. In a collaborative effort, our organizations aim to provide insight into the cost cutting strategies that we are witnessing from our extensive national client base. This whitepaper provides solutions for immediate impact, as well as long-term ideas for strategic implementation.

Consider the following: In 2018, the median operating profit margin for wealth management firms managing between $100 million and $250 million was 28.9% net compensation costs.[i] Firms operating at these levels may feel no need to make alterations to their expenses. However, uncertain times call for certain measures. Regardless of your current operating margin, would your practice be sustainable with another twenty to thirty percent reduction in equity markets? We are agnostic to future market direction, but we are stress testing each applicant through similar drawdowns.

Expense Attribution Breakdown

When looking to mitigate expenses, businesses realize the largest impact from the more sizeable line items. Below are ten of the larger expense lines for firms, as tracked in Schwab's Benchmarking Study for RIAs with $1B-$2.5B AUM.[ii]

1. Salaries & Bonus – administrative & support staff
2. Office Rent & Maintenance
3. Information Technology (equipment & outsourcing)
4. Health Insurance & other employee insurance benefits
5. Travel & Auto Expenses
6. Payroll Taxes
7. Marketing & Business Development
8. Professional Services (excluding compliance & IT)
9. Business Insurance (P&C, E&O, etc.)
10. Office Expenses (supplies, copies, etc.)

The best place to start is by examining your income statement for the past few years:

- Which line items account for the largest percentage of total expenses?
- Which expenses have grown most markedly in prior years?
- Can you easily identify areas where you are over-spending?
- Prioritize expense categories from essential to discretionary.

Some expense mitigation mechanisms are more difficult to spot and implement. Consequently, we have delineated the expense mitigation strategies into the following categories based on timing and impact.

Immediate and Large Impact Strategies

Looking at the largest expense lines, we start with owner's compensation and staff payroll. Each owner's personal financial situation dictates the options available for the practice. SkyView clients maintain an average EBOC (earnings before owner's compensation) of approximately 48%.[iii] If you are seeking major savings quickly, here are some options that you can consider:

1. **Owner's Compensation** – If financially viable, owners can reduce or eliminate their own compensation to allow for more reserve cash on the balance sheet. Owners can consider accruing any unpaid compensation. Firms may also choose to lighten the burden on each practice's monthly P&L by electing to take discretionary bonuses as market volatility subsides and we have more clarity around normalized revenue.

2. **Staff Payroll** – Our analysis shows that payroll accounts for approximately 70% of non-owner expenses on average. Yet, as market volatility persists, it is important to maintain staff responsible for escalated client service requests and client maintenance. Consider the following:

- **One option available to employers is putting staff on a furlough.** In a furlough, employees are given time off without pay or with lower pay for a temporary period. Some firms have been mandating employees to take an unpaid leave of absence, often staggering them in two-week intervals. While others have engaged in an "on-off furlough", which leaves employees without pay for a recurring period instead of a continuous one. For example, one firm announced one week unpaid per month during April, May and June. These actions accomplish the immediate cost savings desired without having to lay off employees and go through the extensive process of rehiring once conditions improve.

  Important note: the CARES Act (signed by President Trump on March 27th, 2020) provides potentially forgivable federal loans to eligible businesses for certain payroll costs where businesses retain their headcount and do not reduce employee pay beyond 25%. You should review details of the Act and consult with an attorney to discuss how this may impact your specific firm.

- **For exempt salaried employees,** owners can implement a ten to twenty percent salary reduction across *all* employees (if doing so selectively, employers should ensure that they are complying with all federal, state and local laws concerning equal employment and anti-discrimination). Employees should be more accommodative of pay reductions in an effort to avoid layoffs, especially in this market environment. Employers can accrue payroll reduction in accounts payable or make good faith effort to recapture lost wages after markets have stabilized via discretionary bonuses.

- **For non-exempt hourly employees,** owners can cut hours while maintaining hourly rate. Owners may even cut hourly rates across *all* employees as discussed above. Firms can also reduce costs by reducing the amount of overtime hourly employees would otherwise work.

Immediate, But Slightly Less Impactful

- **Advertising & Marketing** – This may be an area you can cut immediately and pick back up when cash flows re-accelerate. We've seen advisors reduce advertising and marketing expenses, at least for the short-term, particularly in client events. Conversely, we have witnessed an uptick in spending in select advertising mediums that have become discernably more cost-effective very recently.

  Some advisors have shifted to utilizing online webinars and podcasts for both client and prospect events. Experts have found Webinar Jam to be best in class for marketing-based webinars focused on larger groups due to its additional marketing features, analytics, and automation. Longer term, in addition to reducing marketing expenses by saving on event room rental and meals, online presentations can also help reduce the large expense line of travel and auto expenses, while still allowing visual interaction with attendees in real-time.

