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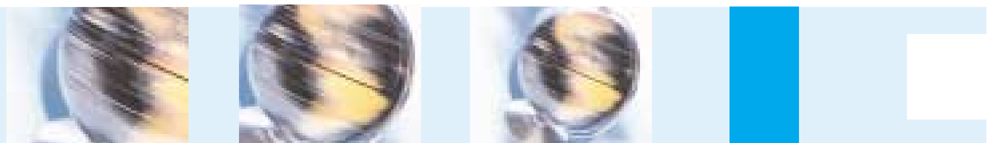
Hypercompetition

The Dynamic Future of Financial Planning in Australia



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Introduction & Acknowledgments

This paper was born out of a discussion we had after Brian's return from an afternoon's meeting with Harold Evensky of Evensky Katz and Brown in Miami, USA[1]. Brian and Harold were interested in the huge competitive forces that were around the corner in the US financial planning market and the fact that many of the US planners were oblivious to an outlook with much more intense competition for their services.

Taking this and the ideas of Mark Hurley[2] back to Australia, we began a number of discussions with other industry people who were interested in how our dynamic and vibrant financial planning business is going to develop in the future.

We thank Jim Stackpool, Tom Collins and Tony Thomas for their contributions as well as the valuable research that Ross Cameron conducted on our behalf. We also spoke to numerous planners about the future of their industry and we would like to thank Phil Clinton, Barry Lambert, Robert Schavarien, Rob Keavney, Ian Knox, Kevin Bailey, Paul Brady, Colin Scully in Australia and Gary Shatsky, Mark Hurley, Harold Evensky, Deena Katz, Frank Armstrong, Linda Hartley, Scott Kahan, Richard Bregman, Guy Horner, Tim Ermi. Stephen Plump, Ben Phillips and John Bowen in the US. Ian Chimes and others in UK/Europe also gave us a European context. There are undoubtedly many others whose ideas and discussions with us over the last twelve months have also contributed to this paper and we thank them for their time and interest in our industry.

This paper is divided into five parts:

1. Overview
2. Global Financial Services Trends – The Backdrop
3. Understanding the Australian Financial Planning Industry
4. Key Trends in the Australian Industry
5. Strategies for Success

Throughout this document we refer to a survey conducted by Ross Cameron of Business Owner Research. Ross was commissioned to conduct a series of telephone interviews with a diverse range of financial planners across Australia in the large, mid sized and boutique categories across Australia. These interviews were conducted in the first week of October 2001.

We hope that this paper starts an ongoing, intelligent dialogue about how our industry should remain world class and develop into one that is world leading.

Brian Thomas & Clayton Coplestone

12 November 2001

1 Evensky, Katz and Brown are a successful US financial planning business. The principals have written numerous books and articles on the business and practice of financial planning.

2 Mark Hurley is the CEO of Undiscovered Managers and one of the authors of a paper on the US planning industry. See www.undiscoveredmanagers.com

Part 1 – Overview

The Dynamic Future of Financial Planning in Australia

Part 1 Overview

"You Aint Seen Nothing Yet"

Bachman-Turner Overdrive

This paper is focused on the business side of financial planning - building profitable businesses where clients are happy to pay for planning services. The financial planning business is not about wealth building strategies and portfolio construction, that is the "product" – from a planner's perspective. The business is about convincing people to buy their set of "products" and services, rather than their competitors or to try to do it themselves. In boom times, focusing on these issues seems like unnecessary detail - but when competition hots up, and the consumer becomes more discerning about value, an understanding of this "business" side becomes crucial for success.

1.1 Key Insights

In putting this paper together we uncovered four major insights which we hope will start an ongoing discussion and debate.

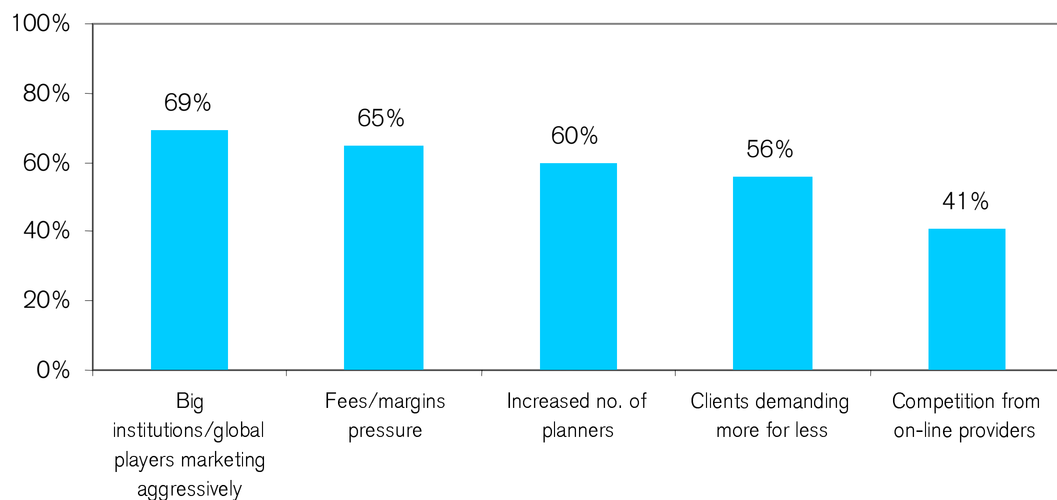
Insight 1

'Hypercompetition', is the incredible boom coming to the competitive landscape of financial planning that will change the industry dramatically. This is at the same time as many of the early successful planners are looking to exit their businesses in the next few years.

We conducted an industry survey of over 150 financial planners from various large and small practices. The conclusions support our hypercompetition thesis and are summarised below:

- 84% of financial planners believe that there will be more financial planners in Australia in 5 years time.
- Similarly, most (90%) financial planners are expecting an increase in the ability and expertise of financial planners in the next five years.
- 83% of financial planners believe that the overall level of competition in the financial planning industry in Australia will increase in the next five years.
- Financial planners attribute this increase in competition to a range of sources, including the big institutions/global players marketing aggressively (69% indicating that this will be a contributing factor to the increased competition), fees/margins pressures (65%), increased number of planners (60%) and clients demanding more for less (56%).
- When asked to discuss other sources of the increase in competition, planners pointed to the emergence of other professionals in the planning arena (eg accountants, banks etc), and the increased level of understanding of the customer.

Figure 1. Factors contributing to the increase in competition.



Insight 2

Given the high margins available, current ease of new client acquisition and the expected growth in this industry, the time is ripe for a new competitor to enter the market and take a dramatic market share. (With around 75% of surveyed advisers receiving some new clients from existing client referrals and 47% receiving some new clients from "other professional" referrals.) By buying practices from mature advisers and overlaying a new 21st Century process we have dubbed the new super competitor "Platform Plus".

In a few years, the margins and growth in this industry will attract a number of new players. Similar to the revolution in home lending brought about by John Symonds at Aussie Home loans, a radical new provider will see through the maze and build a new client centred offer. Where Symonds used securitisation to such great effect, the new provider will attack the current margins using client centric technology as their chief weapon. This is not an argument in favour of the big institutions. In general, they tend to follow current paradigms to extract the market margin out of various businesses. A non-traditional player or new entrant will become the innovator, realising it is possible to give the client face to face support and also 24 hour call centre, Internet, SMS and WAP support in an efficient way.

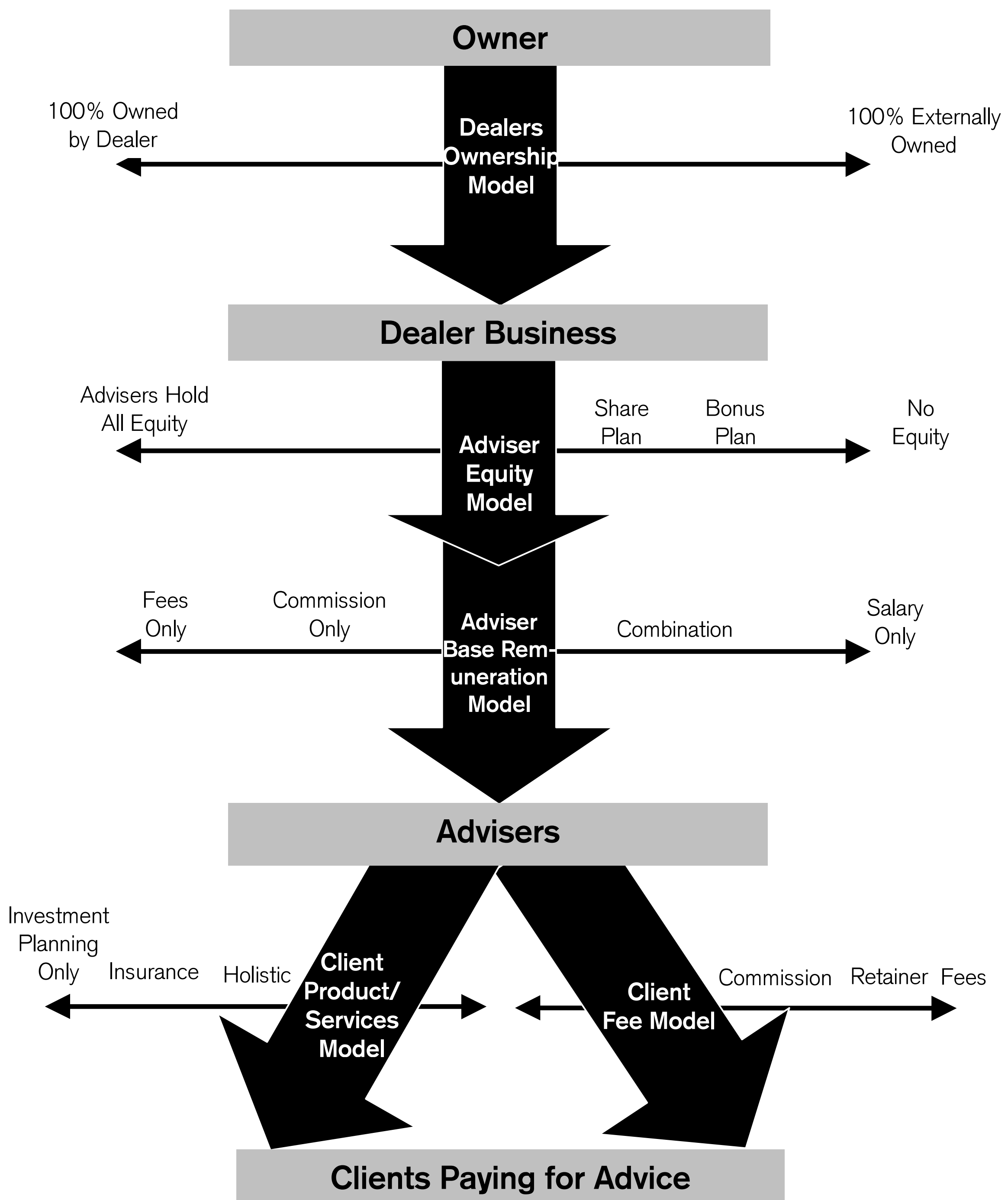
Helping this trend will be the fact that some planning businesses are based on a flawed premise. Planners are currently promising outcomes that may never be met. The new Platform Plus provider will go through a long-term needs based plan with on-line reporting on progress versus goals, taking into account long term assumptions about returns, inflation and tax. Up-to-date Monte Carlo simulations will carefully monitor the chances of meeting key goals and constantly search for a more technically efficient portfolio over time taking tax and transaction costs into account. Clients will be able to access the service at multiple levels therefore moving easily from a full advisory model to doing some transactions on a DIY/self serve basis. All these services will be produced in an efficient "production line", however the similarity to Henry Ford's revolution in car manufacturing ends there in that through the mass customisation available via the Net and CRM technology, you can also have any colour you like.

Insight 3

Most of the literature on the planning industry is flawed in that most commentators are usually only focused on one or perhaps two models of financial planning whereas the industry has a multi model approach. Understanding the multi-layered relationships between the business owners, dealers and planners is crucial.

This was really brought home to us in our industry survey where planners in very large dealer groups still described themselves as small, "independent" practices (and in fact they do operate their business in that way). The following chart gives an overview of the almost infinite range of models available – these models are also in various developmental stages as outlined in Part 3.2.

Figure 2. The multi dimensional nature of financial planning business models



Insight 4

If there was one issue that we wished we spent more time on, it is the nature of the client relationship and in particular what clients must have delivered face to face, when, how often and by whom. It is not simply a matter of a "hi-touch" versus a "hi-tech" approach. We generally reject the current view of some planners that their belly–to-belly communication approach alone is a key competitive advantage.

For example, one may currently be a happy client of Qantas who would fill out any client survey as a happy client. At the next level the question that needs to be asked is how strong is the relationship with Qantas if push comes to shove. In fact, if British Airways were to offer the same services for a lower price one would most certainly switch! Are advisers falling into the trap of believing that the happy relationship with their clients is more than it actually is, that is, that these apparently happy clients would happily switch if someone could offer them better service, more convenience or a lower price.

1.2 The global financial service trends operating as a backdrop to the Australian situation

To assist you in understanding our hypothesis, we have elaborated in Part 2 the key global trends that many financial service experts are familiar with – they are:

- Globalisation is the real thing
- Boom and gloom – the demographic perspective
- Information - from overload to knowledge to mass customisation, and
- You want value with that? Manufacturing products for the new customer.

Most of these trends point to a growing and more competitive world with free information and increasing client sophistication. The product manufacturers also face challenges where investment and product performance, scale and brand become even more critical.

1.3 Understanding the Australian financial planning industry

Many readers will be familiar with our industry however we felt it would be valuable to include some detail on the industry. Tom Collins has contributed a historical perspective in Part 3.1 which outlines how the industry has developed. It highlights how our complex and changing tax, superannuation and social security system has spawned a very sophisticated industry, second only in sophistication to the US according to Cerulli.[3]

This sophistication will lead to many Australian businesses exporting knowledge and technology in the future. A good example of that is Professional Investment Services recent foray into Singapore. Our FPA has also contributed greatly in developing education and raising professional standards. Interestingly we now have 13,000 FPA members for a population of 19m people whereas the US has 30,000 members in the new combined association for a population of 275m people. Whilst the US has Schwab Institutional as the dominant provider of adviser back office support, our unique superannuation system has

[3] Cerulli and Associates, Report Summary for Trends in the Australian Retail Fund Management Marketplace, 27 March 2000.

encouraged the development of a diverse Master Trust Industry, which according to our survey are a more important relationship to advisers than fund managers (this would certainly not have been the case five years ago).

Figure 3. Relative importance of different relationships to financial planners

	Ave importance	Most important relationship (3) %	Second most important relationship (2) %	Third most important relationship (1) %
Mastertrust & wrap providers	2.08	38	33	29
Fund managers	2.07	37	33	30
Financial planning software providers	1.84	25	34	41

Given the diverse range of planning businesses in Australia we asked Jim Stackpool in Part 3.2 to look at the stages of development of planning practices from the focus on selling, high activity stage to stages where the focus is on management and branding. The need to sell high level services, rather than products and corporatise the client relationship is illustrated in the vastly improved performance benchmarks for the firms that achieve this. Many of the success elements are further expounded upon in Part 5 - Strategies for Success.

The consolidation and aggregation activity in Australia is hardly surprising given the expected growth in financial planning and its dominance as a distribution channel with over 90% of sales going through intermediaries (in the US the figure is around 85%). The strategies and multiples paid for planning businesses is a useful study that gets us deeper into the business issues in building larger, branded networks. As Tony Thomas concludes in Part 3.3, the results really are a 'mixed bag'.

1.4 Key trends in the Australian industry

We see a trend towards dramatically increased competition due to the confluence of four interrelated trends:

- the death of the transactor
- the capitalised client value effect
- the bandwagon effect, and
- the industry maturation effect

What does it mean to the Australian financial planning industry? Hypercompetition - competition in financial planning like you've never seen it before. Let's look at the effect of these trends to see why we have come to this conclusion.

1.4.1 The death of the transactor

The death of the transactor should not come as a surprise as most planners have gone beyond being transactors of business to providing more value-added services. The Internet has become today's transactor, providing low value financial planning services and transactions to clients. To compete in this market is nonsensical for the average planner unless they can attract huge volumes. On the other hand, as a

baseline expected service, planners must provide a much more sophisticated on-line service for their clients, especially given the recent development of reasonably sophisticated on-line financial planning services.

At the recent Schwab Conference in Denver, Brian Thomas had an interesting conversation with Frank Armstrong, a very experienced US planner. He has a powerful high net worth practice serving clients face-to-face but is also deeply involved in www.directadvice.com, an on-line advice business. He uses the Internet to service the mass market and also as a tool to provide information to his key full service clients. He sees no conflict in doing both, in that the direct advice model provides a good basic service targeted at the people who could not afford his professional fees in any case. Frank fully understands that different clients have different needs and capabilities to pay for professional services.

1.4.2 The capitalised client value effect

The concept of the capitalised client value effect was brought home to me by the address of Mark Hurley, of Undiscovered Managers at the same conference.

“A publicly traded company will value a client at around 10-12 times the earnings before deductions (or EBIT) generated by the client whereas small planning firms may only be valued at 1-2 times earnings”.

This is driving two outcomes in the US and Australian financial planning markets. The first is a scramble to list planning businesses and to “realise” this current market value. This trend was exacerbated by the high multiples that have been paid for master trusts and planning businesses over the past few years (see figure 8 in Part 3.3). For a planner this is a good thing, because the market can give the business that they are in a relatively high value. The consolidators have definitely got onto this trend but high valuations can only last if the long-term earnings expectations are met and the current euphoria for funds management/planning businesses continues. The recent change in market sentiment for consolidators/planners illustrates that these high valuations are not cast in stone. Naturally high valuations are good news for the planner ready to sell their business.

The second outcome is that larger firms are prepared to spend capital to acquire client relationships and are competing head on with traditional planning practices creating a source of more competitive pressure. The best way to see this is to ask yourself how much capital are you prepared to invest to acquire a new client and then ask a large, well capitalised corporate player the same question. This “deep pockets” argument will become more of an issue as aggressive players enter the market

1.4.3 The bandwagon effect

The bandwagon effect is really a case of supply and demand. As more and more accountants, super funds and others jump on the financial planning “bandwagon”, competition will increase. It makes one wonder when supply will exceed demand.

1.4.4 Industry maturation effect

How will this industry grow and mature? What will the business of financial planning look like in 2010?

To answer these questions it is useful to look at other professional service industries that have matured under increasing corporate competitive pressure to give us some clues.

At the extreme level one could look at what the McDonalds franchise model has done to the previously uncompetitive world of the local take away hamburger store. Since we are in more of a face to face profession perhaps we could also look at how medical and other services will be delivered in the future. Will financial planners go the way of the local bank manager, replaced by a more corporatist model with 24 hour Internet and telephone back up? Will the industry be dominated in 10 years time by five dominant competitors, who like McDonalds have built the sophisticated infrastructure to provide low cost effect solutions. What value will the consumer put on advice in the future, and how will that advice be dispensed?

1.5 Strategies for success

Part 5 outlines a step by step process to cope with hypercompetition but also predicts the emergence of a super competitor, dubbed “Platform Plus”.

Answering the question of how to build a successful strategy is difficult as there are a myriad of financial planning business models in the market (figure 2 illustrates this) so a simplistic answer does not work here. We can however, identify some elements that are essential in building a business that will survive the hypercompetition threat and thrive into the future:

Read and think about the issues that affect the industry -- This paper is a good start but you should constantly look at developments both locally and overseas.

Set your goals and preferred business model for the next five and ten years - Part 3.2 gives a good context of where you may want to take your business. The comments throughout the paper, especially in Part 4.2.1 about which parts of the business will be commoditised in the future are important, as there will be little margin in the commoditised parts of the process.

Don’t be afraid to change - All of the ultra successful businesses interviewed for this paper invariably reached a point where they radically changed their business model to great effect. Sometimes a business coach can help with the discipline of doing this.

Ask your clients what their real relationship and service needs are - Part 5.3 is useful here as it illustrates that many planners focus too much on the relationship and sales process rather than building an effective, growing business.

