

ROI for RIAs

The bottom-line impact of digital document management technology for independent Registered Investment Advisors

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Introduction

As part of our ongoing commitment to help independent financial advisors solve operational and business management challenges, Laserfiche® is pleased to introduce the second in our series of financial advisor-focused white papers. These white papers have been specifically developed for independent Registered Investment Advisors (RIAs), complete with real-world examples of how advisory firms can leverage technology and implement innovative processes to increase productivity and efficiency.

This paper explores how a technology implementation can deliver a significant return on investment with both current savings and a significant increase in long-term business value. Developed in partnership with Nexus Strategy, LLC, a leading consulting firm to the RIA industry, this report documents the real cost savings of digital document management technology.

We invite you to learn more about how you can achieve similar results by visiting www.laserfiche.com to sign up for one of our regularly-scheduled Webinars.

Growing Profitably

As many independent RIA firms have grown, their costs and infrastructures have grown right along with them. One aspect that is often overlooked as simply the cost of doing business is the infrastructure and processes necessary to organize, store and retrieve paper documents. Due to the highly-regulated nature of the financial services industry, a significant amount of paper is created during the normal course of business.

We have found, however, that leading firms have not just taken this paper-intensive process for granted; rather, they have embraced the spirit of innovation and streamlined their workflows with digital document management technology. Leveraging this type of technology delivers not only simplified work processes, speedier client service, reduced overhead expenses and lower rent costs, but also more efficient and cost-effective compliance processes, resulting in appreciable dollar savings and a substantial return on investment. The first white paper in this series, *Registered Investment Advisor Case Study: Halbert Hargrove Investment Counsel*, illustrated these savings and business simplifications by explaining Halbert Hargrove's innovative approach of using a digital document management system to synchronize workflow. Visit <http://www.laserfiche.com/docs/pdf/ria.pdf> to download this white paper.

ROI: The Bottom Line

With an investment in digital document management technology, RIAs can save anywhere from \$40,000 a year in annual operational costs for emerging firms to upwards of \$300,000 for enterprise firms. This increase in profitability can result in increased business valuations of \$200,000 for emerging firms or \$3,000,000 for enterprise firms.

Key Areas of Impact on Return on Investment

An in-depth study of leading RIA firms has identified three key areas where an investment in digital document management technology has an identifiable impact and a substantial return on investment:

- Space Efficiencies
- Back-Office Efficiencies
- Compliance Efficiencies

A fourth area, emerging in importance, is the underlying increase in business valuation that accrues from increased efficiencies and higher profitability. As many firm owners begin to consider retirement, the issue of succession planning becomes crucial. Increased profitability, a solid operating system, reduced risk and enhanced compliance procedures all lead to an increase in operating cash flow. As a result, higher multiples for business valuation equate to hundreds of thousands to even millions of dollars of increased business value realized during ownership transitions.

Using an industry-accepted income statement approach, along with corresponding benchmarks of financial performance for emerging, established and enterprise firms, the return on investment for digital document management technology will be identified, calculated and detailed. Please refer to the appendix for the full analysis for each size firm.

Table 1 – Summary of Staff, Cost Savings and Increased Business Value by Technology Investment and Firm Size

Firm Size	Emerging (\$500,000 in annual revenue)	Established (\$1,000,000 in annual revenue)	Enterprise (\$4,000,000 in annual revenue)
Technology Investment	1.4% of revenues (\$7,000)	2% of revenues (\$20,000)	1% of revenues (\$40,000)
Staff Savings	1000 hours (0.4 of a full-time employee)	1500 hours (0.6 of a full-time employee)	6000 hours (2.4 full-time employees)
Overhead Savings	8.6% of revenues (\$43,000)	8.9% of revenues (\$89,000)	8.6% of revenues (\$342,000)
Profit Increase	41.2%	55.9%	40%
Business Value Increase	\$216,000	\$626,000	\$3,421,000

A Note on Methodology

Because independent RIA firms vary widely in terms of their size, style, lifecycle, geographic location and business models, our analysis is categorized in terms of emerging, established and enterprise advisory firms.

