MISTAKES ADVISORY FIRMS MAKE WITH INCENTIVE COMPENSATION

For financial advisory firms, advisor incentive compensation is among the most important aspects of the business. Few other areas of business operations contribute so directly to performance and achieving the strategic goals of the business than how effectively the compensation plan incentivizes advisors and managers. When incentives aren't right, desired behaviors do not materialize and business objectives are not met.

Many mistakes are made in structuring incentive compensation in financial services businesses. Here are a few of the most common.

INCENTIVE COMPENSATION IS NOT ALIGNED TO THE CORPORATE STRATEGY.

Business strategy needs to adapt to meet changing market conditions, especially during these days of rapid technological innovation. Incentive compensation, however, is often far less responsive to change, in part, due to entrenched rules and onerous accounting processes. It's no longer good enough to have a simple revenue share approach with some modest tiering. Turning a ship is much easier when everyone is contributing.

Consider building in a small number of KPI-driven compensation elements that are valuable to the advisor and valuable to the firm. Take an inclusive approach, enabling the advisors and managers to contribute to selecting and defining these KPIs. Use these to play the long strategy game, while helping to focus on the immediate results that are required.

FAILURE TO MAKE INCENTIVE COMPENSATION MEANINGFUL TO THE ADVISOR.

Recognize that advisors will interpret any compensation plan as an editorial on their value. Failing to make the plan both financially and emotionally meaningful to advisors and managers and not getting their understanding and personal buy-in, can create friction in the relationship and have a negative impact on their performance. Exactly the opposite of your goal. For more on what advisors dislike about some incentive compensation plans, read our article What advisors really don't like about their incentive compensation plans.

Communicate changes to incentive compensation effectively and directly. Understand the impact of the plan design on each advisor in detail and make it your responsibility to ensure they fully understand.

USING THE WRONG DATA.

Getting the right data to drive your incentive compensation plan is hard. We get it. Part of our expertise is helping firms get at the right data. Your compensation data strategy needs to focus on three objectives:

- Timeliness and completeness – Use the most current and complete information possible and avoid the compromises brought by the need to access isolated or walled off data (e.g., information on customer assets held direct with the issuer or investment manager is commonly difficult to access and difficult to make relatable);
- Breadth – Absorb and use data that covers the entirety of the business, not just tickets and revenue, but also products, services, customers and activities;
- Richness – Contextualize data where possible, i.e., location, device used, team members involved, customer

sentiment, reason, etc. Depth or context signals make data come to life.

The right data empowers good compensation strategy and design. Make it a core priority for your incentive compensation planning.

CAPS IN INCENTIVE COMPENSATION IS BAD DESIGN.

Caps arise because of a weak commitment to great design ("just cap it, rather than solve for the risk") or an inability to deal with underlying conflicts ("cap those folks because we would not want to upset some other role in the organization"). Tapers and modifiers are fine, but caps are a sign of organizational weakness and should be avoided.

CONFLICTS BETWEEN ADVISOR AND MANAGER COMPENSATION.

The relationship between advisors and managers is a complicated one with many layers. Financially, there is a symbiotic aspect to the relationship, so when advisors flourish, so do managers. But conflicts do arise and these can typically can be traced back to differences in short-term focus and the manager's responsibility to the enterprise.

Here's a couple of examples of areas where we have observed problems:

a) Advisor compensation is almost always tied to revenue and customer engagement/activity. When managers are compensated based on profitability, this doesn't always support aggressive revenue growth goals and customer satisfaction that are key aspirations of advisors. Short-term profit motives can reduce marketing support expenditures, quality of office space and investment in community development efforts – activities that align more closely with advisor priorities for customer growth and customer satisfaction.

b) Recruiting is a common objective of managers and a logical source of growth for the firm, but it means nothing to most advisors AND can, in fact, be viewed as a consumer of resources that would otherwise have supported growth that the advisor would participate in. But not recruiting isn't the solution either.

In short, do everything possible to eliminate conflicting incentives. Managers should derive all success from the success of the advisors they manage.

FAILURE TO PROPERLY DESIGN AND TEST INCENTIVE COMPENSATION.

For most wealth management firms, advisor compensation represents the top expense of the business. It warrants constant and careful attention. It is the foundation of the performance regime for the organization, which means every other investment in performance will encounter resistance if the advisor compensation programs are poor.

Design incentive compensation carefully. Include advisors and managers in the process. And test in live simulation conditions as much as possible. That means building the capability to simulate all conditions and behaviors.

NOT DOING REGULAR MAINTENANCE CHECKS.

Don't slip into business-as-usual mode. Do an annual maintenance check on your firm's incentive compensation and make adjustments as warranted. Look at everything – objectives, plan design, operations complexity, operations execution, data tactics and integration with the rest of the organization.

Your incentive compensation plan is your most important performance management tool. Keep it in top flight condition.