Control your pricing – You can only build a successful long-term business if you are in control of your pricing policy.

Anaylse how hypercompetition will affect your business - Test your current business model and client service delivery mechanisms against the future world depicted in this paper.

Clearly define your value add or your unique selling proposition that will also be relevant in the future - Businesses that have a definable, demonstrable and clear value add that the target consumer can relate to will succeed.

Corporatise parts or all of your business - Clients should be buying your firm, not necessarily you. Focus on the increased returns available to firms that employ good professional staff (see Part 3.2).

Be passionate about client service. Remember you can control your client's service experience but you cannot control market returns -All successful planning businesses adopt this mantra. Under promise and over-deliver on service.

Strive to continuously improve -This is vital in such a dynamically growing and increasingly competitive environment.

Work to live, don't live to work – Enjoy your business and your lifestyle.

Part 2 – Global Financial Services Trends

The Backdrop

Part 2 Global Financial Services Trends

In order for you to understand our hypothesis we have elaborated in Part 2 the key global trends that many financial service experts are familiar with – they are:

- Globalisation is the real thing
- Boom and gloom – the demographic perspective
- Information - from overload to knowledge to mass customisation, and
- You want value with that? Manufacturing products for the new customer.

Most of these trends point to a growing, more competitive world with free information and increasing client sophistication. The product manufacturers also face challenges where investment and product performance, scale and brand become even more critical.

2.1 Globalisation is the Real Thing

“It’s a Small World After All”

2.1.1 Introduction

Globalisation is unstoppable. It is only the detail of how globalisation will play out that is at question. Whilst the September 2001 terrorist attacks will slow down the process somewhat, and critics[4] will emphasise the oppression on certain classes of people by unscrupulous global companies, the process will continue. In many ways mass communication and the Internet will ensure that it does. This important point was borne home to me in Thomas Friedman’s excellent book “The Lexus and the Olive Tree[5]”

> “ Political scientists note that in the Cold War system, in the world of walls, leaders tended to invite their citizens to compare themselves to their fathers. They would say: ‘Are you doing better than your father? Yes? OK, then shut up’. But now people don’t compare themselves to their fathers. They have so much more information. Now they compare themselves to their neighbours – everywhere. They can track them all over the world; on television, over satellites, on DVDs, and through the Internet. Now they even look into the living rooms of their worst enemies, who used to reside behind the thickest walls of all, and measure themselves against them.”

4 For a summary of the views of the critics of Globalisation, see Naomi Klein’s No Logo, Harper Collins 2000

5 ‘…And the walls came tumbling down’, from The Lexus and the Olive Tree, by Thomas Friedman, Chapter 4, page 70.

2.1.2 Historical perspective

The impact of the fall of the Berlin Wall, coupled with a defined trend to more open economies and global direct investment is amplifying the trend of individual empowerment, through stimulating better laws, lower taxes and freer markets. This has provided education, skills and knowledge to the masses at the lowest cost ever.

Historically, in the mid 1800s through to the late 1920s, globalisation flourished. Then few artificial barriers existed in preventing the exchange of money, goods and labour across borders. This created relatively large flows of products and capital, which came to a halt as the world entered into World War One. The falling of The Wall in 1989 signalled the return to the era of globalisation, which was emphasised by the collapse of the Thai Baht in December 1997 and the disintegration of the Russian economy in the late eighties. It was this latter incident which proved that the global community had the ultimate say in breaking the back of the Kremlin. Observers were left in no doubt that market-based capitalism was the sole remaining economic ideology, replacing central planning as a viable economic belief. It is now argued that many governments have surrendered their power to capitalism, with many of the world's largest companies nowadays more powerful than many of the world's governments. This argument is overstated. Governments do have effective power and companies are increasingly wary of utilising their power in such a way as to damage their all too important brand image.

2.1.3 Broad implications for the financial services industry

Participants in the financial services industry will need to embrace technology and automate where they can to improve the efficiency of the services they provide as in the near term global economies of scale will favour the large, efficient or well executed niche player but not the average. As will be discussed in greater detail in other chapters, there will be little value in transactions and reporting, with a clearer distinction between which elements of the financial service process are necessary and which can be automated. With BT Portfolio Services already outsourcing some of its programming to India one can hardly imagine the financial services landscape when countries allow financial services products to become more global in structure.

Those industry participants who are presently grappling with the concept of either of these forces must embrace the opportunities that each will provide for their businesses and clients. When properly harnessed, technology will have the power to completely erase the geographic borders that currently exist, and completely transform the time that is presently spent communicating with global clients, suppliers and other global partners.

The future survivors will be those companies with strong competitive advantage, who represent 'best practice' in the new transparent global marketplace. The increased acceptance and usage of technology, and in particular the Internet will force common global standards, as the minute you promote yourself you will become a global company. Accepting that the driving idea behind globalisation is free-market capitalism, this promotes the idea that the more you let market forces rule, the more you expose industries to trade and competition.

Whilst the consequential improvement in efficiency brings benefits to consumers, it will present both threats and opportunities to the financial services industry as the world becomes increasingly homogenised through the plummeting costs of the

Internet and communication. Put simply: in the future all players in the financial services industry will be competing on a global-playing-field. Looking ahead to this generation of globalisation, financial service organisations will be under increasing pressure to become more dynamic and entrepreneurial to survive.

Established financial service organisations running a top down bureaucracy and large infrastructures may be unable to support personalised services that consumers require. Many of their ideologies will be tested, as technology permits people to pursue their own goals to serve their own self-interest. There will also be a period of "creative destruction" as new high growth companies replace those older financial service organisations that lack foresight and flexibility.

The result will be spontaneous advances within the financial services industry that cannot be predicted or designed by individuals or governments. Just as E-Trade and other on-line brokerage systems revolutionised the trading ease and cost for individual accounts, globalisation and technology will introduce new competitive pressures to financial service organisations. The litmus test will show up in the marketplace as lost sales and diminishing market share, as individuals will be charged with greater freedoms to choose. The end result will be significant industry winners and losers from a list of global financial service providers.

Closer to home, Australian residents are recognising that they are sitting next to one of the greatest economic growth trends yet to happen. With strong future growth prospects for the neighbouring Asian region, the challenge for the local financial services industry is that globalisation will see a redirection of lower value jobs to our neighbouring countries. Although language difficulties have delayed the trend, it is inevitable. Brian Thomas recalls a conversation in Beijing with a young taxi driver who spoke fluent English with a distinct American twang. "Where did you learn your English?" he enquired. "Oh easy, straight from the TV!" he replied. The advent of globalisation will force the industry to embrace technology, leading towards new delivery mechanisms to maintain margins under pressure. This will be accelerated in the new single-digit environment for portfolio returns. In short, this is the dawn for the financial services industry to think differently about how it operates in the future.

2.2 Boom & Gloom – The Demographic Perspective

"BOOM, BOOM, BOOM"

John Lee Hooker

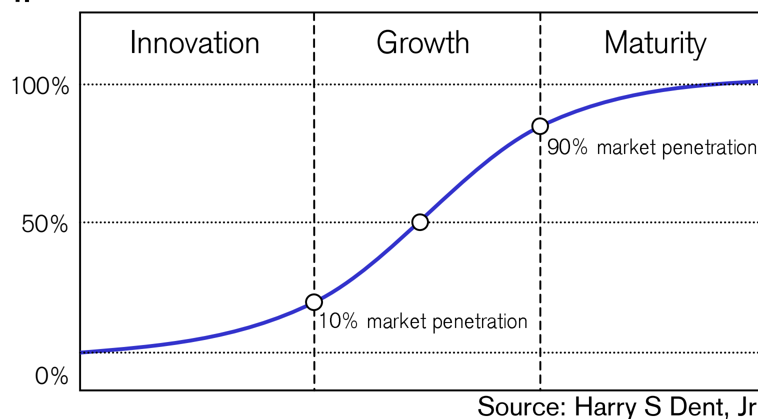
2.2.1 Overview

It can be argued that the single most significant social and economic phenomenon of the twentieth century has been the transformation of the baby boomers. It has been those born in the late 1940s to 1960s who are now entering their prime earning years driving up prices of real estate (particularly over the last few decades), the value of stock markets and creating a boom time for the financial services industry. The increase in life expectancy through better health care, changes in diet and other lifestyle factors has been a key driver of growth in the wealth management industry as populations continue to age.

Millions of baby boomers are reaching an age where they need professional help with their investing, and do not have the time or inclination to do it themselves. However as will be discussed, demography is destiny! Baby boomers are guaranteed to get older and therefore create the greatest economic boom in history, potentially followed by turmoil for the financial services industry. This will place new pressures on large established financial services companies as they grapple with the new delivery fundamentals that are required to assist the wave of advice seekers. Those that fail to adapt their business will pay through the significant loss of market share.

The recent history of the financial service industry is comparable to going to a popular movie with those who show up early getting the better seats. Whilst there are still many good seats available, the industry needs to recognise the changing environment that is ahead as the financial services industry mushrooms from niche to mainstream, as illustrated in figure 4.

Figure 4.



Source: Harry S Dent, Jr.

On the positive side, baby boomers are at a stage in their life where they are serious about saving for retirement, and are actively pursuing a good return for their savings. These middle class baby boomers are suddenly and unexpectedly finding themselves in a position of relative financial ease. Their mortgages have been repaid, the fridge and car are working, and the kids have left (or are about to leave) home. Without any large future expenditures on the immediate horizon, this group now have to cope with a new problem – what to do with all of their extra money.

Although there is a tendency to be more conservative with age, this tidal wave of baby boomers are demanding a better return for their retirement savings than merely leaving it in the bank. This 'weight of money' has created an unbridled level of optimism (one could almost say irrational exuberance) throughout financial markets, contributing to rising real wages, high employment for those willing to work and strong sharemarket growth. Not an entirely surprising outcome in times of low inflation, falling interest rates, robust growth and productivity, and record levels of share buy-backs.

Aided by our compulsory superannuation system, it has also created explosive growth in new money to manage over the past decade, which has assisted many financial advisers and fund managers in getting their businesses established.

With the retirement wave expected to continue through to the early 2030s, what does the financial services industry look like going forward? The combination of baby

boomers entering their peak earning years[6], together with the increase in employees being forced to make their own superannuation investment decisions, will see additional monies entering investment markets, with unrealistic investor expectations for returns based on the past decade. If interest rates and inflation continue to remain low, then sharemarkets will continue to prosper and provide a further decade of good fortune and extraordinary opportunities for baby boomers and financial advisers alike. Further down the track we will also see the impact of massive transference of wealth through inheritance. Whilst this may have an impact upon some families, some observers believe that many baby boomers will use most of their accumulated wealth funding their longer than expected retirements – in other words they will be spending their kid's inheritance.

Whilst the healthy outlook for investment markets over the next decade should provide a cushion of wealth for baby boomers, a significant issue for the industry will be managing the complacency that exists about the changing financial landscape, when many begin to retire. Many future retirees and Governments are woefully unprepared for the financial, social security and health care burdens of the age wave.

2.2.2 The burden on social security

The current social security system can be compared to a pyramid scheme where the current workers are funding those collecting the pension. As individuals age, they accumulate wealth up to the age of retirement, after which they become net consumers of wealth to fund their retirement. This situation is only sustainable while the number of workers exceeds the number of pensioners. This ratio is forecast to change approximately 3.2 workers to each pensioner to approximately 2 workers over the next 20 years. This is clearly unsustainable and will require greater fiscal measures and new innovations to avoid destabilisation, of society, as baby boomers begin placing a huge strain on social security systems. Generation warfare will erupt, as younger generations will be unprepared to pay the massive retirement bills for their older counterparts. The numbers speak for themselves with the percentage of the population over 65 years old as a proportion of the working population rising from 17% today to 25% in 2020 and 33% in 2050.

Figure 5. Elderly Dependency Rations (Population aged 65+ as % of working age population)

	1960	**1990**	**2000**	**2010**	**2020**	**2030**
Australia	13.9	16.0	16.7	18.6	25.1	33.0
Canada	13.0	16.7	18.2	20.4	28.4	39.1
France	18.8	20.8	23.6	24.6	32.3	39.1
Germany	16.0	21.7	23.8	30.3	35.4	49.2
Italy	13.3	21.6	26.5	31.2	37.5	48.3
Japan	9.5	17.1	24.3	33.0	43.0	44.5
New Zealand	Na	16.7	17.1	18.9	24.6	30.5
United Kingdom	17.9	24.0	24.4	25.8	31.2	38.7
United States	15.4	19.1	19.0	20.4	27.6	36.8
Total OECD	**14.9**	**19.3**	**20.9**	**23.5**	**29.8**	**37.7**

Source: OECD

6 In modern economics, wages tend to rise with age peaking in late 40s early 50s.

Of course the Superannuation Guarantee Charge can offset this liability substantially however the IMF has a reasonably sanguine view about Australia's ability to withstand higher pension outlays due to compulsory superannuation, the OECD expects a doubling in health costs to $41bn by 2050, together with higher pension outlays. Although these will be partially offset by declining outlays on family and educational benefits, it is expected to leave a net increase of 5.6% of GDP – or $37bn funding required in today's prices. This has clear implications on the future lifestyles of retirees, as the Government is expected to introduce stealth measures such as an increase in the working age and cost of living adjustments, as 'fix-it' measures. With a reduction in the number of workers, Governments will be forced to consider a move away from the taxation of labour income and more towards taxation of capital or wealth, or the re-introduction of death duties. In practice, this long-term solution may prove politically difficult to introduce, with few governments brave enough to sacrifice a growing 'grey' proportion of their voter base.

At a micro level, there still exists a psychology amongst many baby boomers that real estate is an investment for the future rather than a place to live. For many, housing is their most important asset and for some, it is their only significant asset. Not surprising when considering that many of their parents enjoyed the financial windfall of owning homes during the inflation boom of the 1970s and 80s. As property prices begin to fall the leverage that borrowing for real estate provided during this time will work against those who continue to pursue this philosophy. This will be simply through the principles of demand and supply as waves of boomers begin to downsize their homes en masse and move to new geographic locations taking advantage of low-cost real estate, better lifestyles and warmer climates.

2.2.3 A New Lifestyle?

The net result will be big city incomes combined with small town living. For financial service company employees this also represents a change in lifestyle, as technology will permit the radical decentralisation of business decision making. Over the next decade, many financial services companies will be based out of homes, as working at a distance from the corporate world becomes an increasingly popular alternative. As a result there will be resurgence in the ideal of simple community lifestyle and individualism, with greater incentives to return to small towns, away from the deteriorating condition in the suburbs. Alternatively, house owners will sell-down and relocate into inner city apartments. This exodus will not necessarily mean the demise of the suburbs, merely an inevitable depreciation of its real estate in real terms. As the growing devaluation of the standard three bedroom/two car garage home begins to filter down, baby boomers will be forced to invest an increasing proportion of their retirement savings into the sharemarket. They will have no acceptable alternative but to remove themselves from the real estate carnage. The only wild cards that can save this scenario will be a massive increase in the population base through growing birth levels or migration.

2.2.4 And a New Financial Services Industry

Young graduates who are considering their careers in the industry should note that the industry is expected to slow down whilst they are in the midst of their peak earning years. New entrants should also recognise that there is presently a shortage in capacity of younger qualified financial advisers, with a glut of product manufacturers beginning to fuel mega-mergers and consolidation. We have also seen

growth in the level of retail funds exceeding 14.5%pa over the last decade. Whilst market growth is anticipated to remain high for the next ten years, there have been a number of notable factors such as increased superannuation guarantee and a low starting base which are unlikely to be repeated. Looking forward, the growth rate is expected to be in the proximity of 12%pa.

In general, the prognosis for the financial services industry is remarkably healthy over the next decade, as baby boomers will be financially rich and time poor. The provision of financial advice is clearly becoming the most critical part of the wealth management value chain. What will change is the delivery method used by the financial services industry. Baby boomers will be prepared to pay premium prices for quality products and services (something that will be discussed in other chapters in greater detail), whilst expecting greater levels of choice through open architecture models, for instance, multi-managers. In other words, this wave of consumers will mark the end of traditional financial sales, as automation will adequately cater for this style of delivery. Consumers will instead seek advice from consultants who represent their needs to help clarify their needs from the many affordable choices.

Whilst the next decade represents a tremendous opportunity for companies to participate in an area which has strong growth and low capital intensity, the firms who will prosper will be those who can use demographics and psychographics (eg. age, income and lifestyle) as a mechanism of how to best exploit consumer behaviour. Looking forward, this will require better consideration for consumers expecting greater levels of choice and personalised service. Organisations that respond efficiently to these expectations by cost-effectively delivering services that persuade their customers to 'leave the driving to us', will flourish.

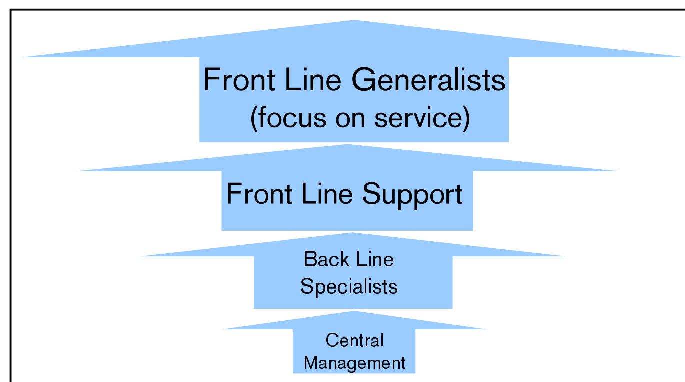
As the complexity of the financial world provides an infinite level of choices, customers without the time or inclination will require the services of someone who is able to add value by fitting a broad array of products or services into a customised solution. This expert filter shields clients from the overwhelming volume of options available, by devising choices that meet their needs. The only affordable way for the financial services industry to achieve this will be by offering highly specialised stores or agents that focus on a narrow niche of customers. These advisers will ultimately represent the customer not the product, and will require an intimate knowledge of each of their customer's needs and objectives. A financial adviser who intimately understands the needs of their segment of investors (eg. small business owners, senior executives, divorcees) becomes a human browser which anticipates questions and concerns and supplies customised information and solutions.

To maintain success, these advice givers will require back-up support in a networked organisational structure as illustrated in figure 6. These back line specialists could both be in-house or outsourced, and provide specialised expertise and products that they need to keep the customer satisfied. This model identifies successful financial advisers who expertly develop niche markets that coordinate their activities with other professional advisers. This architecture will also have implications for the wider financial services industry, as it becomes increasingly more difficult for financial service companies to use tied distribution to market or sell their own line of products. The discerning client will perceive this as biased service and will seek more objective advisers, who act in their best interests.

This will again enforce the need for back line specialists to support the front line generalists. As explained in The Roaring 2000s, by Harry S. Dent Jr, "The network

organisational model represents the only means that we have for regaining the personalised level of service and craftsmanship of the past, without sacrificing the incredible costs efficiencies we gained in the assembly line revolution. We can't get there by endlessly streamlining our old top-down organisations. Everyone, not simply management, must re-evaluate their career, skills, business practices and beliefs with an eye toward what the network model can teach."

Figure 6.



Source: Harry S Dent, Jr.

A sea of change in the financial environment can be expected as large numbers of baby boomers begin to retire and liquidate financial assets en masse. This will force a corresponding change upon the financial services industry to rethink how they interact with the consumer. As will be detailed in further chapters, all participants in the financial services industry have enjoyed boom times over the past decade without having to dedicate enough resources towards attracting and retaining customers. Whilst the wave of baby boomers may provide a buffer to protect some low value participants in the industry over the next decade, the companies that will be succeed will be those who profitably remodel their delivery mechanisms to put the consumer's needs first.