- **Emerging advisory firms:** \$500,000 - \$999,999 in annual revenues
- **Established advisory firms:** \$1,000,000 - \$3,999,999 in annual revenues
- **Enterprise advisory firms:** \$4,000,000 or more in annual revenues

For illustration purposes, we have classified firms as “emerging” after they have reached \$500,000 in annual revenues. For RIA firms that may not have yet reached \$500,000 in annual revenues, digital document management technology has proven to be a worthwhile investment.¹

As firms grow, economies of scale are achieved, which result in increased efficiency and profitability. Similarly, as firms grow, they reach stages where they must invest in infrastructure and staffing. While these investments initially create inefficiencies and reduced profitability, they are necessary for further growth and ultimately spur greater efficiency and increased profitability. To account for these differences in

¹ There is not a definite threshold of annual revenue before a firm can benefit from implementing digital document management; in fact, for smaller firms seeking to increase their annual revenue, attract new clients and add more staff, and reach higher levels of productivity and efficiency, digital document management technology can be a significant factor in achieving these goals.

lifecycle, we have selected the emerging, established and enterprise revenue thresholds as they represent the profiles and economics for the majority of firm sizes.

To calculate savings and return on investment, additional costs for technology investment were added into the sample income statements to reflect the same rigorous business process that most independent RIA firms use to document ROI.

Benchmarking data from recent industry studies prepared by Moss Adams, LLP, the Financial Planning Association and Schwab Institutional has been aggregated to develop average income statement profiles illustrating the impact of ROI by firm size. Additional analysis, based on Laserfiche’s 20-year history and experience with over 23,000 installations worldwide, is used to conservatively approximate the space savings of reduced physical storage, as well as the reduction in operational and administrative time through efficiency gains realized through digital document management technology.

Space Efficiencies

One of the most visible benefits of digital document management technology is a reduced need for physical storage space for paper files. Once a digital document management system has been fully implemented, filing cabinets are no longer a necessity. Firms using digital document management systems are able to reduce their storage space and either move into smaller offices or eliminate the need for more space as they add new advisors.

On average, 6% of revenue for emerging and established firms and 5% of revenue for enterprise firms is generally spent on rent costs. Laserfiche analysis has shown that space reduction achieved by eliminating file cabinets is equivalent to 25% of total rent costs for emerging firms, 30% for established firms and 35% for enterprise firms. This results, on average, in an annual savings of \$8,000 for an emerging firm, \$18,000 for an established firm and \$27,000 for an enterprise firm.

Table 2 – Rent Savings as a Percentage of Revenues

Size of Firm	Emerging	Established	Enterprise
Rent Costs	6% (\$30,000)	6% (\$60,000)	5% (\$76,000)
Savings	1.5% (\$8,000)	1.8% (\$18,000)	1.0% (\$27,000)

Back-Office Efficiencies

Among the most dramatic results delivered by a digital document management system are the substantial and measurable time savings and efficiency improvements for back-office staff. Having documents simultaneously available for front- and back-office staff and advisors to access directly from their desktop computers dramatically increases the speed of search and retrieval. Digital search and retrieval enables staff to locate critical information in seconds, saving the time it takes to search through paper files, locate the appropriate piece of paper and then find the desired piece of information on the page. When the cost of manual alphabetizing, sorting and filing is added in, advisors often find themselves dedicating an entire staff position to managing their firm's paper infrastructure.

This result is magnified in larger firms due to the increased complexity and higher volume of back-office operations. Other key time and cost savings include the elimination of lost files or documents, as well as the costs associated with recreating those files. When recreating a lost file or document, it is not only the cost of paper or labor that makes it so expensive, but also the effort involved in getting new client signatures.

Further, there are the non-quantifiable aspects of an efficient search and retrieval process on client service. How valuable is it to be able to answer a client's question immediately, without having to hang up, retrieve the information and then call the client back, only to find yourself caught in a never-ending game of phone tag? Digital document management offers many improvements in client service that are not immediately quantifiable yet result in time and efficiency savings:

- Ability to answer client questions when they are asked, which reduces phone time for both advisors and assistants.
- Ability to instantaneously share documents with colleagues and staff, whether they are in the office or in another location.
- Ability to have client information available for immediate access, even while another staff member or advisor is viewing them—something which is impossible with paper documents.
- Ability to quickly and easily publish reports to Websites for client viewing.
- Ability to efficiently share documents with clients' advisory team (attorneys, accountants and other professional advisors).