Larger Impact, But May Take Some Time

Two of the larger expense items are related to Insurance:

1. Health Insurance & Other Employee Insurance Benefits
2. Business Insurance (including P&C, E&O, etc.)

If you are experiencing financial difficulties from the COVID-19 pandemic, and need immediate relief, some insurance companies are allowing clients to defer premium payments. Consult your insurance provider to discuss your options.

For longer-term cost savings, consider utilizing an insurance broker like Oberle Risk Strategies that handles all types of insurance for lower and middle market businesses. Independent of market turbulence or current events, firms like this can help you compare multiple providers to find the best price and ensure you have the appropriate amounts of coverage. This type of analysis for your health, employee, and business insurance should be a regular exercise on an annual basis. Even if you prefer not to switch, you can always take the quotes and ask your current provider to price match.

Smaller Impact, But Immediate Cost Savings

- **Review technology applications** – Many of us have technology applications on our devices that we rarely use. Take the time to review and cancel any non-essential technology applications or subscriptions.

  For the applications you need to keep, do you need all of your licenses? Often, firms are paying for everyone on their team to have a license for the software or service while only a few people actually utilize it. Services with monthly, quarterly, and annual charges should be examined carefully. Also, re-examine how many on your team truly need access to each of these?

Additionally, assess the appropriate membership level for each service or application, based on your needs and the functions you use. There may be an opportunity to downgrade memberships to reduce cost and still retain access to the essential features.

- **Consolidating services with others** – Are you paying for separate services (document shredding, etc.) that could be combined with other advisors or other tenants near your office? Shared services can be an effective way to get better pricing and service from some providers.

- **Reduce office expenses & supplies** – A simple option is to reduce the quantity, and potentially the quality, of the daily supplies you use. Some owners have shared that setting a monthly budget and communicating the intent to staff has resulted in observed savings.

  Company efforts to "Go Green" can help save money by switching to non-disposable products and having employees opt to bring in their own cups and utensils for personal use. This also has a positive impact on the environment.

Longer-Term Options with Less Impact

- **Consider going paperless** – The costs of paper, ink, mailing supplies, postage, etc. can add up to a sizeable difference annually. At a minimum, make a conscious effort to reduce unnecessary printing and store files electronically on your computer instead of in a file cabinet. Be sure to follow proper industry guidelines for data storage and protecting client information.

- **Real Estate** – The current economic environment may provide an opportunity to renegotiate existing lease contracts or refinance existing commercial mortgages. Lessors should be more accommodative of requests to alter lease agreements to maintain tenants as tenants from other industries break lease agreements entirely. COVID-19 may also lead to more employers recognizing their willingness to allow more staff to work remotely, reducing square footage required.

  If you own your building, we may be witnessing and extremely accommodative rate environment. Banks are extending credit, especially via the Small Business Association (SBA) 504 loans. This program requires lower down payments of ten percent, up to twenty-five-year terms, and fixed rates up to $20 million.

- **Replacing land lines** – Some firms have saved money by replacing traditional land lines with cell phones, VoIP (Voice over Internet Protocol) and virtual phonelines. VoIP can integrate with some CRMs, allowing recordings of all client calls to be automatically saved in the CRM.

- **Consider moving to the cloud** – Cloud computing is a potential way to reduce both capital costs and ongoing expenses related to IT services. With the cloud, you may no longer need to purchase and maintain expensive servers on-site and pay for expensive software upgrades. Your cloud provider may also take care of most data recovery issues, potentially freeing your business from the requirement of maintaining a complex IT disaster recovery plan.

Utilizing Technology to Gain Efficiencies

Advisors have increasingly been utilizing a variety of technologies to reduce the amount of time and money required to complete certain tasks. One tool that is particularly helpful during hectic times is BombBomb. This technology allows users to easily record video emails and send them to groups of clients. By recording and sending your updated thoughts to everyone at once, you can drastically reduce the amount of time spent on calls repeating the same market commentary to each client, while also reducing message distortion from regular emails by letting clients hear your tone and see your emotion.

Conclusion

In summary, each wealth management practice is different, and each owner has to assess their need and ability to pursue these options for their business. Even in stable markets, these are suggestions that should be analyzed and incorporated into every expense management plan. Although your cash flows may be positive today, as a cautionary measure, you may want to reduce expenses where possible until there is more certainty around the impact of current global and market events.

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[i] https://www.riaintel.com/article/b1kwzymjkch8gn/the-ria-profit-margin-to-weather-a-pandemics-recession

[ii] 2018 RIA Benchmarking Study - Wealth Manager $1B-$2.5B AUM - Peer Report

[iii] SkyView Partners – 2019 Financing Report. February 12, 2020

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