2.3 Information - Overload to Knowledge to Mass Customisation

"57 channels and there's nothin' on"

Bruce Springsteen

"Anyone who predicts the technology future is sure to seem foolish – it springs from human creativity and thus consists of surprise"

George Gilder

2.3.1 Introduction

Much has been written and said about technology. To some technology is simply the "Net" or their groovy new personal organiser. Others talk about the global issues such as the "democratisation of technology"[7]. One thing is for certain technology has profoundly changed our lives since Netscape listed in 1994. From a financial services

7 The Lexus and the Olive Tree, by Thomas Friedman.

perspective it is useful to analyse the key effects of technology under five dimensions:

- Client Dimension
- Productivity Dimension
- Blue Sky Dimension
- Distribution Channel Dimension
- Financial Planning Dimension

2.3.2 Client Dimension

Technology is fundamentally changing the way we live, work and play, by providing cheap transmission, storage, access and manipulation of information. Think back, ten years ago and imagine the investment information available to the public. Then think about today. In newspapers, TV news and money shows, in advertising and newsletters from their super fund and investment manager etc. Then there's the Internet, providing information and the on-line buying and selling of securities and managed funds. This is the same around the developed world. Yet despite all "free" information, personal advice is booming. How can this be the case?

Quite simply, information overload does not solve real financial problems and today's sophisticated clients really do understand the current limitations on the various tools available to them to manage their finances. Information has become a commodity, with advice premiums being paid to those able to best source, interpret and package it for consumption. Importantly however, this is changing rapidly and in the future these tools will become more sophisticated, user friendly and credible. Professor Bill Sharpe's Financial Engines is a great example of a site that provides very complex calculations of efficient asset/fund allocations for US 401k (superannuation) clients.

This also brings into question the nature of the client relationship now and in the future. Will the new client be more specific about the relationships they need in the future. Surely, there will be many friendly corner stores out of business and wondering why – their clients all used to love to come in for a chat but where are they now? Shopping at Shopfast and using that chat time to spend more time with their families? A faster stress rich /time poor society will view relationships differently. They will want it done now, done efficiently with all the information available on the various transactions involved stored in their personal vault[8] where they feel in control of their affairs.

If you underestimated the effect of technology ten years ago (as we all did) how can you sit back and think that technology will not have an effect on the financial planner relationship in the future.

The information revolution has not really begun yet, and won't really be underway until we see the era of networked-based commerce and living. This will occur once consumers are on-line in larger numbers, and are using the Internet for more than casual entertainment and information. The mass acceptance of the Internet will act as a leverage for economies and prosperity. It will provide a direct distribution system

8 A "personal vault" is an Internet accessible set of data on an individual that contains all their financial information. Individuals can give various parties access to information at various time and levels eg when applying for a loan, arranging a financial plan etc.

linking the producer to the consumer, whilst collapsing the many expense layers of administration, marketing and distribution. This is similar to how the assembly line reduced production costs. Electronic communication will allow financial services organisations to tailor products and services to the individual needs of their consumers, for the standardised cost of today.

2.3.3 Productivity Dimension

Since 1950, the power of computers has advanced by a factor of roughly 10 billion, with the future innovations anticipated to continue to enhance productivity gains. The National Office for the Information Economy predicts the following positive effects of e-Commerce

> "Australia's economy and the economies of all States gain in the medium to long term. They are projected to have a higher level of output of between 0.8 to 3.6 per cent by the year 2010, with national GDP rising by 2.9 per cent[9]."

Whilst we currently talk about tech wreck etc, it is important to recall that this technological revolution and ensuing increases in productivity that have driven the great bull market in US stocks have still produced great double digit returns for clients over the last five years. From a wider industry context, if globalisation means exponential gains in competition within the financial services industry, then constant re-configuration of corporate architecture is the response of survivor organisations. Technology should be regarded as the tool to re-engineer the offering, advancing productivity – irrespective of what stage of the economic cycle we are in.

For the financial services industry, the productivity boom that is being nurtured through the growth in technology will have far reaching consequences, as it changes the mechanisms for creating, storing and communicating knowledge. As with globalisation, financial service providers will need to prepare for a faster pace of economic change. Imagine the day when the painfully slow experience of using the Internet changes with all homes having access to cheap high-speed communications. Technology will soon permit the entire content of every edition of the Australian Financial Review to be transmitted in less than one second through a strand of fibre optic cable no larger than a human hair. Imagine the impact of this upon the delivery of financial services.

Technology and in particular the Internet, is forcing the entire world to increase their dependence on communication standards and protocols that have been developed by Americans. English is now accepted as the language of commerce in the business world. With the clock speed of technology accelerating rapidly, agile players will receive the greatest reward. Some financial services organisations will require significant re-engineering, as the embracement of technology will prove a difficult task and no easy feat. Bill Gates refers to the ultimate outcome as "…a frictionless economy with lower searching and communication costs." For the financial service industry, this may mean the arrival of new financial planning firms with no physical presence, replacing the older financial service organisations in the same way that the traditional bookstore has been substituted by many for Amazon.com. But the most significant impact of technology will be on the old economy. In other words the value added of IT to the user is bigger than to the creator, as it changes the methods in which traditional business was done. This is achieved through making the

9 National Office for the Information Economy, Current State of Play, June 2001 refer www.noie.gov.au

management of a global business more efficient than a domestic one through significant lowering of costs. This reduction in the cost of interacting with current and prospective clients permits effective one-to-many broadcasting rather than the relatively costly narrow casting of one-to-one. This will spur revolutionary changes in the way financial service organisations interact with consumers in the future.

So what does this mean for the financial services industry? Technology will enable the commoditisation of funds management (manufacturing) and parts of the advice giving (distribution) process. It will also lower the already-low barriers to entry, reduce the competitive lead-time for new products and services and allow for the unbundling of unit trusts, platforms and financial planning software. At the distribution end of the industry, technology will assist with fragmentation. The consumer and boutique adviser will have access to the same services and product as the institutionally based adviser. It is currently not difficult to set up a 'virtual broker' with nominal set-up or on-going costs. Within the next year distribution will be effected through the introduction of the virtual dealer, followed by the virtual fund manager.

Whilst it is difficult to accurately predict how globalisation and technology will influence financial services industry participants, one thing is certain –they will enforce change. The consumer will increasingly have access to the 'best' products and services at a global level, forcing those who want to prosper, to embrace change.

2.3.4 Blue Sky Dimension

In many ways this is the opposite and negative dimension to the very real productivity gains described above. In the highs of the dot com mania many people salivated over the huge return on equity possible for "virtual" businesses with very low marginal costs and historically low set up costs – simply push enough sales through these pipes and the return on equity sails into blue sky territory. Whilst many businesses will achieve this nirvana, the ability to push enough sales through at the costs indicated has been much harder to achieve, although the B2B cost savings achieved almost overnight by some businesses does illustrate the positive side to this argument. Whilst their arguments are different the publishing of the book "Dow 100,000" in 1999 and the extraordinary haste to rush through IPOs in this sector showed that good old fashioned greed is a big market driver.

2.3.5 Distribution Channel Dimension

Financial services are already a virtual product that, unlike the distribution of physical books and CDs at Amazon.com is a natural for Internet distribution. While people have turned to face-to-face advice, the Internet has in no way replaced the intermediary. With over 90% of investment product sales being intermediated in Australia, the Internet will figure more prominently every day in financial services. Clients will expect to have all their detailed strategy objectives, current balances, wills and other documents (buy/sell agreements, insurance details etc) on-line. They will also expect an automated SMS message or phone call when their portfolio returns fall below expectations.

2.3.6 Financial Planning Dimension

Whilst we were cynics to start with, it appears that on-line financial planning will develop as a viable alternative, although many people will want to have some face to

face input in the process. A good example is Directadvice.com a US based on line service, which provides an infinitely updateable on-line financial plan for US$75 pa. We have tested this site and found the client data entry painful and laborious, and the plan that one receives reasonably simplistic. Yet, one could still argue this is tremendous value for money. One of the aspects we liked was that any time data was added or updated the plan would be automatically re-optimised for no additional cost. We believe this market will be small in the future, however, learning from the efficiency of the process that the on-line providers use may be more valuable than worrying about the competitive threat that these services imply.

2.3.7 The promise of mass customisation

From a financial planning perspective, one of the key uses of all these technologies is the ability to provide what feels to the client like a unique solution to their particular needs. Based on input of that client data into a common system which optimises each client's portfolio, sophisticated systems can then effect strategy changes across multiple portfolios at the press of a button.

2.4 You want value with that? Manufacturing products for the new consumer

"And the company takes what the company wants…."

Blue Sky Mine, Midnight Oil

2.4.1 An Australian perspective

Whilst this paper focuses on the planning industry (ie. the distribution side) it is useful to spend some time on the manufacturing side. It is interesting that from a global perspective the race is on for scale and brand development however when we look at the Australian retail industry our complex environment means that Australia is aside from pure funds management, a true island. This may create some long term high relative costs but it has also served to make the Australian market quite creative with the development of sophisticated master trusts and registry systems aimed at solving our complex client servicing and regulatory requirements. Let us explore some of these issues.

2.4.2 The defined contribution revolution

Around the developed world Governments are realising the perils of continuing with unfunded government pensions and are increasingly promoting defined contribution pension funds with compulsory or incentivised employer contributions and tax incentives for individuals to further contribute for their savings. It is also clear that most of these schemes are providing more and more choice at the individual level. This has however shifted the funds management focus from sell to large pension funds to promoting their brands and latest ratings successes to the general public and their advisers.

2.4.3 Commoditisation of traditional funds management

Pure funds management is being increasingly commoditised both in Australia and in other parts of the world. Financial planners have a wealth of products to choose from and very few mangers manage to stand out from the pack.

2.4.4 New products

There appears to be five discernible trends in the types of products being developed:

- A clear trend to managed accounts and like customised products for retail customers
- A rush to develop alternative investments - Hedge Funds and Private Equity
- A clear trend to corporate and securitised debt as the supply of Government bonds dries up
- Exchange traded funds are increasing in popularity around the world, and
- Some unique consolidated reporting style products will continue to develop.

2.4.5 Coming to grips with the likelihood of lower returns in the 2000's

Falling inflation is the best time for equity valuations and with inflation subdued and likely to remain subdued around the world it is likely that the halcyon days of being able to easily achieve net double-digit returns for investors may be over. Initially we will see an increase in the range of alternative investment vehicles and then a new focus on fees across the entire investor value chain. If the experts prove to be correct, and the industry can only provide sub double-digit returns (albeit above inflation), then the consumer will begin to question and require justification for each layer of fees incurred. It is worth appreciating that a total cost to the consumer of 3%pa is a reasonable amount (15% of returns) when the portfolio earns 20%pa. Things become substantially different when the portfolio performance drops to 6%pa, resulting in the fees representing a whopping 50% of returns. It is usually at this stage of our conversation with distributors, administrators and manufacturers that each replies "I can't lower my fees, as I'm the one that adds the most value…". This is where the industry conflict seems to arise, with each component anxious to retain margins by passing on costs to other participants in the industry.

There is mounting pressure from the consumer expecting more for less, whilst the distributors are squeezing the administrators and manufactures for higher trails, revenue participation and lower MERs. The administrators are also approaching the manufacturers seeking additional revenue for 'shelf space' as they struggle to keep up with the impending revenue squeeze.

It appears that most distributors are currently charging between 75bp and 1%pa to monitor their client's portfolios. The value-add to justify this usually centres around strategic asset allocation, consolidated reporting or product placement. Very few appear to put a value on the relationship that they have with the consumer, which ironically is the only part that is difficult to successfully commoditise, institutionalise or replace. Unfortunately the future for this strategy is flawed. If the strategic asset allocation has been set up properly from day one and has not changed significantly over time then it can easily become a service that the consumer may no longer

require. After all, the concept of rebalancing is not a difficult one to understand. Also, if the value-add is centred around consolidated reporting then this technology solution will also become cheaper and more freely available. Elsewhere it is possible for consumers to subscribe to online consolidated reporting for as little as US$4 per quarter.

2.4.6 Lack of trust and the end of opportunism

Unfortunately most fund managers are too far removed from the consumer with most sales coming through an intermediary. This is a sound business strategy, which provides their businesses with distribution leverage. Because of this however, it is difficult for them to communicate effectively with consumers, as they are unaware of how their investment sits in the context of the client's overall plan and expectations. In the US in particular fund mangers have been quick to cash in on the latest bull market sector with new sector funds that are promoted on performance rather than a sensible portfolio construction.

2.4.7 A new transparency

Sophisticated clients, encouraged by the detailed information they get on the Net, will demand a much more transparent approach to how their funds are managed, with reporting on the rationale for individual stock selections being increasingly common.

Part 3 - Understanding the Australian Financial Planning Industry

Part 3 Understanding the Australian Financial Planning Industry[10]

"History never repeats, I tell myself before I go to sleep at night…"

Split Enz

3.1 History & Growth

3.1.1 Genesis

Although the first unit trust (managed fund) was established in Australia in 1936 the financial planning industry did not really take off until the early 1980s with the first wave of retirees post 1940. These retirees had relatively large lump sum payouts to invest, because they were mainly in defined benefit funds, they had been in them a long time, and the high inflation period of the 70s had considerably boosted their salaries.

Also, at that time there was no capital gains tax and no assets test on the pension. This led to some innovative product design. The banks were offering special 'no interest' accounts to retirees so that they could receive the pension. But in the main, the banks and the mutual life companies, who then dominated the financial services industry, did not respond to the opportunity. This was left to the unit trust companies, for example Australian Fixed Trusts, who designed products to maximise pensions and minimise tax – and who have continued to do so.

Distribution was an issue, as traditional channels: ie. life agents, accountants, bankers and stockbrokers, were not that interested in financial planning. This was because they were too busy doing what they were doing and some of the unit trust companies had had a bit of a checkered history. Because of this, the unit trust companies had their tied investment advisers (salespersons) who were compensated for their last sale - not for advice given or retention of assets under management.

3.1.2 The First Wave

Because the demand was so great (and the banks and life companies did not respond, nor did the accountants) more unit trust companies started (eg. BT) and independent financial planning firms emerged (eg. Godfrey Weston). In 1981, Macquarie Bank (then Hill Samuel) launched the first CMT. The rest is history!

The next boost to the industry was by the government introducing the superannuation rollover sytem after 1983 and compulsory award based superannuation from 1986. With this came vesting, preservation and portability. When a person changed jobs, they had to take their superannuation balance with them and transfer it either to another superannuation fund or a rollover vehicle (approved deposit fund or ADF). As most superannuation funds were not geared to take in balances transferred from other funds, the funds in ADFs grew strongly.

10 This chapter is largely the contribution of Tom Collins.

As some of the funds being transferred were large, the concept of a Personal ADF (PADF) emerged. This allowed the members to have their own discreet investment portfolio, but each PADF had its own trust deed.

3.1.3 Master Trusts/Wrap Services

The concept of the master trust was first devised by National Mutual (now AXA) back in the 1960s to facilitate the administration of corporate superannuation funds. (In those days the life companies were the main administrators and fund managers of superannuation funds.) However, it took Asgard in the mid-1980s to translate the concept to the public offer superannuation menu-based (discretionary) product.

Initially, Asgard offered ADF and personal superannuation divisions then subsequently broadened its offering to include personal investment (non-super), allocated pension and corporate superannuation divisions. (The ADF division is now incorporated in the personal superannuation division.)

Initially, the retail discretionary master trusts only invested in unit trust investments. Subsequently they extended to listed securities, term deposits and even some single premium products. The superannuation divisions provided for risk insurance (eg. term, salary continuance).

The legal structure of the master trust was found by many not to be suitable for non-super monies. There are issues with CGT, corporate actions, loyalty cards etc. This lead to the development of the wrap account for non-super monies. The wrap is no more that a custodial service – a service that trustee companies have been offering for many years. (It is not the same as what they call a wrap in the USA – the Aussie wrap it is more akin to what the Americans call a marketplace eg. Schwab OneSource.) As the super monies are required by law to be held in a trust structure, superannuation funds cannot be set up as wraps.

Early in 2000, ASIC decided that non-super retail discretionary master trusts and wrap services would be regulated in the same way, and ASIC now calls them Investor Directed Portfolio Services (IDPSs). Unfortunately, the public offer discretionary master trusts are still regulated differently. Master funds were initially marketed by entrepreneurs who were quick to offer a consolidated reporting service in an otherwise fragmented industry.

Initially, fund mangers did not like master trusts as it saw them (and rightly so) pushing them further down the value chain. Their response was the setting up of InvestmentLink which is still to be adapted as an industry wide standard. On the other hand, financial planning groups set up their own master trusts/wrap services as they saw them giving them more control and higher margins. Control, because they believed it locked the financial planners and clients in and concealed their clients' details from the fund managers. Higher margins, because they had another, and lucrative and on-going, 'sticky' revenue stream. (A number of the medium to large independent financial planning firms would not have survived without this revenue stream.) Now all the major institutions and the larger financial planning groups have their own master trust/wrap service. BT have set up a 'white label' facility and Macquarie has three offerings, being 'white label' co-branded and Macquarie branded. As at July 2001 there were 18 operators willing to 'white label' wraps and master trusts. Irrespective of which brand used, these platforms still represent a consolidated reporting system with 'ancillary stuff' offered to incentivise the financial

adviser. Ultimately it is the value the adviser and consumer places upon this 'ancillary stuff' which will determine their success, as technology rapidly commoditises and cheapens the consolidated reporting component.

3.1.4 The dominance of financial planners as distributors

Financial planners dominate the distribution of managed products (some put it as high as 95%) and they 'hold dearly' the tenets of asset allocation, diversification through the use of multiple products and multiple managers, and on-going reviews. (It seems that we lead the world with these tenets.) The holding of these tenets has led to two interesting outcomes. Firstly, it explains why master trusts/wrap services have become so popular – as they ease the administrative burden. Secondly, it has meant that even, financial planning firms owned by product manufacturers have had to accept that their financial planners' advice will not be biased towards their products. There are very few exceptions to this.

The institutions (banks and life companies) have had many attempts at setting up financial planning arms. In the 1980s they bought some of the independent firms (eg. National Mutual (now AXA) bought Godfrey Weston (now Godfrey Pembroke and now owned by NAB/MLC)) but this did not work for them. It has only been from the middle of 1990s that the institutions have got their act together with financial planning distribution. And, it is only recently that the non-institutional fund managers have considered overtly having their own financial planning arm – BT says they will still not do it. They are afraid they will upset the financial planners.

It is estimated that there are about 17,000 financial planners (advisers) in Australia, belonging to about 700 firms (Dealers). Over 12,700 (75%) of these are in firms with more than fourteen planners, and 8,850 (52%) with firms owned (in part or full) by institutions and fund managers. Further detail is set out below and in the Appendix to this paper

Figure 7. Breakup of Distribution by Ownership Type[11]

	At 30 June 2001			At 30 June 2000		
	Number	**% Top 100**	**% Total**	**Number**	**% Top 100**	**% Total**
Bank	4,936	38.9	29.0	4,464	40.6	29.8
Fund manager (life)	3,915	30.8	23.0	3,324	30.3	22.2
	8,851	**69.7**	**52.0**	**7,788**	**70.9**	**52.0**
NBI	376	3.0	2.2	210	1.9	1.4
Super fund/admin	146	1.1	0.9	154	1.4	1.0
Stockbroker	329	2.6	1.9	255	2.32	1.7
Listed	215	1.7	1.3	200	1.8	1.3
Independent	2,783	21.9	16.4	2,376	21.6	15.8
	12,700		**74.7**	**10,983**		**73.2**
Rest	4,300		25.3			
Total	**17,000**			**15,000**		

In the last five years we have seen the emergence of wraps (custody based administration platforms for non-superannuation monies), the big banks buying up distribution, the arrival of consolidators, more regulation, Internet broking, electronic

11 Source: Tom Collins

interfaces (between advisers and platforms) and advisers doing more and more listed securities.

Today, life is beautiful for advisers. Most are making a lot of money, demand exceeds supply, fund managers fete them and with platforms (wraps and master trusts) they have been able to increase revenue and decrease costs. Those that have been in the industry more than five years do little or no marketing as they gain sufficient new clients from referrals. (Most attract clients that are nearing retirement or who have been retrenched.)

However, there are a number of inefficiencies in the industry. Planning is over-engineered and in most cases, each plan is individually crafted. This means that advisers can only afford to see clients who have a reasonable ($50,000 to $100,000 plus) to invest. Financial planning software and research sits on advisers' PCs.