Clearly there is the additional back-office task of scanning the documents into the system. In the analysis, it has been included as part of the net efficiencies accrued in operational staff time. However, recent bulk-scanning enhancements to digital document management software, including automatic categorizing and electronic filing, has dramatically reduced the time associated with this task.

Additionally, many firms have integrated digital document management with their customer relationship management (CRM) systems, enabling an extremely efficient process for scanning, electronically filing and retrieving client information. This automated workflow increases back-office and operational efficiencies and further reduces the costs associated with these processes. The first white paper in this series, *Registered Investment Advisor Case Study: Halbert Hargrove Investment Counsel*, focused on the specifics of integrating digital document management into portfolio management and CRM systems. Again, to download this white paper, visit <http://www.laserfiche.com/docs/pdf/ria.pdf>.

Based on hundreds of installations and associated experience with investment advisors worldwide, Laserfiche conservatively estimates that the savings from back-office efficiencies equate to a 20% savings in staff time. For advisory firms, salaries and associated expenses for back-office staff represent 24% of revenue for emerging firms, 27% of revenue for established firms and 23% of revenue for enterprise firms. Applying these savings shows that emerging firms realize a 4.8% reduction in total overhead costs, established firms realize a 5.4% reduction in overhead costs and enterprise firms realize a 4.6% reduction in overhead costs.

Table 3 – Back Office Savings as a Percent of Revenues

Size of Firm	Emerging	Established	Enterprise
Back-office staff costs as a percentage of annual revenue	24% (\$120,000)	27% (\$270,000)	23% (\$920,000)
Efficiency Savings (annual)	4.8% (\$24,000)	5.4% (\$54,000)	4.6% (\$184,000)

Compliance Efficiencies

As the regulatory landscape continues to evolve and change, RIA firms are reporting that it is taking more and more of their energy, time and focus to keep up with the latest rules and regulations.

A recent study by JD Power and Associates² found that advisors were spending, on average, 9 hours per week per advisor on compliance related procedures, processes and tasks. Contrast this with those firms who have established efficient systems for compliance and that number drops to 5 hours per week per advisor.

Digital document management has many compliance benefits, including enhanced security, improved disaster recovery/business continuity planning and efficient audit preparation. Paper is a vulnerable archival medium. Fire, flood, natural disasters and theft threaten the integrity of paper archives, but duplicating paper documents for off-site storage is an expensive, time-consuming process.

Software features including access rights, passwords and central storage enhance security, particularly for larger firms with multiple offices. An enterprise-quality digital document management system should accommodate user-based security, protecting entire folders (such as Human Resources or tax information), subfolders (such as client tax information) or individual documents. Digital redactions can protect extremely sensitive information from unauthorized users. All these security features are simply unavailable with paper-based systems and are a key benefit of digital document management systems.

The SEC expects advisors to have considered disaster recovery and business continuity planning issues, including the possibility of a future significant business disruption and a plan to access systems and replace files in case of a disaster. Digital archiving eases compliance by simplifying disaster preparation and recovery and assuring the long-term accessibility of critical information. Simple and efficient CD or DVD back-up procedures assure data back-up and recovery while making it simple to maintain client information outside of the office, in accordance with SEC Rule 17a-4. Instead of the expense of photocopying, transporting and storing paper back-up archives, entire document repositories can be securely stored offsite on CDs or DVDs.

Many advisors dread SEC audits, and especially fear surprise audits. The ability to quickly search and retrieve documents by client, date, type, advisor, product or any other necessary piece of information streamlines data gathering. For example, with digital document management technology, auditors are able to access a workstation in an advisor's office and search directly for the documents they need during an examination. Firm staff no longer have to spend days pulling files to get them ready

² J.D Power and Associates 2007 Financial Advisor Satisfaction Study.SM

for auditors. The firm as a whole no longer has to set aside a conference room for the auditors' exclusive use. With digital document management, firms are able to create specific limited-access login ID's for auditors, restricting access only to requested files. This method has the additional benefit of keeping other sensitive documents, such as those with attorney-client privilege, protected.

Additionally, with a digital document management system, instead of depending on a staff member, advisors themselves can quickly pull up the requested documents, burn them to a CD and deliver it to the auditors in less than one business day.

