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RIAs are Growing Rapidly but not Equally. Here's Why

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The growth of registered investment advisory firms is accelerating, but their fragmentation is giving the largest ones an edge in confronting the challenges of launching and expanding.

Financial advisor headcounts at RIAs surged 9% and the number of retail client-focused firms in the channel jumped 11% in 2022 — compared to their assets declining by 13% amid slumping stocks and bonds that year and an annualized headcount increase rate of just 4% over the previous decade, research consultancy Cerulli Associates found in a study earlier this month.

Advisor breakaway moves from wirehouses, regional firms and independent brokerages will keep driving the channel's market share as the volume of RIAs reaches record levels each year.

Within the continuing momentum of RIAs, though, experts say advisors may be taking risks in trying to compete with giant consolidators that are vacuuming up smaller firms by the billions of dollars in client assets and in taking on the added burden of completing a variety of tasks that used to be handled by a corporate office.

"Reflecting on the last 12 months, what I've noticed is what the report shares: an increase in new independent RIAs seeking autonomy," RIA business coach and operations consultant Cameo Roberson of Atlas Park Consulting and Finance said in an email. "I'm currently working with three new firms launching this spring. From an operations and practice management perspective, particularly those who previously worked at employee models were told how to run their businesses, when to jump and how high. It's new territory as an independent where you must figure things out on your own."

Compliance questions such as creating written supervisory procedures and registration requirements often lose out on the list of priorities to issues like the advisors' choices of custodian, marketing tools, planning software or other technology vendors, according to Scott Gill, the CEO of Synergy RIA Compliance Solutions.

"A lot of advisors dont have the compliance knowledge and expertise to design their firm's compliance program," Gill said in an interview. "Advisors get overwhelmed with the pieces of the puzzle that are right in front of them that are, quite honestly, more exciting."

The numbers

The vast majority of RIAs remain relatively small firms. Just 7% manage more than $1 billion in client assets, and only 8% have a staff with more than 10 employees, according to Cerulli. Yet the channel keeps grabbing market share from the competition: the current count of 78,282 advisors at independent and hybrid RIAs represents 27% of the total across the industry. That portion will climb to 30% by the end of 2027. In terms of assets, the RIA channel's piece of the market will rise by 5 percentage points to 32% between 2022 and 2027.

Those gains aren't going to flow to all RIAs equally. The private equity investors and consolidators often deploying their capital will tap into "acquisition opportunities among growth-challenged firms with complementary processes, talent, and clients," the report said.

"2022 continued to highlight the obstacles that many smaller firms face due to not having the resources or capacity to differentiate and foster inorganic growth in a challenging market," Cerulli Senior Analyst Stephen Caruso said in a statement. "The largest RIAs will continue to dominate as breakaway teams leave employee-based models to join large established RIAs that offer more autonomy, without advisors needing to sacrifice resources that they are accustomed to."

RIAs with more than $1 billion in client assets manage 71% of the channel's total holdings and employ 47% of its advisors, and the consolidators are flying with a tailwind amounting to an addressable market of firms looking for a buyer while managing $3.3 trillion in assets. That includes about $2.3 trillion from expected advisor retirements, with the rest divided roughly evenly between breakaway teams and "growth-challenged" RIAs. Their advisors manage, on average, about $35 million more client assets than those at other RIAs.

And they have another potential advantage over independent brokerages that work with hybrid RIAs. More than a third, or 37%, of hybrid advisors told Cerulli they plan to drop their brokerage affiliation at some point, with the vast majority saying their broker-dealer isn't adding enough value for the cost.

"Over half of hybrid RIAs report back-office and operational support and a technology platform from their BD are very important services," the report said. "As RIA consolidators mature, their best-of-breed platforms present an attrition risk for BDs that do not improve their offerings."

Threats large and small

In other words, independent broker-dealers face a competitive threat from RIA consolidators that often charge clients and advisors lower fees, according to recruiter Simon Hoyle of RIA Choice.

"A confluence of wirehouse advisors finally finding the independent model worth jumping to, combined with IBD advisors craving more flexibility, better technology and a different service model (to enjoy the major benefits of using direct institutional custodians like [Charles] Schwab, Fidelity [Investments] and many other appealing providers," Hoyle said in an email. "Wirehouse advisors have gained some independence but have enjoyed tuck-in RIAs. No longer beholden to production requirements and receiving a bevy of practice-related improvements, they have supported independence. Quality of life and eschewing the pressures of selling high-profit margin products is a breath of fresh air."

In particular, technology is playing a major role in helping advisors launch RIAs, Gill said.

"The catalyst for the growth in that segment of that business is heavily predicated on technology," he said. "There are now so many tools that are available for advisors to launch and run their own practice that it makes the process seem a lot more feasible than it used to seem a decade or two decades ago."

Still, the newly independent advisors must figure out how to handle needs like compliance, day-to-day operations and the client experience outside of systems "where things were all spelled out" for them, Roberson said. Many advisors "don't know what they don't know" and aren't sure what to ask, she said.

"New RIAs will eventually figure it out, but often by trial and error," Roberson said. "The race to build a firm is torrid, with operations often taking a backseat, until things are too chaotic to continue 'business as usual.' As they grow, prudent advisors who build operational systems sooner versus later will be happy when it's time to add staff or seek to automate processes within their firms."