Currently the wraps and master trusts are expensive, especially for listed securities and fixed interest investments. They do not handle existing and non-unitised investments. They lack investor portability, as they are usually dealer-based and use wholesale product. Because there is no straight through processing of transactions (for any managed investments) their back end is manual and inefficient. This is a major industry issue, which willl be born out as the consumer unbundles the value chain and begins to question the cost/benefit of each component.

3.2 Stages of Development[12]

"And I'll keep on trying until I reach a higher ground…."

Higher Ground, Stevie Wonder

3.2.1 Advisory Stages

This chapter looks at the various stages in the development of adviser businesses and some of the current performance metrics of firms operating in these various stages.

Considering the infancy of the industry, there are various stages in which advisers are operating. For the purposes of this paper these have been defined as:

- Activity Stage
- Administration Stage
- Management Stage
- Branding Stage, and
- Merger & Acquisition Stage.

[12] This chapter is largely the contribution of Jim Stackpool.

3.2.2 The Activity Stage

Advisers within the activity stage are generally within:

- Banks
- Start-up advisory firms, or
- Large new industry entrants.

The activity stage is the usual entry point into the industry. It is so named because longer-term success comes following a focus on necessary activity to acquire market share and experience.

As supply gradually meets demand within the industry over the coming two to three years, advisers still operating within activity stage will come under the most pressure, as their service is primarily transactional. The quality of the relationships between these advisers and their 'client bases' are generally the poorest in the marketplace.

(i) Activity Stage - Performance Benchmarks

Research from The Dashboard™ Reports[13] shows the characteristics of advisers operating within this stage:

- On average $8-10M gross inflows (funds under advice) per annum per adviser
- Annual gross revenues generated per adviser per annum on average between $275,000 - $325,000
- Ratio of adviser to support staff is between 1:0.25 – 1:0.5
- On-going revenue per client per annum is approximately $1000
- Ratio of client/adviser approximately 1:550, and
- Pricing models are asset or brokerage based.

(ii) Activity Stage - The Banks

As demand for advice and products meets supply, salaried advisers within banks will dominate this low-profit end of the marketplace.

If the banks can re-position their offer to clients in this low-profit environment for a deeper relationship between the bank and client, then their opportunities are huge. However, as their traditional margins have been squeezed, a deeper relationship will need to be paid for by higher fees.

13 ® "Dashboard" is a registered trademark of The Dashboard Company.

This will be difficult for the banks as fees are already meeting with aggressive resistance from consumer groups, political parties, unions and the non-accountable media.

Regardless of banks movement into fees for additional services, the banks' salaried adviser bases will have to work more collaboratively with their branch/store/kiosk networks than they do today. Retention of clients and their funds will become increasingly important as demand and supply converge. Banks have a history of being the 'first port of call' for superannuation roll-overs and first-time investors, who quickly depart for better service, generally at a higher price, from non-banking advisers.

The banks generally do not pay their salaried adviser-base trail brokerage on products sold and thus they can theoretically tighten product margins further than advisers who rely upon trail brokerages. However, as the banks have lost market share to mortgage re-sellers over the last five years, they are at threat to lose similar funds under advice market share to new entrants who share the banks large client bases. These new entrants also have significant market capitalisation and will leverage off the current negative market acceptance of the banks in the Australian marketplace.

Comparatively to their non-banking industry colleagues within the Activity stage, advisers within banks are generally better paid. This seems to be their major retention strategy.

However, these highly paid advisers are becoming increasingly frustrated with a hard working (albeit well paid) lifestyle which fails to provide the 'equity light at the end of the tunnel'.

To date, the banks have not been able to provide anything other than 'private banker' status to their most talented and able. Increasingly, these professionals want a 'piece of the action' ie a piece of the equity. Without a branded or non- branded banking joint venture with their most talented, the banks will continue to lose their highly trained and skilled professionals to private interests (along with most of their clients too)

Successful salaried advisers within banks are usually the most self-disciplined. Compared to their non-banking colleagues in activity stage, they commonly rely on little internal administration support. They thus learn to juggle their client visits, their kiosk/branch/store visits, their plan writing, their pre-appointment preparation and their own administration. These advisers often have little time for two or three selling appointments let alone on-going client review appointments. Banks often impose targets for numbers of first appointments per week ensuring their advisers stay activity rather than productivity focused.

Herein lies the paradox for banks operating in the activity stage. Their advisers currently lack the time and resources to forge deeper relationships with clients, however, without deeper relationships, their clients focus on short-term issues such as immediate investment returns or price. This nexus needs to be broken by simultaneous re-position of the bank's skills and an

education for clients on the benefits of long-term, on-going relationships with bank advisers.

Obviously, the strengths of the banks are their scale and patience for results. Each of the major Australian banks have client bases well into the millions and current funds under advice/management well into the billions. The boards governing today's banks (and all industry participants) need to consider their make-up as their decisions become more service-oriented rather than product-oriented.

(iii) Activity Stage - Start-up Advisory Firms

For the first eighteen months of their existence, start-up advisory firms traverse through the activity stage. This is the stage where they gain valuable experience.

These firms have generally acquired a client base or their clients have 'followed them' from another firm. Starting from scratch without any clients is becoming rarer as the market gets more sophisticated.

One or two talented individuals dominate these start-ups with a small administration team supporting their efforts. These firms generally resemble the 'backyard game of cricket' where the major contributor to the game is enthusiasm rather than a team of talented individuals. There are some 'star players' but these generally carry the success for the rest of the team.

As with most start-ups, these firms focus on revenue rather than profits, they over-promise and over-deliver, and they pride themselves on their flexibility and ability to 'deliver' the client's specific requirements. They treasure and cultivate qualified referrals from satisfied clients and 'aligned' professional firms. They work the hours necessary, whilst often working under-paid. They are working for the long-term rewards rather than the short-term salary.

Unfortunately, initial business plans encourage individual performance rather than team performance. This often creates sub-sets of clients 'attached' to specific advisers rather than all clients belonging to the 'house' or firm.

Also, start-ups can often leverage off lower fixed costs and sometimes offer price as an advantage. This focuses initial clients on price which becomes an issue, as the start-up matures.

The weaknesses of the start-ups are obvious. They don't have committed career oriented staff teams or referring client bases. They lack their own internal procedures and precedents, business planning is 'on the run', and everything is simultaneously an opportunity and a priority.

To date, the marketplace has been ripe for start-ups and will continue to be until demand meets supply.

The long-term for firms/individuals entering the industry today are arguably better than for more established firms/individuals who have prospered in an era about to come to an end. The newer entrants don't have the 'baggage'

that has come from decades of product-based remuneration and single-focused (ie investment selling) offers.

(iv) Activity Stage - Large New Industry Entrants

New entrants employing 'aligned' advisers are expected into the activity stage of the marketplace over the coming twelve months. Their advisers will work with existing large client bases. These organisations will both offer financial advice/products to their existing clients as well as aim to extend their client base.

These organisations will include:

- credit unions
- telephone companies
- credit card companies
- superannuation funds
- legal firms
- health care funds
- insurance groups
- football clubs
- agribusinesses
- supermarket chains, and
- international mutual funds/wirehouses/pension funds.

These firms will have significant advantages over the banks provided they can leverage off the quality of their existing client relationships whilst re-positioning themselves as a trusted financial advisory organisation.

The challenges these firms will face are pre-dominantly constructing the necessary scale and professional support to provide their guaranteed service standards.

3.2.3 The Administration Stage

Advisers within this stage are generally within dealership groups.

The administration stage is the second most populated stage within the Australian financial services industry.

It is so named, because longer-term success comes following the adoption of administrative systems to better support the adviser. Advisers within administration stage have gained experience from the activity stage, but are frustrated but the

amount of non-client work (ie administration) that distracts them from more revenue-earning work.

(i) Administration Stage - Performance Benchmarks

Research from The Dashboard Reports shows the characteristics of advisers operating within this stage:

- On average $12-15 million gross inflows (funds under advice) per annum per adviser
- Annual gross revenues generated per adviser per annum on average is between $350,000 - $385,000
- Ratio of professional to support staff is between 1:1 – 1:1.5
- On-going revenue per client per annum is approximately $1250.00
- Ratio of client/producer 1:350, and
- Pricing models are asset or brokerage based.

(ii) Administration Stage – Dealer Groups

Advisers within administration stage have proven to themselves that they can provide advice, albeit whilst being generally paid for products they sell. They have built a reputation, a growing client base, probably realised original business plans earlier than expected (demand still exceeds supply) yet are finding an increasing need to change things.

These advisers are facing the inevitable problems of success. They have a capacity problem that needs a solution. In classic 'E-Myth'[14] speak, they realise the need to corporatise themselves. These individuals/firms are sourcing smarter ways to do business. They desperately want to work on their businesses rather than in their businesses.

They are sourcing wrap accounts, master funds, client database software systems, compliance systems/auditors, head-hunters, telephone systems, office space, para-planners, junior accountants, paperless office procedures, web-page developers, newsletter writers, research suppliers, business management consultants and pre-written procedure manuals complete with trained administration staff.

The more advanced dealership managers are building 'integrated business solutions' to assist their advisory channels to cope with their Administration challenges whilst 'locking' their advisory business partners into long-term relationships. Re-badged wrap services, customised web pages and non-branded client education support are some examples of innovative dealership techniques aimed at assisting advisers to build better businesses.

[14] Michael Gerber, "The E-Myth".

The systems are letting these advisory firms down. The advisers are wasting too much time on low-value tasks or with low-value team members. Unfortunately, during the initial activity stage, they hired staff on cost rather than investment and now find that many initial team members are loyal but are not built for their future.

These advisers are working in highly principal-dependent environments holding proper authorities for dealerships aligned within organisations such as AMP, MLC, AXA and ING.

These dealerships are quickly building administration scale. They realise that their future is intrinsically linked to supporting the administration needs of their distribution channels.

The successful development strategies for advisory firms in this stage are straightforward. Outsource/delegate as much administration as possible, whilst ensuring the duties of client care, compliance and know you client rules are observed. This frees up the revenue-producers to re-focus on their strengths – providing quality advice to their growing client base.

The weakness of advisers within this stage is their inefficiencies.

Their client bases are not properly segmented, nor are there clear and guaranteed levels of service standards. These advisers believe that all new business is generally good business, whilst over-rating the potential of new clients. These advisers generally under-service existing client bases. They have not developed career plans for staff teams, and in fact, rarely pro-actively manage their staff teams.

These advisers often ‘pool’ together with other similarly placed advisers sharing common resources such as administration staff, rent and office equipment. This has been an obvious short-term attempt to resolve the administration issues facing firms with growing client bases. These arrangements however, often limit advisers as their success continues and places greater strain on the shared resources that are attempting to serve multiple ‘bosses’.

A major issue for advisers within this stage is the relationship dependency on one adviser. Clients of these advisers are rarely introduced to more than one professional on whom they depend for most of their service and enquiry.

A majority of the smaller financial advisory firms (which accounts for 91% of the inflows according to Cerulli[15]) have been able to survive and thrive within administration stage over the last decade. When demand exceeds supply, inefficiencies are frustrating but not a priority.

Product manufacturers usually determine the pricing models of advisers in Administration stage. This represents a significant threat to their continued success and growth towards advice based pricing models. Placed in this

15 Refer to the Cerulli Report.

position for too long and they potentially will not be able to gain control of the direction of the revenue flows.

Dealership management serving this advisory group have to focus on both their growing and stagnating advisers. Unfortunately for dealership management this often results in the most-profitable relationships at the top, leaving to form their own dealerships due to the lack of understanding for their unique high-end distribution issues. With 80% of the inflow coming from 20% of the better performers a significant migration from the top ranks could be lethal.

Another threat for advisers within administration stage is their pursuit of perfection. Certain advisers believe their value-add is their perfection and can find few, if any, out-sourced providers (eg paraplanners, software providers, research providers) that come close to their own standards. These advisers attempt to reinvent the wheel for their own clients. This creates significant distractions in the name of perfection. Some believe they cannot delegate a perceived crucial technical function (such as base plan writing) and thus must maintain their expertise in-house. These technicians will remain in administration stage until control is wrested from them by larger controlling interests clients for in-house financial planning does not come from existing partners. Rather, the majority of new clients come from traditional sources of satisfied referring clients or external centres of influence.

As administration tasks are delegated or outsourced, activity levels reach higher new levels. Whilst operations could be said to be effective (ie. the right resource is doing the right job), they could not be said to be efficient. These effective but inefficient advisers enter the management stage.

3.2.4 The Management Stage

Advisers within this stage are generally within:

- mid-tier accounting firms
- large consolidator groups
- large dealership groups (excluding 'salaried' advisers), and
- very small dealers (5 or less proper authority holders).

The management stage is the most populated stage within the Australian financial services industry. It is so named, because longer-term success comes following the adoption of management systems to drive advisers to better quality returns.

The industry is chronically under-managed. The industry confuses administration with management. An arrogance of success in previous stages of development causes talented advisers to believe they are talented business-people. Few have made that transition from adviser-thinking to business-thinking.

Advisers within management stage have gained valuable experience from the Activity and Administration stages. However, their business model is out-dated as they find forward progress frustrated by a lack of management which ensures internal

resources (including themselves) are doing the right job at the right time for the right price.

These advisory firms are often accountable to no one but themselves. Herein lies a key reason for their inefficiency.

(i) Management Stage - Performance Benchmarks

Research from The Dashboard Reports shows the characteristics of advisers operating within this stage:

- On average $15-20 million gross inflows per annum (funds under advice) per adviser
- Annual gross revenue per adviser per annum is approximately $400,000 - $500,000
- Ratios of professional to support staff is between 1:2 – 1:2.5
- Average annual income per client is approximately $3250
- Ratio of Client/Producer 1:120, and
- Pricing is a mixture of job-based fees and product/asset brokerages.

(ii) Management Stage - Mid-Tier Accounting Firms

Mid-tier accounting groups are quickly establishing financial planning departments.

These firms have large established client bases (some of the best financial planning prospects are, in fact, often the firm's partners) and a growing awareness amongst partners of the potential of building a 'rent roll'-type income stream off a growing funds under advice base.

Accounting partners often see only the investment management aspect of financial planning often due to their own inexperience with the emerging holistic planning services. This creates uneven referral bases within a firm's partner base with same partners always referring quality clients. Contrary to popular belief the greatest percentage of new clients for in-house financial planning does not come from existing partners. Rather, the majority of new clients come from traditional sources of satisfied referring clients or external centres of influence.

This may change as the internal partners develop a greater awareness of the role of financial planning for their client bases and internal clients are 'cross-sold' more effectively than today.

These organisations also have fee-based charging models, which whilst not perfect, provide a more stable platform for future pricing models than asset-based charge rates.

The challenges facing these internal financial planning divisions are effective integration into the whole firm 'value add'. A 'poor' financial planning client may be an excellent 'tax' client and vice versa. Also, client segmentation ratings in accounting organisations are rarely built upon the relationship standards that are becoming more popular within financial planning firms.

Client bases within these firms are sometimes jealously guarded as fiefdoms of senior professionals. There can be little client sharing among senior professionals as most remuneration models are linked to individual performances rather than team-based performances. Most of these firms do not share clients within.

(iii) Management Stage - Small Dealers

Small dealers (less than five proper authority holders) generally do not have the scale necessary to employ internal management to get them out of their inefficiencies.

These advisory firms sought a dealer's license for perceived independence and are being increasingly faced with added administrative burdens and costs without management or ability to ramp up revenue as quickly as their costs are rising.

These small dealers have a greater urgency to develop a quality offering at a boutique price for a traditional smaller client base than their colleagues do if they are to prosper. They must leverage off their independence with a quality offering that warrants higher pricing. This will require more management than most have in place today.

All these aforementioned advisory firms are best placed to re-invent themselves.

With proper structured management on all roles to clear deliverables these firms have successfully re-invented themselves. The move to greater range of financial service for a 'holistic' approach best suits firms in this stage of development. This necessitates an internal re-management and willingness to client share.

Provided team-base remuneration methods are also introduced, this re-invention provides significant benefits, not least of which is less reliance on any one professional and a corresponding increase in fees per client.

The threats to these firms is stagnation. Interestingly more fund managers and dealer groups are introducing Buyer of Last Resort (BOLR) offers to support these structures out of the industry whilst retaining the client base.

With management, these firms progress to branded stages.

(iv) Management Stage - Large Consolidator Groups

The larger consolidator groups are characterised by collections of small advisory firms with well-developed administration procedures. Consolidators

provide scale, operational support and valuation enhancement which small advisory firms find difficult to raise by themselves.

The strengths of these groups are their size and 'hybrid vigour' not attainable as stand-alone units, whilst this is also their weakness. These firms have 'fiefdoms' of clients whose primary relationship is with the principals of each advisory firm within the consolidator. These firms will be judged by their ability to repeatedly generate on-going annual profit streams from satisfied clients who continue to pay regardless of from whom they receive their advice. Without management, relationships will not be corporatised.

(v) Management Stage - Large Dealership Groups

The top 20% of most large dealership groups (who live up to Pareto's principle and generate 80% of the returns) are within the management stage.

These advisory firms are principal-dependent. Their staff is managed in a reactionary way. They have segmented client bases but these are not up-to-date or are too dependent on the interpretation by the principals. Review systems and procedure manuals are mainly administration in structure and implementation.

Within large dealership groups, their principal-dependent behaviours have been largely rewarded as compared to peers within the group their performances have been better. However, most large dealerships today grew up in a different era to one where demand and supply will meet.

3.2.5 The Branded Stage

Advisers within this stage generally fall within these classes:

- 'boutique' small dealers;
- 'boutique' accounting firms;
- 'boutique' legal firms

There are few firms in this industry stage.

It is so named because longer-term success comes from 'branding' the services and internal culture of the firm whilst ensuring a consistent service standard for selective clients. 'Branding' in this context refers to a consistent client service experience regardless of the individual delivering the service.

During the preceding stages, client generally 'buy' the person providing the advice. During this stage, firms attempt to leverage off the activity, administration and management skills developed in preceding stages so clients 'buy' a consistent service delivered by a collection of geniuses each with specialties. These specialties may range from accounting, law, investments, insurance, client management, superannuation, banking, real estate, or consulting. These advisory firms are accountable to internal management whose role is to hold all resources (including principals) accountable to a collaborated business plan.

(i) Branded Stage - Performance Benchmarks

Research from The Dashboard Reports shows the characteristics of advisers operating within this stage. These individuals/firms generate:

- On average $25-50M gross inflows per annum (funds under advice) per adviser
- Annual gross revenue per adviser per annum is between $750,000 - $2m
- Ratios of professional to support staff is between 1:3 – 1:5
- Average annual revenue per client is approximately $10,000
- Ratio of Client/Producer: 1:75, and
- Pricing is majority fee based with minority of revenue mix from product/asset brokerages.

(ii) Branded Stage - “Boutique” Advisory Firms

These advisory firms have management, various divisions of speciality structured in hybrid teams serving and being remunerated on a common client base.

Advisers are paid salaries with bonuses linked to firm-wide and team-wide bonuses. There are also ad hoc bonuses for extraordinary individual efforts.

These firms have a culture of consistent service delivery. They are totally focused on client needs and generally charge a fee for service. Their range of services are broad including financial planning, investment advice, taxation consulting, insurance consulting, legal support/structuring, estate planning, business consulting, remuneration consulting, management accounting, risk brokering, loan securitisation and capital raising.

These firms attract the accomplished professionals offering attractive remuneration and long term equity plans for pre-qualified advisers (and non-advisers as professional non-revenue earning managers become more integral to their long-term success). Headed by charismatic principals with long experience in financial services, often founded in accountancy or insurance. These firms have professional management, holding all resources accountable to operational roles. They also have professional Boards providing strategic governance, advice, networks, accountability and support to a group of owners.

Clients who work with these firms rarely, if ever, meet with only one professional within these firms during an appointment or review. Clients understand that several professionals (investment specialists, risk specialists, management accounting specialists, account management specialists) are ‘on top of their issues’. These firms understand that they are selling ‘peace of mind’ whilst assisting clients to meet their lifestyle objectives and they

attempt to bring together the necessary in-house experts to ensure this occurs. They also charge highly for their services.