The impact of compliance efficiencies in reducing total overhead costs is substantial and can be quantified in terms of time savings. Using the data from the JD Power study as a conservative proxy, we can document the cost of advisor time spent on compliance as an hourly figure and compare it to firms with efficient compliance systems to calculate the savings.

For emerging firms, compliance time savings equates to \$19,000 in annual savings, for established firms, \$37,000 in annual savings, while an enterprise firm realizes \$158,000 in annual savings.

Table 4 – Compliance Time Savings as a Percent of Revenues

Size of Firm	Emerging	Established	Enterprise
Compliance Costs	6.7% (\$34,000)	6.7% (\$67,000)	7.1% (\$285,000)
Efficiency Savings	3.7% (\$19,000)	3.7% (\$37,000)	4.0% (\$158,000)

Increased Business Valuation

One of the more timely topics in the RIA industry is the subject of business valuation. Due to the success and growth of independent RIA business models, as well as demographics (over half of all advisors are over the age of 50), there has been an increasing interest in understanding how firms are valued.

While there are several methodologies and approaches to valuing an independent RIA firm, many industry experts view multiples of cash flow as the best model. Until recently, several business brokers and Websites have been using multiples of revenue as a common practice. Due to its inherent flaw of ignoring the underlying profitability of firms, however, it has been discounted as an inadequate approach. For example, which is more valuable—a firm with \$1 million in annual revenue that is growing and highly profitable, or a firm with \$1 million in annual revenue that is in decline and unprofitable? Using a multiple of revenue, the two firms are valued the same, yet there is a clear difference between the value of the two.

Therefore, valuing an advisory firm by its profitability and cash flow is an approach that not only makes economic sense, but also highlights ways an advisor can maximize that value by understanding the key drivers of business value.

For obvious reasons, a firm with a systematized and efficient infrastructure is more highly valued, due to lower operational and ownership risk, as well as higher profitability. Applying these concepts to the return on investment for a technology implementation like a digital document management system, the dramatic impact on business value becomes clear.

Industry experts Moss Adams, LLP, and Succession Planning Consultants have participated in and examined hundreds of completed transactions in the independent RIA marketplace. Their research and data show that independent RIA firms are typically valued, on average, between five to twelve times operating cash flows (after owner’s compensation), also known as earnings before interest, taxes, depreciation and amortization (EBITDA). Due to many factors, including firm size, economies of scale, infrastructure, systematized business models and geographic location, the value multiple varies by firm. However, one consistent aspect is that larger firms receive higher multiples due to their lower risk profiles, higher profitability and economies of scale.

Using a conservative estimate for the multiples of cash flow determines the increased business value for the examples of emerging (5 times cash flow), established (7 times cash flow) and enterprise firms (10 times cash flow). Based on the income statement approach, the dramatic increase in business value can be seen in the efficiency and profitability realized through digital document management savings, documented earlier.

Using numbers rounded to the nearest thousand, for emerging firms, an increase in profitability of \$43,000 through back-office savings resulted in an increased business value of \$216,000. Established firms realized an increase in profitability of \$89,000, resulting in an increased business value of \$626,000. Even more dramatic is the impact on enterprise firms, where back-office savings of \$342,000 resulted in a business value increase of \$3,421,000.

Table 5 – Increased Business Value

Size of Firm	Emerging	Established	Enterprise
Multiple on cash flow	5	7	10
Increased net income	\$43,000	\$89,000	\$342,000
Net Value increase	\$216,000	\$626,000	\$3,421,000

Conclusion

Every advisory firm is different and actual dollar savings and business value increases will vary from firm to firm. It is clear, however, that a digital document management technology solution can deliver a significant return on investment in terms of both current savings and long-term business value.

This white paper has used a practical approach, focused on industry benchmarks and hundreds of real-life examples of cost and time savings, to determine the return on investment that digital document management technology can provide. By leveraging available technology, registered investment advisory firms can make a powerful improvement in current income today as well as in long-term business value tomorrow.

Advisors should learn more about how they can achieve a considerable return on investment simply by looking for ways to automate wherever they can and by retiring an outdated system, no matter how successful it may be.