These firms generally grow their 'geniuses' organically from within. They can also successfully position and induct senior advisers into their firms above long serving, loyal and talented advisers where and when necessary. Their strong internal management achieves this.

Depending on the number of advisers within their firms, they have developed a number of centres of influence. These centres are ''unpaid qualified prospect generators" who provide steady stream of new qualified prospects. These 'centres' are rarely remunerated as their motivation is not financial but rather similar professional ambitions for their referrals as for themselves, namely to deal with the best.

The strengths of these firms are their people and culture. These firms are profitable, have experienced growth over the past five years in the order of 25% annually.

The weaknesses of these firms are generally their size and, at least to date, their lack of scale. They are not good remunerators of prima donna advisers who cannot work within their tight team structure. Nor can they work with every client. If a client doesn't fit their 'boutique' culture, they will not usually accommodate to meet the needs of every client. If they were to be penalised for their hard-fought culture, they would probably still adhere to it, for it is stronger to them than simply the pursuit of money.

These firms cannot meet team demand. They simply cannot find the team members quick enough. However, their employment procedures require them to recruit, induct and train very intensively, which works against them in getting a new recruit to operational stage very quickly. They do not seek advisers to join their firms AND bring their old client bases with them. This will only add to their current capacity issues. They prefer to bring in new advisers at either junior or senior level without client bases to ensure new advisers adhere with and add to the current culture.

Too many clients per adviser than their culture can sustain (say, greater than 1:100) will mean a fall in service standards. Whilst technology can assist the effectiveness of the communication between advisers and client, these firms find technology ubiquitous and not a value-add in itself, but an increasing necessity to perform at this level.

The threats for these firms are loss of key people, especially the charismatic leaders within. Another threat is missed opportunities. As these firms enjoy greater success they discover that organic internal growth is often not 'quick' enough to react to market opportunities. Thus some firms progress to the next stage and accelerate growth via entering into a series of mergers and acquisitions.

3.2.6 The Merger & Acquisition Stage

There comes a time when firms in the branded stage can no longer grow organically and have to acquire complementary firms to meet their internal needs and client demands. Thus firms enter the merger and acquisition stage.

There are a few consolidators, aggregators in the marketplace today in aggressive merger and acquisition mode. Most of these organisations have by-passed the previously discussed management and branded stages. Thus, their business foundations are shaky until branding.

There is little doubt that the marketplace will be awash with mergers and acquisitions between participants over the coming years. Tired and confused professionals in administration stage will take the money and retire or become a smaller 'cog' in an acquirer.

Equally frustrated professionals from management stage will also provide opportunities for owners of branded and/or merger and acquisition stage firms to leverage their existing expertise with new professional skills.

One of the biggest impediments to merger and acquisition activity is current inflated valuations of distribution channels. The current irrational exuberance in the marketplace is obviously attributable to large organisations seeking market share rather than the purchase based upon traditional EBITA-style valuations.

Valuations will become more realistic over the next three years as acquirers realise that on-going product based charges (Management Expense Ratios) are destined to fall. In addition, a greater share of the client fee will come from service related issues rather than product or master trust fees which are currently highly valued by institutions.

The big organisations will continue to capitalise upon their economies of scale in areas of back office support, shared administration services, research, marketing and technical expertise. They will continue to be in good positions to purchase hypercompetition: The future of the financial services industry".

Organisations satisfy their desires for multi-brand segmentation by integrating different distribution channels within one group. However, without consistent cultural branding and operational management on all resources, their returns will not be maximised.

As there are few firms today in this defined stage of mergers and acquisition, group statistics are difficult to interpret. Suffice to say that their performance will be similar to those of the branded organisations.

3.3 Aggregators and consolidators – A mixed bag[16]

"Money can buy you anything, but what you want I just can't give…."

Can't Buy Me Love, BEATLES

3.3.1 Why accountants are important in the financial planning process

Public accountants are becoming the essential channels from financial product manufacturers to the retail marketplace. The accounting firms, of both the chartered and CPA variety, have a client base ranging from 500 individuals and small businesses for a sole practitioner to 12,000 or so for a mid-sized firm of four partners and 30 staff.

The clients have an exceptionally trusting relationship with their accountant. They see the accountant as their protector against the inquisitors of the Australian Taxation Office, unraveller of their bungled in-house accounting, and source of wise, impartial advice on business problems and opportunities. Few other professionals, apart from nurses and heart surgeons, enjoy such status. Try ranking accountants, even the dull ones, for user-friendliness compared with lawyers, retail or wholesale bankers, and life and real estate agents.

Now imagine your Uncle Jack has died leaving you $250,000. You ask your accountant Mr Smith what to do about the money. He replies, "Well, we have our own financial planner Miss Brown in the next room". Or maybe he says, "Well, we don't do financial planning ourselves, but you can trust Mr White of XYZ Financial Planners in Main Street to do a very good job".

Either way, the accountant has become the link between a valuable prospect and the managed funds and financial products favoured by in-house planner Miss Brown or external planner Mr White.

3.3.2 Accessing these important influencers

The challenge for financial product suppliers is to influence that accountant's referral towards their own stable of products.

A simple response, bordering on the crude, is to buy part or the entire accounting firm. The pace-setter in this approach in the United States was American Express, which through its Tax & Business Services operation has bought more than 100 accounting firms with collective fees in $US325 million in 2000[17]. It actually began the process with a string of purchases of small, virtually insignificant firms from 1990-96. From 1997 to late 1999 it went on a purchasing spree in competition with other acquirers, seizing firms in 1998 as large as America's single-city flagship firm GGK New York, with $US50 million fees, and AM&G Chicago, with $US58 fees. However, it has apparently lost its appetite for accounting-firm purchases and since 1999 has bought only one significant firm, Hausser + Taylor ($US30 million fees), in Cleveland, Ohio, in February 2000.

[16] This chapter is largely the contribution of Tony Thomas.

[17] Accounting Today, April 24, 2001.

A series of Amex TBS spokesmen have put different 'spins' on Amex's rationale. A few years ago they stressed cross-selling of Amex products, but lately they have softened this line, emphasising the value of accounting business per se and suggesting that any cross-sales are nice but incidental.

In Australia, the analogue of Amex is the Challenger International group, the first and (at September 2001) only financial-product manufacturer to get into the Australian accounting-consolidation game. In late 2000, Challenger took a 46% stake in an Adelaide-based listed minnow, now re-named Garrisons Accounting Group (GAG) and still (September 2001) with a market capitalisation of only about $16 million. GAG is a sister company to Challenger's financial planning subsidiary Garrisons. GAG has acquired five mid-sized ($4-6 million fees) accounting firms with the intention of adding to them a Challenger-friendly financial planning unit.

Challenger managing director Bill Ireland makes no bones about his motives: product distribution: "Capturing the retail client is the single most important aspect of Challenge International's business plan…"[18]. The accounting work is incidental.

Ireland is an enthusiast for grass-roots distribution networks and agencies. "The best product in the world, without distributors, is as useless as an ashtray on a motorbike," he says[19].

Ireland says that 90% of the distribution business in Australia is now through intermediaries and only 10% by the product manufacturers themselves. A decade ago, banks for example used their own branch managers to 'sell' their products. This role has virtually disappeared and distribution houses with their own retail clients have been given the job. The trend is accelerating. Planners, in groups owned by banks, are up from 2000 in the year 2000, to 3700 in mid-2001[20].

Challenger, a quasi-investment-bank, itself joined the trend by buying the Garrisons planning group, with 70 branches, in November 1999 for $37 million in cash and shares. It has a further strategy of locating and wooing independent intermediaries (brokers/planners/accountants) about the advantages of Challenger's annuity products. The dealers' sales translate to rewards in the form of loyalty points, which convert to in-the-money options on Challenger scrip. The arrangement costs the company about $2 million a year.

The methodology for locating new distribution points is astute. Challenger has inspected each of 300 population centres and identified a potential annuity distributor (eg an accountant), with the help of surveys of the throwaway suburban newspapers. These prospects are screened and the process has generated about 140 new agents. To keep the ball rolling, Challenger employs 60 support marketeers, offering advice and the customary tools such as theatre tickets and golf days. Challenger maintains vigorous advertising for brand recognition, ensuring the ads direct clients to the intermediaries and not to Challenger itself.

Compared with Amex and Challenger, other consolidations or 'roll-ups' of accounting firms have less-direct linkages with financial product producers. The roll-up sponsors seek to maximise the value of acquired firms (and hence the consolidator itself) by

[18] Australian Financial Review, 22 November 2000, p32.

[19] Mission Critical, June 2001, Tony Thomas & Associates, p1.

[20] ibid.

initiating or strengthening their financial planning. The centre provides the administration and support (usually after tendering for suppliers) but steers clear of pushing particular investment products, lest it compromise accountants' independence.

Financial planning and funds placement is strikingly lucrative compared with plain-vanilla accounting and tax work based on hourly fees. This conventional work by accounting firms is typically priced in the range 60c per dollar of fees to an approximate dollar for dollar cap. It is noteworthy that in acquiring more than 30 accounting firms, listed consolidator Stockford claims never to have paid $1.00-1.10 per dollar of fees [21].

In terms of financial planning/placements-of-funds, the story is very different. The planning practice gets a market value of more than double the accounting work, per dollar of fees. Higher up the chain, the dealership mobilising the clients' funds will sell for about five times earnings, while the product provider itself is likely to fetch ten times earnings[22].

For example, assume an accounting/planning firm mobilises $20 million from clients for a dealer's master trust. This would give the firm a revenue stream of $70,000 a year, worth $140,000 on the two-times multiple. The dealer gets $10,000 or a sale value of $50,000 (five times earnings). The product manufacturer gets $56,000 or $560,000 added value, or ten times earnings[23].

Figure 8. Consolidators

Target	Purchaser	Date	Price $A million	P/E Ratio, x	Price/Funds under management %
Deutsche Financial Planning	National Bank	2/2001	115	23	2.2
MLC	National Bank	4/2000	4,560	23.6	11.9
BT Funds Management	Principal	6/1999	2,100	25	5.2
Sealcorp	St George Bank	12/1997	272	27.4	6.8
Poynton Asset Mgt&&	Challenger Life	22/6/98	(835,000 CLI shares)	Na	($176m FUM)
Bridges	Tower	8/2000	188	25.3	6.4
Beston Pacific&	Challenger	12/99	4.14	Na	5.5
Godfrey Pembroke	MLC	6/1999	40.6	Na	6.4
Garrisons/ Synergy MT	Challenger	11/1999	37	Na	6.5
Wilson Dilworth	Perpetual	12/1998	22.5	27.2	6.4
Deutsche Life*	Challenger Life	3/2000	45.6	Na	15.7
DFS (Deloitte Financial Services)	Stockford	7/2000	7.5	Na	$260m FUM = 2.88 ($630m FUA)
Moneywise	Stockford	12/2000	6.75	Na	($450FUA) = 1.5
Professional Financial Planners	Stockford	12/2000	3.46	Na	($100mFUA) = 3.46
Neville James UK**	Challenger	1/2001	16.6	Na	6.15

Source: Investor's Advisor, 18/9/2000 and Wealthplan Equities, 28/2/2001. Other data: Australian Financial Review, various; and company announcements.

[21] Mission Critical, February 2001, Tony Thomas & Associates, page 9.

[22] Stephen Reed, CEO of financial cooperative AustAccount, quoted in "Co-op wants the key to products cashbox", BRW April 7, 2000.

[23] ibid.

Consolidators create their own dealer groups and, if they can grow to sufficient scale, they may move further upstream into product manufacturing, thus capturing all stages of the value chain[24]. The rewards are great, as figure 8 demonstrates.

While each deal has its own peculiarities, there is no mistaking the high valuations put on managed funds. It could even be that operational earnings are somewhat irrelevant for a dealer group, providing that they can fund losses long enough to be taken out by a party wanting their controlled funds. Are the recent valuations silly then later regretted by the purchaser? Bill Ireland of Challenger is very happy with his purchase of Garrisons, a key plank in his distribution strategy. In the case of St George Bank's pace-setting acquisition of Sealcorp in 1997, the market viewed the $272 million price as a vastly extravagant sum; the scepticism was reinforced when half a dozen senior Sealcorp executives left in the first year, taking their St George golden handshakes with them[25]. In late 2000 Tony Thomas asked St George's group executive (investment services) Richard Cawsey whether the bank now regretted such an 'over-payment'. He told me Sealcorp was an absolute bargain. When bought, it had $2 billion under administration. By October 2000 it had $11 billion and was the largest master-trust in Australia. "Pretty bloody meteoric!" he told him. It has since grown to a $14 billion operation with 140,000 clients[26], involving $9.5 billion with master trust ASGARD, $2 billion administered through Advance Asset Management and $2 billion with institutional clients including Hillross, William Mercer, Suncorp Metway and Beacon Investment Management[27].

If we apply the "6.5% of funds" valuation rule of thumb to the $9.5 billion, we get a 2001 value for Sealcorp of about $620 million. Cawsey has good reason to be cheerful, although the bank must be less happy about its 8% stake in Stockford, given Stockford's decline from its high of $2.10 to under 50c at mid-August 2001.

Let us now survey the various roll-ups of accounting firms to note their financial products distribution strategies, starting with the US models.

3.3.3 United States

(i) Century Business Services (CBIZ)

History: In 1996 Canadian entrepreneur Michael de Groote and Florida-based multi-billionaire Wayne Huizenga teamed to convert a waste-management company into a financial services group now called CBIZ. Their track record with previous rollups (trucking, ambulances, waste management, video stores), plus the 1997 popularity of roll-ups, led to CBIZ shares rapidly accelerating from $US3 in mid-1996 to a high of $US25 in mid-1998. Concurrently, CBIZ embarked on a roll-up that gathered in 140 accounting and business services firms, gaining CBIZ seventh-ranking in the Year 2000 league ladder of US accounting firms. However, CBIZ net earnings from continuing operations collapsed in 2000 (from $US11.4 million in 1999 to a loss of $US119 million). Traders dumped the stock to under $US1 in late-2000. By late2001 it had recovered to $US3 or so.

[24] Stockford however disavows any plans for 'manufacturing' - conversation with Mark Rantall, 21 August.

[25] BRW, 9 September 1999, p38.

[26] Press release by Stockford, 21 August 2001.

[27] Conversation with Sealcorp chief executive Ian Knox, 21August.

Distributions outcome: Tony Thomas has detected little evidence that CBIZ ever generated a coherent financial planning/managed funds strategy. Management acquired some financial planning, insurance and pension administration businesses, but executives were pre-occupied both with further acquisitions and being taken-out by a financial institution of some kind. Very little grass-roots integration of acquired firms took place; internal accounting reporting was weak. Progress was slow on moving firms to a common financial-services distribution platform and pushing the group up the financial value-chain. However, financial planning continues to be advertised as a CBIZ service both at group and individual firm level.

(ii) RSM McGladrey

History: Tax preparer H&R Block, a producer of 19 million US tax returns, from 1997 began a strategy to become a full-service provider of financial products to its 20 million tax clients. It joined the rush to buy accounting firms, acquired seven of medium size before staging a coup in mid-1999: buying the Top 10 US accounting group McGladrey & Pullen. It paid a generous 1.2 times for the group's $US240 million non-audit fees. Block then did an internal roll-up of its accounting firms under the RSM McGladrey banner, governance and systems.

Distributions outcome: Initially RSM McGladrey targeted both small-medium enterprises for general accounting/tax work, and Block's upper-tier tax clients. However, this plan was quickly displaced and RSM now focuses on the SMEs. It apparently leaves the high-net-worth individual clients in Block to be serviced by the Block specialists. Any firm dealing with SMEs will pick up opportunities for financial services to SME executives and owners: a sale of business for example will put an individual client into the 'hot prospect' category with a lump sum begging to be placed. In June 2000 RSM announced that it would 'expand its service offering to include investment advisory services', a move that would seem to an Australian observer to be rather belated. A press release (November 2, 2000) implied that RSM had financial planners in only half of its 20 geographic US markets, but with plans to cover the other half by end-2000, with considerable emphasis on the insurance aspects. In the same month it formed referral alliances with several major insurers.

(iii) Centerprise Advisors Inc.

History: This group is an unlisted roll-up that in July 2000 combined seven large firms with a total $US141 million fees. It ranked in 2001 as America's 16th largest firm.

Distributions outcome: As with RSM and Centerprise, its emphasis is on SME services per se. Financial planning for individuals gets low emphasis. The group's name "tax and business services" seems to set the ground-rules.

(iv) American Express Tax & Business Services

History: A large-scale amalgamation since 1996 of medium-large US accounting firms, earlier described in this chapter.

Distributions outcome: As with RSM and Centerprise, its emphasis is on SMEs per se. Financial planning for individuals gets low emphasis. The web home page, for example, lists eight key services; none specific to financial planning as Australians would know it (www.rsmmcgladrey.com). Individual RSM firm members commonly have a financial planner on staff, but the group's name "tax & business services" seems to set the ground-rules.

(v) Gilman & Ciocia

This small White Plains, New York, company, has a 20-year track record (18 years listed), most unusual for a consolidator. It has 335,000 clients and year-2001 revenue of about $US100 million, but a market capitalisation of only $US30 million. It has accumulated 158 offices, mainly by acquisition, which it has been upgrading from small tax firms to financial services outlets for individual clients. The acquisitions in fiscal 2000 totalled 17 firms. It claims more than $US8 billion in 'assets under management'. The revenue split is about 20% tax and 80% financial services - the reverse of Australian models. It is noteworthy that in 1998, the company's ratio was 42% tax-prep, 58% financial services, indicating that cross-selling has become more effective. However, the business as a whole is at best only marginally profitable.

3.3.4 Australia

(i) Investor Group

Melbourne-based Investor Group, a listed company, is the 'veteran' of the Australian consolidation industry, having bought its first accounting and planning firm in 1997/98. It now has 14 accounting firms and four specialist financial planning firms. Managing director Kevin White describes the accounting firms as 'independent' in an operational sense. The group's annualised income is $90 million-plus and with the September 2001 acquisition of Ord Minnett SA (OMSA), it has $2.8 billion in funds under advice. OMSA was a significant acquisition, involving $800 million under advice, 50 staff, and a track record of 20% compound ten-year annual growth. The price was $6 million cash and $6 million in Investor scrip at $3, plus 1 million performance options at $3.30. The principals will get further a $2 million cash if they meet profit-performance hurdles. Strategically, Investor will roll out, or at least offer OMSA's best-practice systems and procedures to all its regional firms and use OMSA as a magnet to attract other high-quality planning groups.

Investor Group's 2000-01 results were a disappointment to brokers such as Macquarie Equities, which put Investor on a short and long-term 'hold' with a 'medium' risk rating.

The company made a $4.04 million net profit after tax, up 54%, on revenue of $64 million, up 124%. The revenue was split 80-20 between $51 million in 'business services' income and $12.7 million from financial planning.

Investor's financial services group is made up of its original two niche planners Spectrum Financial Services (self-managed super specialists) and Supermaster Corp (retirement investment planning), bought in 1997-98, plus planning arms of acquired firms and Adelaide's OMSA group.

Asked if the accounting work is really just the sprat to catch the mackerel of financial planning, White says, "To some extent, right. Five years ahead, where is the real added value? Doing more accounting, tax and audit? Or is it that we build an allied financial planning business? The answer is a no-brainer."[28].

This has been a consistent strategy. In April 2000 White described[29] financial planning as the preferred growth sector for the foreseeable future. He continued: "A key element of Investor Group's strategy is to capture the underlying value of financial planning within and across member firms, particularly as they expand by consolidation, in conjunction with an appropriate IT strategy…"

Investor Group makes a point, when announcing an acquisition, of referring to the acquired firm's tax-return base, and stressing the total tax returns now done within the company (currently, more than 100,000). The implicit point is that each of these tax clients is a potential client for upgrading to planning and administered funds. This routine tax-return work is inherently none-too-profitable; hence, Investor has created a fail-safe strategy of buying regional firms that also have strong roots in their community and a good base of small-medium business clients. It has never bought parcels of tax returns or small tax shops per se, a strategy used in the US by comparably sized listed consolidator Gilman & Ciocia.

The company bit off more than it could chew when it announced on March 19, 2001 the intended purchase of eastern seaboard offices of second-tier accounting firm PKF, with $45 million fees, which would have increased the company size by more than 50%. The parties mutually killed the deal on June 25 after the marriage preliminaries proved too complex and time-consuming.

If successful, the merger would have added a strong capital-city accounting/business services base to Investor, while PKF would have had the benefit of Investor's well-developed financial planning systems to upgrade some of its 100,000 tax-return clients to financial services.

PKF had been operating far under its capacity in financial-planning, with only $200 million under advice, the bulk of it in the Sydney firm. It saw Investor Group as a way to re-launch planning and add planning to many of the 700 firms in PKF's Professional Practice Network loose alliance.

[28] Interview with author, July 10, 2001.

[29] Press release, 20 April, 2000.

Speaking after the merger's termination, White makes it clear that he does not rule out further forays into second-tier capital city firms. He says, "We see ourselves ultimately as a financial services entity. For example, if we were to buy a second-tier capital-city accounting firm, we would not be buying it for the sake of the accounting base-load but to get another strong financial planning base."

While the accounting businesses now within Investor Group run their own race (with performance-based options to enhance motivation), the financial planning side is being coordinated from Melbourne headquarters. "What we deliver to every member is a fully integrated financial planning platform," White says. "Every member has changed or is changing from their legacy dealer groups Count or RetireInvest or whoever to our Investor Group licence and infrastructure. What do we charge them? Basically nothing. This service is our contribution, our reinvestment of profits into their growth."

Company policy is to stick to core operations, using a very lean head office, and outsource whatever it can. The financial planning platform now comprises

- A fully functional BT Australia-provided wrap account (" Wealth Wrap") and super master trust (investment administration)
- Dealer services including software, research, para-planning, technical support and training through Zurich Dealer Back Office Services (DBOS), and
- Compliance services (through Accent Consulting).

As the company said in its 2000 annual report: "The progressive transition from funds under advice to funds under administration is expected to become a major contributing factor to the long term profitability of the group."

White has alerted the market that the heavy investments in these systems will be a drag on performance for two years until funds under administration achieve critical mass.

The financial planning units fund their own budgets and normally do their own recruitment of compatible planners. "As a listed company, we can generate the resources that make our planning units attractive both for incumbents and for recruits," White says.

A small case study of his grass-roots distribution strategy in financial services involves the northwest Tasmanian region. In October 2000 Investor bought 70-year-old Launceston firm Garrotts ($5 million fees, five partners, 70 staff, more than 8000 tax returns) for about $3.25 million in scrip, plus its affiliate Paterson Financial Services. This is a blue-chip planning service headed by a former state manager of National Mutual, David Gibson. Garrotts partners say they sold (for scrip) partly to get capital to expand into southern

Tasmania, and to get the benefits of liaison with successful peer firms within Investor[30].

Nine months later, in June 2001, Garrotts bought Pinnacle Consulting Group, another accountancy business in north-west Tasmania, for $1 million in Investor scrip, and in July bought Wiseman & Templeton, a financial planner in the same region with a significant $45 million funds under advice, to be merged with Pinnacle. This acquisition cost $840,000 in scrip. In October 2001 the company added a Hobart practice, Moore Robsons, to its Tasmanian group, paying the Hobart partners with 330,000 Investor shares.

While this type of rationalisation in the fragmented Tasmanian market is logical, you doubt it would have occurred without the driving force of a listed company behind it, paying for acquisitions with scrip. Trying to achieve rationalisation through convoluted, cash-poor mergers or funding it with bank debt secured on partners' business and homes, would not be attractive options for small-firm partners.

Investor is adept at this strategy of 'tucking-in' appropriate small firms to its flagship firms. Acquired firm Rutherfords, at Lismore, with no established financial planning, was assisted to buy Conways & Co., a small accounting/planning group in the same city, adding three planners to the core firm. In Armidale, New England, the Cameron Kirk Rose flagship in June 2000 made an add-on purchase for $300,000 of the planning practice of David ter Hedde, paying in Investor scrip and options.

Investor managing director White comments, "It was a win-win for all parties. CKR is confident about referring clients to David, whom they have known for many years. They know that if they don't offer financial planning in-house, someone else is sure to make the offer to their clients. The clients then probably bring the plan back to CKR anyway to vet, so keeping it all in-house is very sensible."

It is sometimes suggested that Investor Group is preparing itself to be taken out by a big financial institution wanting to add ready-made operations to its distribution of products. White replies that he has had no serious approaches from large institutions to buy the company. (BT Financial Group has an 8% stake in Investor, and Terry Powers, Investor's chairman, was formerly head of retail distribution for BT Funds Management). Investor shares are held about 60% by 'insiders', ie management and ex-owners of acquired firms, whom White says are all committed long-term to organic growth. "They would be likely to approve only a bid that involved an institution adding significant value to their operations, rather than just waving a cheque book," he says.

(ii) Stockford Australia

Consolidator Stockford is Australia's sixth-largest accounting firm, with annualised revenue of about $140 million and $2.8 billion under administration (September 2001). Stockford floated at $1 in November

[30] BRW Tracklines, 6 October, 2000.

2000, capitalising the company at $182 million, with St George Bank having taken a 7% equity stake in October 2000, a $10 million investment. The shares hit a high of $2.20 in early 2001, and crashed to 50c in mid-July 2001 after its second profit warning, involving a halving of 2000-01 and 2001-02 NPAT forecasts. This fall from grace has put the whole consolidation movement in Australia under a cloud.

In mid-June 2001, a month before the company's share price crashed, Tony Thomas interviewed chief executive Jim Phillipson and Mark Rantall, general manager, financial services, about general strategy and financial planning strategy in particular.

They are running a twin strategy of growth in funds serviced and rationalisation of a formidably complex assortment of legacy financial planning systems in the 50 acquired firms.

Phillipson has often quoted his five-year target of $5 billion funds under management, and Rantall says the target includes a further $10 billion under advice. Rantall described the $5 billion figure as "do-able providing a lot of things go right". Given the share slide and consequent crisis mode in the company, the target is probably no longer 'do-able'.

The Stockford Financial Services businesses, with their own board, have five key divisions: private-client pooled funds, administrative services, super consulting, private executive planning and financial planning & insurance.

As at June, the five-year target for the private-client pool managed funds was $1 billion (at mid-2001, the actual was $70 million). The funds involved were property securitisation, income fund, growth fund and international fund.

There is also $2 billion under administration with an annual inflow of $100-150 million of miscellaneous new business. “When we have our own master and wrap funds, Tony Thomas expects 80% of that ($100-150m) inflow to be going into them, and we expect to get switched a fair proportion of the $2 billion administered by retail and other master funds," Rantall says. "We’d love to get 50% of that (ie. $1 billion). Conservatively, we expect $500 million of it within three years to come under management.

“So our $5 billion total target would be met by $1 billion in self-managed super funds, $1 billion in private-client pooled funds, and $500 million corporate super; plus $2.5 billion in our own master and wrap funds. That $2.5 billion would emerge from $100 million net inflow per year plus compounding plus transfers of up to $1 billion formerly under administration, plus funds coming in to us from acquisitions of new firms.”

The rationalisation process of legacy systems is a major task.

Rantall said Stockford has 13 financial planning licences, of which six are independent dealerships within acquired firms and seven are with mainstream providers such as Count, Securitor and Pact. All up they involve 110 Proper Authority holders, and a great variety of compliance regimes needing rationalisation. “The independents all meet at least regulatory standards but a

number are not the structure we would have initially chosen," Rantall says. "Our first focus is to integrate the independent licensees. We estimate we will save $350,000 a year just from that exercise. The other licences will be gradually shut down over the following three months and all licensees will then be operating through our own central master fund and wrap account."

On August 21, 2001, Stockford announced Sealcorp's ASGARD had won the tender to provide Stockford's wrap and master fund administration, which Stockford accountants and planners can badge as their own offering.

At a macro level, Stockford has been running a scrip-based acquisition policy aimed at balancing within a region its accounting firm acquisitions with financial services firms. Currently, Phillipson sees Stockford as heavily overweight in accounting firms. His original plans were to redress that by overweighting planning firms in new acquisitions. Currently the acquisition program has been deferred because of the low share price and lack of confidence among target firms.

Among the largest financial-planning acquisitions have been Canberra-based Civic Financial Planning with 12 planners and paraplanners, and more than $500 million funds under advice (acquired pre-float); HLB Mann Judd, Melbourne's super business ($250m under advice); Moneywise Personal Financial Management (25 staff, $450m under advice, and bought for 6.25m Stockford shares at $1 and $500,000 cash); Professional Financial Planners (part-owned by Mann Judd Melbourne, bought for $3.46m cash and $75,000 in scrip at $1); and Deloitte Financial Services. This purchase on July 3, 2001 involved a total price of $7.5 million in shares and cash, for a business with $630 million under advice. Ten days later Stockford disclosed that the share component was 3.13 million shares priced at $1.55, ie. $4.86 million. Unfortunately for Deloitte, the Stockford share price crash occurred a bare week later, taking the value of Deloitte's Stockford scrip back to about $1.6 million.

Stockford has been implementing a vigorous pilot exercise in cross-selling to promote financial planning to accounting/tax clients. One trial in early 2001 involved accounting firms Holmes & Partners, Gold Coast and Marsh & Partners, Brisbane; with the referrals going to Peter Smith Financial Planning, Brisbane. (Referring to the acquired firms; they are rapidly re-branding as one-firm "Stockford" members).

One influence on the program was a book called "New Sell" involving 'activity-based selling'. Each step in marketing and selling is laid out in terms of activity, and people involved get some fun injected by competitions and novelty prizes. The activities create the referrals, and accountability then passes to the planner to convert them.

Jim Phillipson has referred to the Brisbane program generating 2500 "activities" such as touch-points, phone-calls, mentions during tax work, e-mails etc. These created 158 qualified referrals, with a prospective $15 million to come under management. By late May 2001, $3 million had been placed under management.

“The accountant is the primary gateway to the relationship. But as soon as he/she identifies a client need, we wheel in the specialists such as planners, risk advisers, CGT, sales tax etc," he says.

Referrals run both ways, with the financial services people so far having referred 500 audits of self-managed funds to Stockford accountants.

Darren Riley of best-practice member firm Purkiss Partners, Gosford, has been organising client-base analysis and segmentation across the whole Stockford group of about 100,000 clients, to determine actual and prospective sources of revenue.

In a nutshell, Stockford in its client screening:

- Scores the value of the client now to Stockford
- Array of services toward the 'excellent' clients
- Provides products to lower-value clients
- Increases the average fee and percentage of cross-selling

Some products will be developed with banks, in a scheme matching banks' intellectual property with Stockford's client relationships. Stockford has entered strategic services alliances with Commonwealth Bank, NAB and St George, which have similar client bases and complementary products to Stockford among the SMEs. “The combination of their products and our advice at grass roots on their suitability for our clients will go well,” he says. “We have already licensed from banks their financial risk analysis systems. All firms should work together with banks to close the three sides of the triangle involving bank, accountant and client, which presently involves too many glitches.”

In late 2000, Phillipson told me the company had a strategy to actually run country branch banks, moving into premises banks may vacate in country towns or taking over their ad hoc operations run, for example, from country pharmacies. In Gippsland, Victoria, Stockford took over Westpac's Bank of Melbourne offices in the towns of Maffra, Yarram and Orbost. In Maffra, it converted a defunct supermarket to a branch. "Country towns can be built up again with one-stop financial services as their hubs," Phillipson said. One suspects that in the current depressed share climate, these bank plans have been put on the back burner.

(iii) Garrisons Accounting Group (GAG)

This group, formerly listed as David Garry Holdings, became controlled 46.5% in late 2000 by investment and annuity products manufacturer and distributor Challenger International. Its holding in late 2001 was watered sown to 38%. Challenger in November 2001had a market capitalization of about $800 million. Its core products are property-based annuities.

Managing director Bill Ireland told the Financial Review[31], "We started more as an institutional provider, but the business has changed now. Our strategy for growth going forward is largely with financial planners, brokers and accountants. It's a retail-based strategy." He added that the company would continue as manufacturer of products.

In November 1999 Challenger moved closer into grass-roots distribution by buying the Garrisons Financial Services group for $11.5 million cash. In February 2001, it bought through Garrisons Accounting Group three mid-sized accounting firms, Wearne & Co., Sydney; Duesburys, Canberra, and McLachlan Hodge Mitchell, Adelaide, with combined $15 million income. The price was 19.8 million GAG shares at 25c, $8.9 million cash, 7.9 million 'foundation' shares at 25c (a reward for the high risk), and 15.8 million partner-incentive and 4.3 million staff-incentive shares. In March, GAG bought a further two firms Alexander & Spence (Melbourne) and Calabro Partners (Brisbane), taking its gross accounting fees to $27 million. The two further acquisitions were for $8.66 million cash and 11.753 million Garrisons shares, issued at 33.5c (the shares at late October 2001 were under 20c).

"Financial planning and wealth creation products and services will be added to expand the revenue base of the firms being acquired and build funds under advice," GAG deputy chairman David Garry told the ASX on February 7.

Challenger's ambition for GAG at May 2001 was for 30 firms with $250 million accounting fees within 18 months, although the April 2001 in-house newsletter Nexia Link and partners involved put the target more modestly at $80-90 million within two to three years.

The Challenger/GAG model is unusual. The firms' goodwill has been bought but the partnership remains owned by the partners, who have committed to a ten-year practice management deal. This ensures operational independence of the firms, creating an even more decentralized structure than with Investor Group. As GAG executive Ian McLachlan, of the McLachlan Hodge firm in Adelaide put it, "We liked the chance to sell in and then enjoy complete autonomy in daily management under our own brand. All the three firms are top-tier for growth and profitability, so why should Garrisons interfere and risk damaging the goodwill they have bought?" Keith Wearne, chairman of Wearne & Co, said, "We would not have done the deal if it meant interference with our daily management."[32].

McLachlan Hodge Mitchell, Wearne and Duesburys had no financial planning base and had reluctantly been referring clients to third parties. Their aging client demographics and client succession issues was a further spur to towards planning work.

[31] 22 November, 2000.

[32] BRW February 23, 2001.

(iv) Harts Australasia

The Harts Australasia roll-up was an ignominious failure, ending with the company in liquidation in October 2001. It had announced a $93 million loss for 2000-01, almost equivalent to its inaugural market capitalization in early 2000 of $100 million. For a brief time in mid-2000 the $1 shares ran to $1.50, but a succession of catastrophes ensued, culminating in founder Steve Hart appearing in court in October 2001 charged personally with serious fraud against investors and the Commonwealth, pre-dating formation of Harts (Hart is vigorously defending the charges). A dozen small accounting firms in 2000/01 sold into Harts Australasia for Harts scrip at prices of $1 or so, in effect committing hara-kiri.

To the uninformed, the collapse of Harts appears as yet another nail in the coffin of the consolidator exercise. However, Harts was in fact an aberration founded (and foundered) on the unsophisticated style of Steve Hart, who dominated the company with his close-to-50% shareholding. In contrast, the three mainstream consolidators Investor, Stockford and Garrisons are run by conservative and capable leaders, many with Big Five backgrounds and long experience in corporate operations. The real mystery was not the failure of the Harts company in late 2001, but its ability to gain favorable recommendations from several leading broking houses in its first six months in 2000, notwithstanding some ominous disclosures even in the Harts prospectus.

3.3.5 Conclusions

The success of accounting-firm consolidators' strategy is far from assured; nor, at late 2001, could one dismiss them as failures. After all, a year or two of pioneering operations is not much of a fair trial.

The stockmarket has to date given the sector the thumbs-down. Stockford has halved its float price; Harts has been virtually wiped out; and Garrisons Accounting Group shares are below the 25c share price at which it bought its first three firms, and well down on the 33.5c shares issued to its second tranche of firms. We are talking thin and volatile trading here, but it is not a pretty picture. Investor Group touched almost $4 in early 2001 on the strength of the (planned, later aborted) PKF acquisition, and has subsided below $3, but the first firms bought by Investor with cheaply valued scrip (from 40c to $2.50) are not doing badly. It is important to note that Investor has been meeting its profit forecasts and indeed lifted dividends 33% in 2001, while continuing on a strong growth path of acquisitions.

In the US, CBIZ has been a disaster but with some indications of modest recovery, while small consolidator Gilman & Ciocia, having peaked at above $US20 in mid-1998, is back to sub-$US5 prices. British consolidator Tenon Group, which cranked up its pace of acquisitions from mid-2001, has been marked back to roughly its early 2000 float price. Its integration work has hardly started, while a new consolidator, Numerica, has floated in October 2001 on the strength of its top 20 accounting firm acquisition Level Gee.

The main issues are still open to debate, viz. strong corporate centres vs autonomous day-to-day operations; whether sale of local-firm ownership will demotivate the ex-owners; and whether accountants and financial planners will successfully cross-sell

their services in practice as opposed to theory. The players could be suffering teething troubles; or the model could be fundamentally flawed.

Scenarios must include the chance of a consolidator being bought holus-bolus by a major institution, and on the downside, the chance of morale losses and walkouts by ex-owners of firms holding severely devalued scrip. An alternative would be a management buy-back of a consolidator that cannot achieve a scrip price commensurate with the underlying operations.

The conclusions on the success of these models are, as you can see a real mixed bag.

Part 4 - Key Trends in the Australian Industry

Part 4 Key Trends in the Australian Industry

"We come from the land downunder…"
Men At Work

4.1 Introduction

In Australia, we see a very big crunch on the way for financial planning businesses. This dynamic industry is relatively new and there is currently no shortage of potential clients. As more Australians open up to financial planning, superannuation balances grow, and our complex tax and social security systems make legislative arbitrage a real value add. However, this so called "low hanging fruit" scenario will not last forever. Rather we see a trend towards dramatically increased competition due to the confluence of four interrelated trends:

- the death of the transactor
- the capitalised client value effect
- the bandwagon effect, and
- the industry maturation effect

And what does it mean to the Australian financial planning industry? Hypercompetition - competition in financial planning like you've never seen it before. Let's look at the effect of these trends to see why we have come to this conclusion.

4.2 The death of the transactor

The death of the transactor and the commoditisation of certain aspects of the planning process should not come as a surprise as most planners have gone beyond being transactors of business to providing more value-added services. The Internet has become today's transactor, providing low value financial planning services and transactions to clients. To compete in this market is nonsensical for the average planner unless they can attract huge volumes. Planners on the other hand must provide a much more sophisticated on-line service for the clients as a baseline expected service, especially given the recent development of reasonably sophisticated reporting and on-line financial planning services. Importantly the new adviser should carefully consider what the consumer thinks is a commodity (or "easy to do" transaction) and what aspects of the process represents a premium for which advisers can command high fees.

4.2.1 Other aspects of advice will be commoditised[33]

To provide advice more efficiently, the industry will embrace technology and automate where they can. They won't see any value in transactions and reporting – they may even let the clients do it (just as the banks do). They will look at all of the elements of the process to determine which ones are necessary and which ones can be

33 This argument that follows is largely the work of Tom Collins.

automated. Although many planners may say that the client really doesn't want to unbundle the growth, some direct placement services such as ComSec indicate that clients may already be doing this to a certain extent.

Following is a list of the elements in the financial planning process. Those that can be automated, centralised and/or outsourced, or in other words commoditised, have a line through them. (Risk profiling and strategy/modelling could also have been included). These have been defined as commodity elements. The remainder have been defined as value add elements.

- New client
    - Data collection
    - Needs analysis
    - Risk profiling
    - Strategy/modelling
- ~~Plan Preparation~~
    - ~~Asset Allocation~~
    - ~~Porfolio Construction~~
    - ~~Product Construction~~
- ~~Maintenance~~
    - ~~Transactions~~
    - ~~Consolidation of Information~~
    - ~~Reports~~
    - Reviews
- Management
    - Education
    - Coaching
    - Discipline

Many advisers spend most of their time on commodity elements. This is where they see their value. But is the role of the adviser as a clerk, counsellor, investment adviser, or as a financial planner? Can the adviser be all three. Possibly in the past, yes, but not in the future. The competition and the margin squeeze will not allow it.