Your firm may have achieved success with your current document management system—be it digital or otherwise—but that should not stop you from searching for better options. Higher revenues, increased efficiency, decreased compliance risk and greater business value are all within your grasp, all you have to do is take the initiative to make it a reality for your firm.

Appendix

	Emerging			Established			Enterprise					
	Pre	Post	ROI	Pre	Post	ROI	Pre	Post	ROI			
Revenues	\$500	100%	\$500	100%	\$1,000	100%	\$1,000	100%	\$4,000	100%	\$4,000	100%
Direct Expenses	\$180	36%	\$180	36%	\$360	36%	\$360	36%	\$1,520	38%	\$1,520	38%
Gross Profit	\$320	64%	\$320	64%	\$640	64%	\$640	64%	\$2,480	62%	\$2,480	62%
Overhead	\$215	43%	\$172	34%	\$480	48%	\$391	39%	\$1,640	41%	\$1,298	32%
Operating Profit	\$105	21%	\$148	30%	\$160	16%	\$249	25%	\$840	21%	\$1,182	30%
NET OVERHEAD REDUCTION												
Efficiency Savings minus Technology Investment			\$43	8.6%	\$89		8.9%		\$342		8.6%	
PERCENT PROFIT INCREASE				41.2%			55.9%					40.7%
Multiple on Operating Profit (EBITDA) for Valuation purposes	5				7				10			
Firm Value	\$525		\$741		\$1,120		\$1,746		\$8,400		\$11,821	
			\$216				\$626				\$3,421	

Assumptions / Benchmarks

Clients	60	151	395
Total Staff	3	6	21
Advisors	1	3	9
Back office	2	3	12

Staff Man-Hour Analysis

Total back office hours capacity (2500 hours per year per back office staff, 50 hours per week per 50 weeks)	5000	7500	30000
20% savings of time for filing, retrieving, mis-filing, workflow efficiencies (estimate based on Laserfiche analysis)	1000	1500	6000
Back office Staff	0.40	0.60	2.40

Direct expenses are defined as total compensation (salaries and bonuses) for professional staff involved in client service or business development and do not include profit sharing.

Overhead expenses are defined as all other expenses associated with managing and operating the firm, including rent, compliance, admin and operational staff and other expenses.

Source Nexus Strategy, LLC, Schwab Institutional, Moss Adams, Succession Planning Consultants

	Emerging		Established		Enterprise	
	\$ Thousands	% of Revenue	\$ Thousands	% of Revenue	\$ Thousands	% of Revenue
Technology Costs Increase Implementation, maintenance, training and ongoing costs associated with document management system (source Laserfiche)	\$7	1%	\$20	2%	\$40	1%
Back Office Efficiencies back office staff = 24% of revenues for emerging firms, 27% for established firms, 23% for enterprise firms (from benchmarking data)	\$120	24%	\$270	27%	\$920	23%
<i>Cost savings for filing, retrieving, mis-filing, workflow efficiencies = 20% of back-office staff time (estimate based on Laserfiche analysis)</i>	\$24	5%	\$54	5%	\$184	5%
Space Efficiencies Rent = 6% of revenues for emerging and established firms, 5% for enterprise firms (from benchmarking data)	\$30	6%	\$60	6%	\$76	5%
<i>Reduction in space needs by eliminating filing cabinet storage is 25% in emerging firms, 30% in established firms and 35% in enterprise firms (estimate based on Laserfiche analysis)</i>	\$8	2%	\$18	2%	\$27	1%
Compliance Efficiencies Cost of compliance (hours*advisor hourly rate)	\$34	7%	\$67	7%	285	7%
Reduction in compliance costs to 5 hours per week per advisor	\$19	4%	\$37	4%	\$158	4%

About Laserfiche

Laserfiche creates simple and elegant document management solutions that help organizations run smarter. Since 1987, more than 23,000 organizations—including numerous independent registered investment advisory firms, broker-dealers, financial planning firms, banks and credit unions worldwide—have used Laserfiche software to streamline processes for managing documents, records and workflow. By digitizing paper archives, Laserfiche enables users to instantly pinpoint the information they need, to collaborate more effectively and to complete daily tasks more efficiently. Secure Web access allows organizations to share information with remote offices, business partners and customers, while user- and role-based security options ensure compliance with government- and industry-mandated standards, including Department of Defense (DoD) standard 5015.2.

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