The adviser that focuses on the commodity elements will be a mechanic, and their offering will be a commodity, with price the only differentiator. Those that focus on value add elements – understanding the client, turning information into insights and educating the client – will not be offering a commodity, and will be able to premium price.

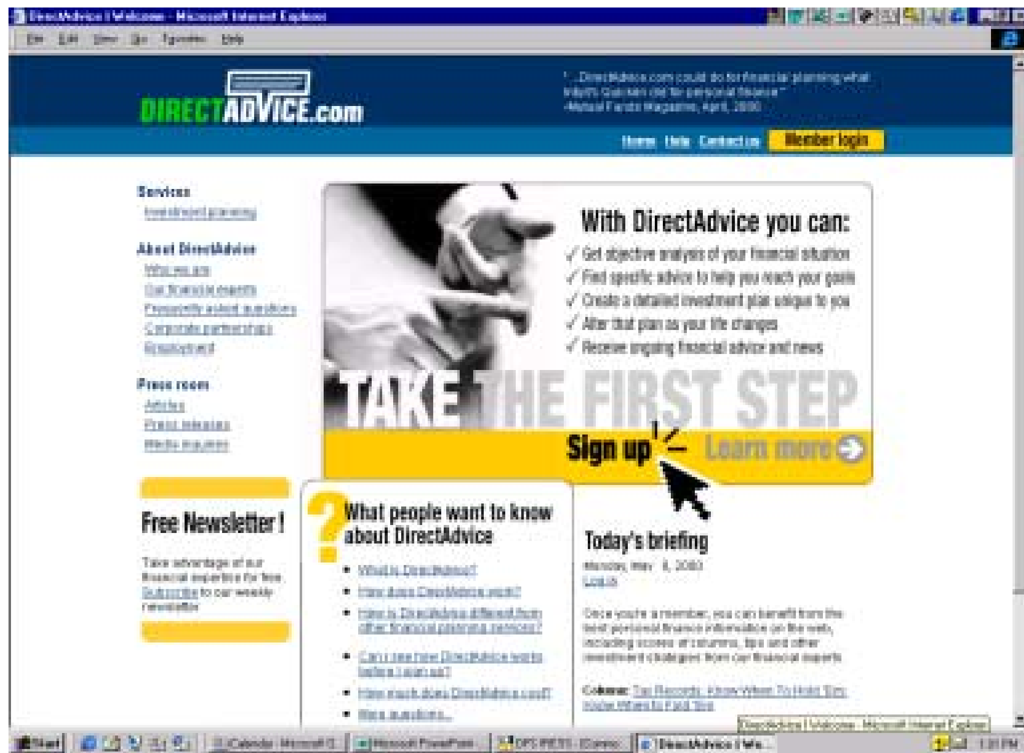
There will be advisers all along the commodity to value add continuum. No longer are advisers able to be all things to all people. They will have to decide where they want to be along the continuum and structure their business and offer accordingly.

4.2.2 The advent of on-line advice

At the recent Schwab Conference in Denver Brian Thomas had an interesting conversation with Frank Armstrong, a very experienced US planner. Although deeply involved in directadvice.com, an on-line advice business, he also has a powerful high net worth practice serving clients face to face. He uses the Internet to service the mass market but also as a tool to provide information to his key full service clients.

He sees no conflict in doing both, as the direct advice model provides a good basic service targeted at the people that cannot afford his professional fees.

Whilst a bit clunky and cumbersome to deal with, on-line advice illustrates that an adviser must offer more and more value, especially if basic plan construction gets commoditised. If other new computer technologies are anything to go by, it is very possible to imagine one of these services breaking through to provide a must have hook for the average consumer – if that happens it is crucial that the planner is easily able to adapt to, or include these services as a part of their offering.



4.2.3 In summary

Technology allows:

- prices to come down
- people to be aware of changes that affect them instantly
- the improvement of “old economy:” businesses, and
- automated supply processes
- easy information consolidation.

Technology does not allow:

- the anticipation of an individual’s needs or reaction to risk
- the easy recognition of trust or effort

- the interpretation of complex data that cannot be reduced to simple optimisation problems, and
- the consumer to feel important.

4.3 The capitalised client value effect

The concept of the capitalised client value effect was brought home to me by the address of Mark Hurley, of Undiscovered Managers at the Schwab Institutional conference[34]. "A publicly traded company will value a client at around 10-12 times the earnings before deductions (or EBIT) generated by the client whereas small planning firms may only be valued at 1-2 times earnings". This is driving two outcomes in the US and the Australian financial planning markets. The first is a scramble to list planning businesses and to "realise" this current market value. This trend was exacerbated by the high multiples that have been paid for master trusts and planning businesses over the past few years (see figure 8 in Part 3.3 for a summary of multiples paid).

For a planner this is a good thing in that, in relative terms, the business that they are in can be quite highly valued by the market. The consolidators have definitely got onto this trend but high valuations can only last if the long-term earnings expectations are met and the current euphoria for funds management/planning businesses continues. The recent change in market sentiment for consolidators/planners illustrates that these high valuations are not cast in stone. Naturally high valuations are good news for the planner ready to sell their business. Tony Thomas has given a good overview of consolidators and aggregators in Part 3.3.

More recently, the tide has turned somewhat. It is not only the consolidators that have experienced the change in recent market sentiment, but also the large corporates who have paid premium prices to acquire distribution. These groups have discovered that clients and/or their advisers are readily able to "shop elsewhere". Many of those responsible for such acquisitions usually relied upon the 1980's theory of vertical integration in owning every step of the financial planning process, to justify their prices paid. Unfortunately for some, the additional outlay required to retain the loyalty of the advisers and their clients has stripped away much of future financial benefits.

The reaction of the adviser in remaining fiercely independent has also had a negative effect on the acquirers marginal funds flow into their own branded products. When this independence is challenged by the new business owner seeking to bolster their funds flows, the adviser and their clients have been able to move to a new business structure elsewhere – despite the restraint of trade restrictions that exist. This is in an industry that makes it relatively simple to move between business owners. This portability is expected to increase, as the conflict between the client's needs, the adviser's needs and the shareholder's expectations clash. The "knock-on" effect will see many corporates amend their strategies away from acquisition of distribution where they have encountered difficulties corporatising the client relationship towards developing multiple systems and structures that build funds under administration/management without the need to purchase distribution. These changes may dramatically change the valuation dynamics for valuing independent planning businesses.

The second outcome is that larger firms are prepared to spend capital to acquire, build or retain client relationships and are competing head on with traditional planning practices creating a source of more competitive pressure. The best way to see this is to ask yourself

[34] Denver, September 2000.

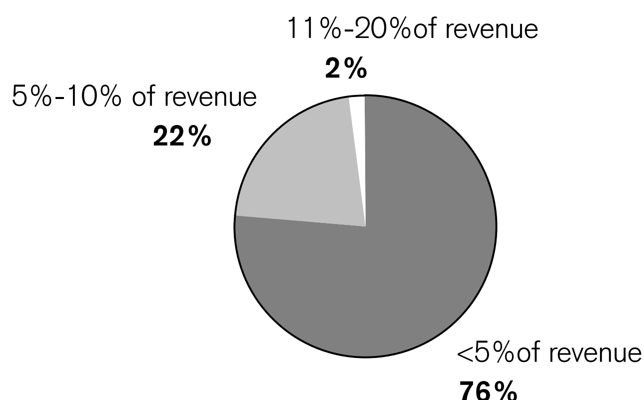
how much capital are you prepared to invest to acquire a new client and then ask a large, well capitalised corporate player the same question. This "deep pockets" argument will become more of an issue as aggressive players enter the market. Before looking in greater detail at what this means to planning businesses, it is useful to analyse current practices of marketng spend, new client acquisition and business planning from our survey[35].

4.3.1 Current advertising/marketing spend by advisers is minimal

Although our survey focused on marketing spend which can be classified different ways by different people it appears that there is little spent on marketing and probably in the current environment little need to change. As competition hots up many firms may have to revisit this. The survey found:

- Over three-quarters of the financial planners surveyed spend less than 5% of their gross revenue on advertising/marketing. A further 22% spend between 5%-10% of their gross revenue on advertising/marketing.
- 27% of financial planners believe they spend too little on their advertising/marketing while 65% believe that the amount they spend is 'about right'. Around 90% of the financial planners that stated they spend too much on advertising/marketing indicated that the amount they spend is less than 5% of their gross revenue. Younger respondents – presumably those in the process of building their business – spend the greatest proportion on marketing.

Figure 9. Advertising/marketing spend - % of gross revenue



4.3.2 Referrals are the predominant source of new clients

- Most of the financial planners surveyed are seeking new clients – either actively (35% of financial planners) or selectively (56%). Only 6% indicated that they are reducing the number of clients. (Some indicated more than one response).
- Findings do vary marginally by market segment of respondent. Consistent with earlier trends, the younger financial planners surveyed are most likely to be building their business, and therefore are more likely to be actively seeking clients, as is highlighted in figure 10.

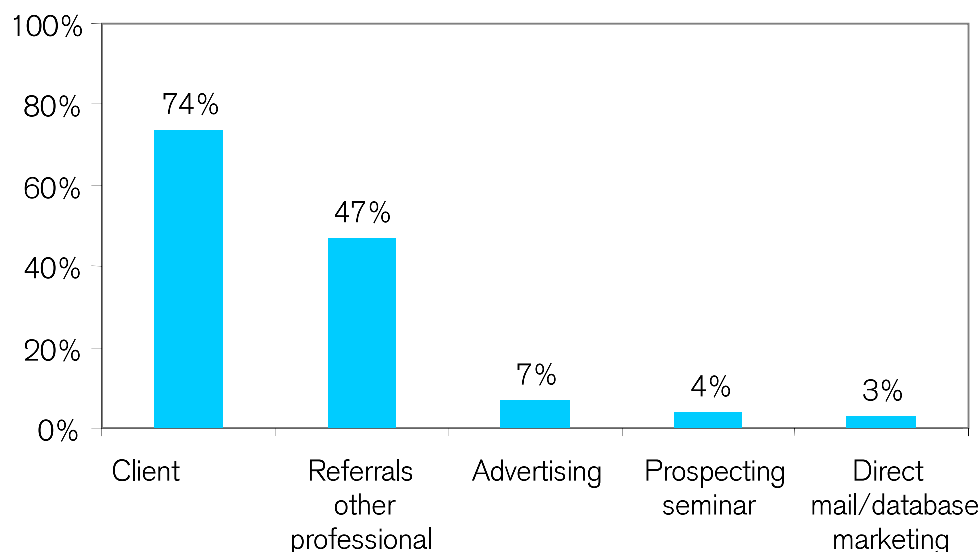
[35] Survey commissioned for this report by Ross Cameron.

- Those financial planners that are seeking new clients highlighted a very heavy reliance on obtaining referrals from clients (74%) or from other professionals (47%) as the major means of sourcing new clients.

Figure 10. Interest in attracting new clients

		CSAM Category			Age of respondent		
	Total %	Large %	Midsize %	Boutique %	<40 %	41-50 %	51+ %
Actively seeking new clients	35	38	65	22	50	36	22
Selectively seeking new clients	56	52	30	70	48	57	62
Not really seeking new clients	7	6	9	8	2	2	16
Reducing the number of clients	6	11	9	0	6	5	7

Figure 11. Means of attracting new clients



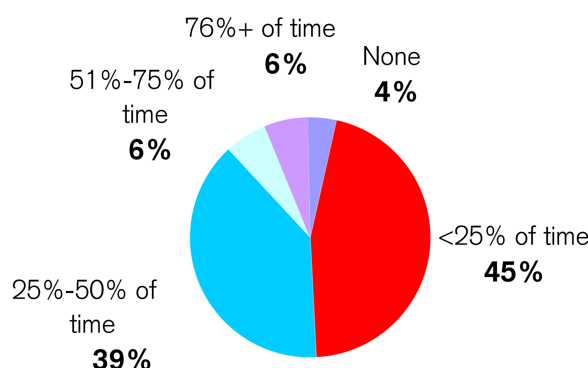
4.3.3 Is there a need for professional management?

- 12% of respondents indicated that they spend at least 50% of their time managing the business as compared to client work. Most planners (45%) spend between 1%-25% of their time managing the business, while a further 39% spend 25%-50% of their time managing the business.

- On average, planners surveyed indicated that they spend 29.3% of their time 'managing the business'. Behaviour does not differ discernibly by market segment of financial planner.

- This raises the question of whether numbers are appropriate. That is, should these planners be spending more time with clients or alternatively hiring more sales staff and focussing on business management.

Figure 12. Proportion of time spent managing the business



4.3.4 Are planners planning for themselves?

- 67% of financial planners indicated that they have a documented business plan. An additional 9% revealed that they are currently developing a business plan. Almost a quarter (24%) revealed that they do not have a business plan. The boutique planners surveyed are least likely to have/be developing a business plan: 29% of boutique planners do not have a business plan or do not have one in development, compared with 23% of midsize planners, or 19% of large planners.
- 49% of financial planners have what they would describe as a 'clearly defined succession plan'. 11% are currently developing a defined succession plan, while 40% do not have a clearly defined succession plan. Existence of a clearly defined succession plan is highly correlated with the number of full time employees of the business, as indicated in figure 13.

Figure 13. Existence of a clearly defined succession plan.

		Number of full time employees				
	Total %	**1-2 %**	**3-5 %**	**6-10 %**	**11-20 %**	**21+ %**
Yes	49	38	47	46	50	81
No	40	51	35	50	38	19
Currently being developed	11	11	18	4	13	0

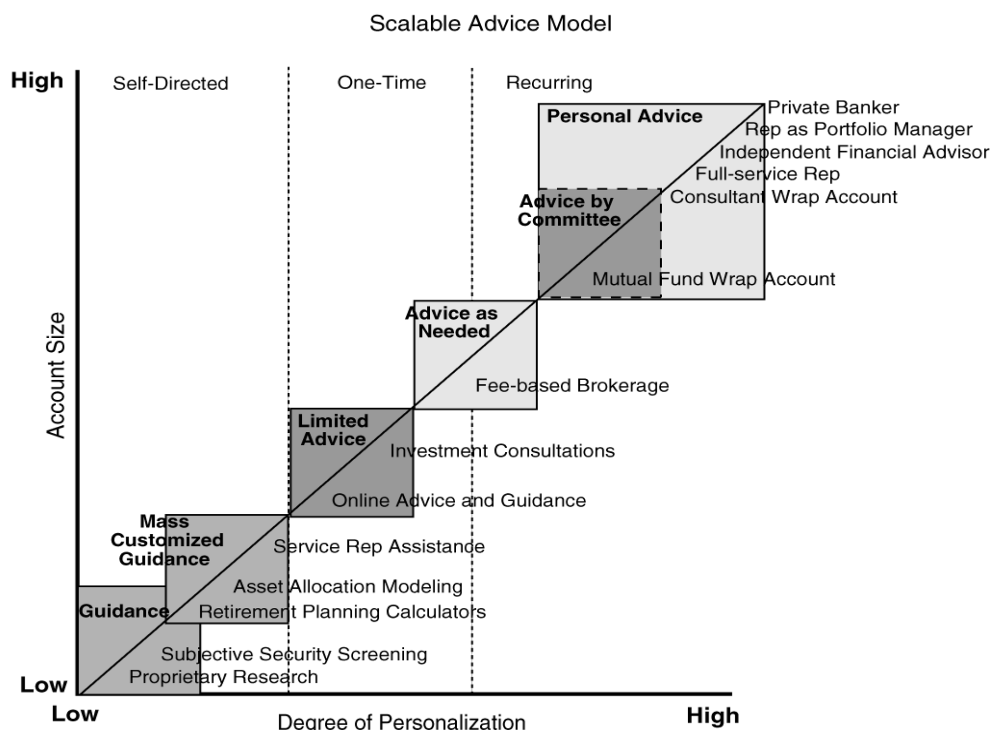
4.3.5 The institutions have deep pockets

Deena Katz of Evensky Katz and Brown in Miami USA see the deep marketing pockets of the large institutions as a potential threat – "they can afford to lose money just to get your clients" Deena commented to Brian Thomas recently when talking about a large institutional competitor that had set up close by and was offering free advice for 12 months to try to get clients to move to their new service.

4.3.6 The new competitor – scalable advice?

Scalable Advice[36] is a model that offers access to any level of advice (see figure 14). Clients can use any level of service or multiple levels of service simultaneously. This is from DIY to high-touch, human-based advice. It provides for the delivery of a full spectrum of information, guidance, advice levels, product and pricing options. Scalable Advice integrates technological and human financial service solutions.

Figure 14.



Source: Cerulli and Associates

In many ways National/MLC offer this sort of scalable advice in Australia through different sub brands (Your Prosperity, Plum, Godfrey Pembroke etc). Whilst smaller practices will be able to "plug into" this technology via the services of the platforms and large dealers, some large institutions will attempt to use such a model to build a brand that captures the client early and maintains the client for life.

Brian Thomas discussed this point at length with Harold Evensky who sees that the large brokerage firms must move aggressively into financial planning as they lose revenue on their transactional business

> "The big institutions, they've got it, they no longer see financial planning as a product delivery, they understand it is a process…. And they will be extraordinary competition……..they are hiring people like us …good people … with all the personal skills…..[37]"

[36] Cerulli & Associates.

[37] Discussion with Harold Evensky 2001.

4.4 The bandwagon effect

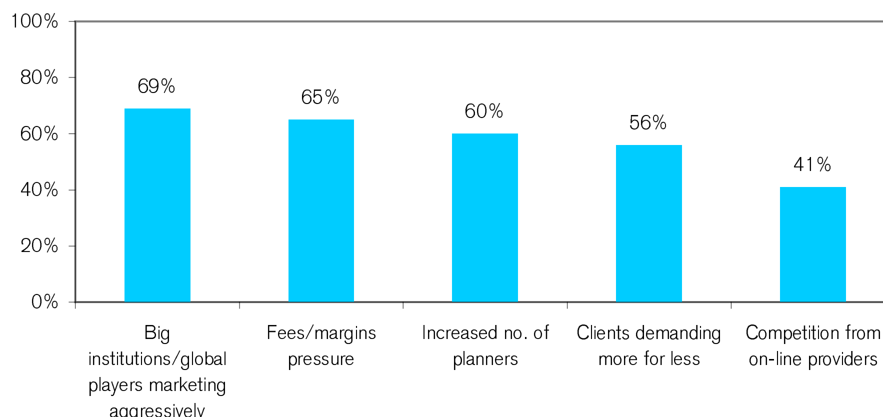
The bandwagon effect is really a case of supply and demand. As more and more accountants, super funds and others jump on the financial planning “bandwagon”, competition will increase. Total individual membership of the Financial Planning Association (FPA) has almost trebled since 1993 with now over 12,600 members, with the number of licensed dealers in the FPA doubling over the same period to 534 members. It makes one wonder when supply will exceed demand. Our survey supported the fact that advisers saw competition really hotting up.

4.4.1 Factors that will impact on increasing competition in the financial planning industry

As is illustrated in figure 15 below, financial planners believe that the big institutions/global players marketing more aggressively will be the major – but certainly not the only – factor that will increase the level of competition in the financial planning industry in the next five years. In fact, findings are probably most noteworthy for the extent to which financial planners believe that there will be multiple factors contributing to the expected increase in competition. Pressure on fees, the increased number of planners and increasing client expectations were also emphasised as significant factors that are expected to increase the level of competition.

Financial planners were also asked if there were any other factors that would contribute to the increased competition. As is clear from the verbatim comments that appear below, most financial planners referred to increasing pressure on the supply side (eg. entrance of accountants, banks etc) as well as greater client expectations/understanding.

Figure 15: Factors contributing to the increase in competition



4.4.2 Comments from the survey from planners regarding increased competition

“The clients are getting more sophisticated, they know they can shop around. And the large institutions are coming in.”

“Just the improved education of consumers and the increase in funds under management.”

“Less dealer principal firms and pressures on fees.”

"Industry super funds offering their own services."

"The banks and their relationships with clients."

"Greater client education - we will have to work harder as people are more educated these days and have a better idea of exactly what they want … They understand a lot more about the business than perhaps they used to – like they know what questions to ask to get what they want."

"The increased education of clients and the public."

"Because of Government legislation on choosing super funds."

"Accountancy practices focusing on our profession."

"Accountants doing more and more, and the demands from clients are choking up their time … The higher level of education of clients."

"The increased ability of the planners."

"Compliance issues will force a lot of smaller companies out – they will cause mergers."

"Other people entering the industry – like accountants."

"An increase in the number of people seeking financial advice and also increased client awareness of the industry."

"Banks getting in on the act – ready made client base that they have – it's easy for them to get lots of clients."

4.5 Industry maturation effect

How will this industry grow and mature? What will the business of financial planning look like in 2010?'

To answer these questions it is useful to look at other professional service industries that have matured under increasing corporate competitive pressure to give us some clues.

At the extreme level one could look at what the McDonalds franchise model has done to the previously uncompetitive world of the local take away hamburger store. Since we are in more of a face to face profession perhaps we could also look at how medical and other services will be delivered in the future. Will financial planners go the way of the local bank manager to be replaced by a more corporatised model with 24 hour Internet and telephone back up? Will the industry be dominated in 10 years time by five dominant competitors, who like McDonalds have built the sophisticated infrastructure to provide low cost effect solutions. One thing is clear from our survey is the perception that clients' needs will be more demanding – so with clients needs changing and an evolution in business models best practices today may not be the best practices of the future.

4.5.1 Range of services currently provided

The survey illustrates the point that not all financial planners are alike and while all naturally offer managed funds advice the range of services offered directly beyond that is reasonably diverse.

Figure 16. Services currently provided

	Provide internally %	Provide referral %	Don't provide/refer %
Managed funds investment advice	100	0	0
Life and income protection insurance sales	76	21	3
Taxation advice as it relates to investment strategy and products	72	21	7
Self managed superannuation services	63	24	13
Estate planning	53	40	7
Direct share investment advice	43	46	11
Taxation return service	23	49	28
Direct property advice	12	37	51

4.5.2 Current and expected future means of charging clients.

The vast majority (87%) of financial planners charge their clients on a 'percentage of funds invested' basis. Around a third charge clients a flat fee; while around a third charge an hourly fee. Of course, some planners use a range of means of charging clients.

Looking forward, planners expect a rather sharp fall in the proportion of clients that they will charge on a 'percentage of funds invested' basis, although this is still expected to be the most common means of charging clients in 5 years time.

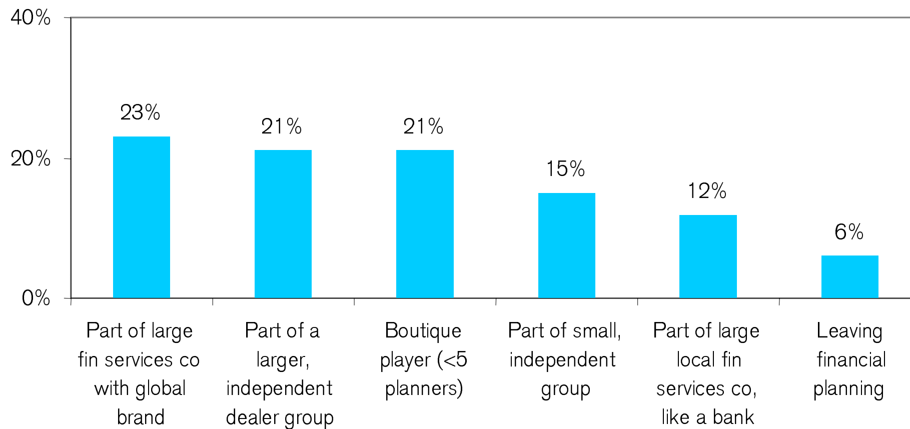
4.5.3 Means of charging clients.

Figure 17.

	Flat fee %	Hourly fee %	% of funds invested %	Other %
Current means of charging clients	34	29	87	2
Expected future means of charging clients	28	30	60	5

4.5.4 Expected business structure in five years time

Figure 18.



4.6 Conclusion

Putting it all together, what do these trends mean to planners and how they should respond in their business? All these trends add up to dramatically increased competition or hypercompetition and an increase in the threshold needed to survive. The death of the transactor means not only increased competition from on-line providers but also means, that increasingly advisers will have to add more value to the client experience. But this also increases the basic costs of providing first class service. The capitalised client value effect will bring in the big guns, eager to buy financial planning businesses and attempting to cement a long term relationship between the client and their brand, rather than the client and the individual planner. You can either join these corporates or take them on, competing in your own strong niche market. The bandwagon effect tips the demand/supply equation more in favour of excess supply for planning services, thus further forcing planners to offer a better form of added value than their competitors or to develop strong niche marketing techniques.

The industry maturation effect may favour a new form of planning delivery where dominant players will receive the greater market share.

In any case it is essential that all players in the industry review their current strategy to see if they will survive in 2010.

Part 5 - Strategies for Success

Part 5 Strategies for Success

"It's a long way to the top…."

AC DC

5.1 How to build a successful strategy

This is a difficult question to answer as there are a myriad of financial planning business models in the market (figure 2 in Part 1illustrates this) so a simplistic answer does not work here. We can however, identify some elements that are essential in building a business that will survive the hypercompetition threat and thrive into the future:

Read and think about the issues that affect the industry - This paper is a good start but you should constantly look at developments that occur both locally and overseas

Set your goals and preferred business model for the next five and ten years - Part 3.2 gives a good context of where you may want to take your business. The comments throughout the paper, especially in Part 4.2.1 about which parts of the business will be commoditised in the future are important, as there will be little margin in the commoditised parts of the process.

Don't be afraid to change - All of the ultra successful businesses interviewed for this paper invariably reached a point where they radically changed their business model to great effect. Sometimes a business coach can help with the discipline of doing this.

Ask your clients what their real relationship and service needs are - Part 5.3 is useful here in that it illustrates that many planners focus too much on the relationship and sales process rather than building an effective, growing business.

Control your pricing – You can only build a successful long term business if you are in control of your pricing policy. **Anaylse how Hypercompetition will affect your business** - Test your current business model and client service delivery mechanisms against the future world depicted in this paper.

Clearly define your value add or your unique selling proposition that will also be relevant in the future - Businesses that have a definable, demonstrable and clear value add that the target consumer can relate to will succeed.

Corporatise parts or all of your business - Clients should be buying your firm, not necessarily you. Focus on the increased returns available to firms that employ good professional staff (see Part 3.2)

Be passionate about client service – remember you can control your client's service experience but you cannot control market returns - all successful planning businesses adopt this mantra. Underpromise and over deliver on service

Strive to continuously improve -This is vital in such a dynamically growing and increasingly competitive environment

Work to live, don't live to work – Enjoy your business and your lifestyle

5.2 Strategies for success

Every business will develop a different path to success, however, it is useful to outline some of the typical strategies that we will see in this hypercompetitive environment. We have identified 8 strategies for success.

The "Do Nothing" Strategy for planners about to retire and sell their business or those with an effective business plan.

The Niche Strategy. In times of intense competition both large, scale players and smaller niche players tend to be successful in any industry. And by niche we don't just mean a general approach to attracting say "high net worth" clients. A niche must be definable both in terms of the market and also in terms of the unique set of services that are offered to that market to give the business a unique selling proposition for that market.

The Holistic Practice Strategy. This is the model that many successful independent practices tend to adopt. The concept is to offer either directly or by closely monitored referral a very wide range of services to ensure that every client pays a high average fee. The focus is on superb client service and a deep understanding of the client's personal, family and business needs.

The Get with the Strength Strategy. Realising that competition will hot up this strategy is where an individual simply aligns themselves with a dealer business that is thought to have the capital backing and flexibility to be a dominant future player.

The Co-operative Strategy involves developing a loose affiliation of liked minded dealer businesses with a view to provide greater strategic thrust, buying power and idea sharing.

The Dominator Strategy. Firms with enough capital can buy in the technology and systems necessary to build a large practice and develop a financial planning brand.

The Monetise and Grow Strategy where the principals sell their equity into a larger player with capital and use the funds to grow the business under some equity or profit sharing.

The Predator Strategy involves buying up weaker practices (which may include tax and accounting practices) at good prices and leveraging your business model.

All of these strategies can be successful in the future provided they are superbly executed and mindful of the dynamic competitive and consumer environment.

But even so, it is clear that low quality generalists will falter as we move to 2010.

5.3 My clients love me

"All you need is love"

Beatles

5.3.1 The Client Relationship[38]

The last ten years of demand exceeding supply have done little to build sustainable service based firms providing gilt-edged advice to a growing number of clients. The life agents, accountants, stockbrokers and early financial planners have had a successful ten years struggling to keep up with demand. The better ones have been solving client problems, but most have been selling products. Many have the belief that they do not have to worry too much about competition as they have a very special relationship with their clients

'Product' income and performance rather than 'service' income and performance often drive the distribution models that have been built. This therefore has aligned adviser behaviour with rewards for 'product' sales or 'product placements'. The solving of clients' financial problems with products is similar to a national health system which throws medicines at patients without stopping to listen to their needs and fears.

The proliferation over the last ten years has been of 'cottage-based' firms who are dependent on a small number of talented individuals whose own success lies more in their sales-ability and relationship skills (hence the title "My clients love me") than their profitable business processes. A similarity could be seen between the computer industry of the late 1970s where, supposedly, the better programmers operated out of converted garages. Whilst a few of those 'programmers' have now become part of the world's richest, on reflection, their efforts of late 1970s were only the start. The financial services industry is currently positioned at a similar starting point to the computer industry of the late 1970s with similar phenomenal growth expected over the forthcoming decades.

The biggest impediment to growing profitable and sustainable financial services distribution models is the success advisory firms and advisory channels have experienced over the last ten years. These successes have reinforced the non-sustainable distribution model characterised by top-heavy adviser-dependency, product-based payment processes, and a constant drive to increase the number of clients serviced rather than increase the quality of client services. These paradigms are being challenged by minorities who will by their performance, take the industry out of infancy towards adolescence that is more service based and remunerated than current product focus.

The performance and workings of 'boutique' financial services are being studied ferociously. Most dealer groups and fund managers construct branded administration services and technology platforms to ensure both their 'poorest' and 'best' performing representative/proper authority holder will straddle the short-term (but continual) hurdles of compliance, accreditation and performance.

38 This section is largely the contribution of Jim Stackpool.

Most dealer groups and fund managers are realising the scale necessary to earn the 'ticket to the game' of future financial services success. This is against a backdrop of lower current product margins. The required IT spend alone will force many dealerships to amalgamate or disappear within the next five years. Dealer groups must be querying when they will start to make the profits for all their hard work. Getting good profits from running a dealer group continues to be a hard job.

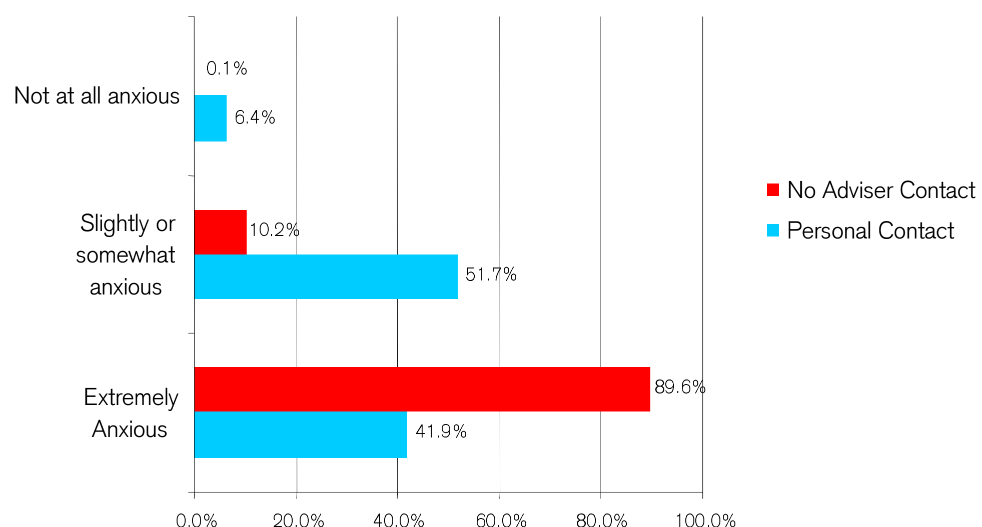
Whilst the inevitable 'McDonald-ising' analogies of building the ultimate franchise model for the provision of financial services will be considered, we have seen little evidence to show that intensively service-based relationships can be effectively franchised. This will, of course, not always be the case.

5.3.2 Case Study: "What is Relationship?"

Most advisers believe that their relationship with the client is at a level where they have full permission to advise on the client's financial affairs. However, when speaking to the clients, many of them have a differing interpretation of this relationship, as seen in this recent example:

Merrill Lynch Investment Management recently commissioned a survey to determine how many clients had been contacted by their primary financial adviser during the two weeks following the September 11 terrorist attacks on America. This personal contact was defined as either a phone call or face-to-face meeting as opposed to email or a message on an answering machine. The results showed that one in five advisers (18.3%) had contacted their clients within this time frame, with almost all of the areas of discussion (93.5%) revolving around how the client was doing emotionally, rather than their investments. These statistics are not dissimilar following the October 1997 stock market correction, when one in five financial advisers failed to serve their clients, and missed a huge marketing opportunity.

Figure 19.



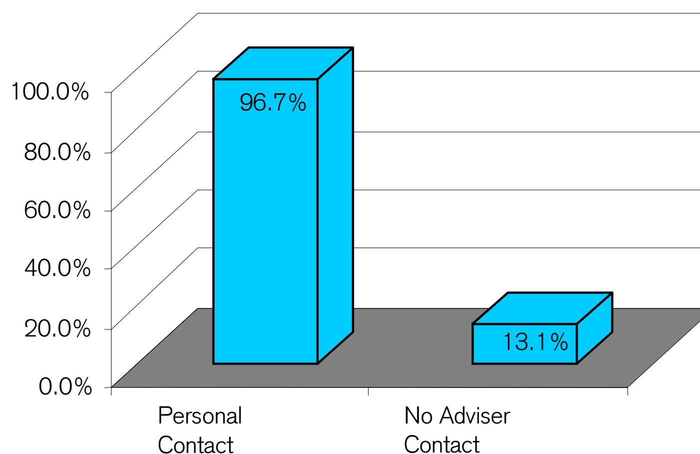
Source: Merrill Lynch Investment Managers

As illustrated in Figure 13, almost all investors were somewhat anxious following the terrorist attacks, with significantly higher anxiety amongst those investors who were not contacted by their adviser. For those clients not contacted by their adviser, many

of them sought advice from family or friends or the media – with less that 1% relying upon the adviser's web site for information.

So how did this event effect the relationship between the adviser and their client? As illustrated in Figure 14, those investors who were contacted by their adviser had a higher opinion of their adviser's professionalism and felt that they genuinely cared about their financial circumstances. The overall response was a strong endorsement that the adviser was able to add on-going value to the client.

Figure 20. Highly Satisfied with Primary Investment Adviser



Source: Merrill Lynch Investment Managers

The final outcome from this survey indicated that the client was almost certain to follow the advice from their financial advisers if they contacted them. In excess of 74.2% of clients who were contacted by their adviser would be prepared to move all assets to their adviser. A substantial number of investors (25.0%) who were not contacted indicated that they were going to look for a new primary adviser. This personal contact also had a huge impact upon the willingness of the client to make referrals to their adviser, with over 72.0% of investors who had received personal contact prepared to refer their family and friends.

When advisers were asked why they failed to capitalise on this opportunity to make contact with their client, most of them (75.9%) replied that they were busy "putting out fires" or "evaluating the market" (61.7%) – an interesting outcome when most professional investors openly acknowledge they do not fully understanding the market.

It is worth considering the implications following the events of September 11, and the impact that they will have upon both the financial adviser's and client's definition of relationship. As expressed earlier within this paper, how many Qantas frequent flyers would choose to retain their primary relationship with Qantas if an alternative airline offered similar benefits and cheaper fares? Is your relationship as 'water-tight' as you think, and can it be easily replaced by some of the alternatives that are available?

5.4 We touch, we tech, we dominate – The new competitor

"Touch me babe, can't you see that I am not afraid…"
The Doors

5.4.1 Platform Plus – The new competitor

The debate may rage on issues such as fragmentation of advisers versus consolidation, cottage versus corporate, and the question of the number of still standing platforms in a few years. Meanwhile, the margins and growth in this industry will attract a number of new players. John Symonds at Aussie Home Loans, brought about a revolution in home lending by using securitisation to such great effect. Similarly, a radical new provider will see through the maze and build a new client centred offer by attacking the current margins and using client centric technology as their chief weapon. This is not an argument in favour of the big institutions. In general they tend to follow current paradigms to extract the market margin out of the various businesses they are in.

A non-traditional player or new entrant will become the innovator, realising it is possible to give the client face to face support and also 24 hour call centre, Internet, SMS and WAP support in an efficient way. Assisting this trend will be the fact that some planning businesses are based on a flawed premise, promising return outcomes that may never be met.

The new Platform Plus provider will go through a long term needs based plan with on-line reporting on progress versus goals, taking into account long term assumptions about returns, inflation and tax. Up to date Monto Carlo simulations will carefully monitor the chances of meeting key goals and constantly search for a more technically efficient portfolio over time, taking tax and transaction costs into account. Clients will be able to access the service at multiple levels, thus moving easily from a full advisory model to doing some transactions on a DIY, self serve basis.

Part 6 - Appendix

Part 6 Appendix[39]

6.1 Top Dealer Groups by Revenue & Funds Under Advice per Planner

Rank	Company	No. of FP's 2001	Gross Revenue $m	Gr Rev $ by planner	FUA $m	FUA $m by planner
1	ipac securities limited	36	55.0	1,527,778	5,746	160
2	Perpetual Private Clients	29	24.0	827,586	1,663	57
3	Undisclosed	28	10.0	0.4	1,500	53.6
4	Tynan Mackenzie	20	11.0	550,000	1,000	50
5	Mercer Financial Planning	49	19.2	391,000	2,200	45
6	Godfrey Pembroke Financial Consultants	187	43.0	229,947	7,500	40
7	RetireInvest Pty Limited	249	66.3	266,454	9,547	38
8	JPMorgan	12	5.0	416,667	400	33
9	State Super Financial Services Limited	102	46.8	459,216	3,393	33
10	Stockford Financial Services Pty Ltd	70	10.5	150,000	2,200	31
11	Investor Security Group	15	6.0	400,000	444	30
12	Bodinnars Personal Financial Planners	17	3.2	188,235	500	29
13	National Australia Financial Planning	358	70.0	195,531	10,000	28
14	Hillross Financial Services Limited	196	36.8	187,658	5,000	26
15	Garrisons	106	37.2	350,749	2,500	24
16	FYG Planners Pty Ltd	20	5.0	250,000	460	23
17	Ozplan Financial Services	18	3.0	166,667	410	23
18	Apogee Financial Planning	262	48.0	183,206	5,500	21
19	Monitor Money Corporation Pty Limited	28	6.0	214,286	576	21
20	Associated Planners Financial Services Limited	173	43.0	248,555	3,500	20
21	Premium Accounting Group	50	2.5	50,000	940	19
22	Avenue Capital Management Limited	36	2.3	64,583	650	18
23	Western Pacific Portfolio Planning Pty Ltd	35	5.2	148,571	550	16
24	Benwest Investment Services Pty Ltd	17	1.1	64,706	250	15
25	Matrix Planning Solutions Pty Ltd	56	12.0	214,286	800	14
26	Westpac Financial Planning & Advice	703	135.0	192,034	9,500	14
27	Australian Financial Services	103	20.0	194,175	1,340	13
28	Hartley Poynton	214	74.6	348,598	2,455	11
29	Australian Central Credit Union Limited	29	1.5	51,724	310	11
30	Integrity Financial Planners Pty Ltd	15	1.1	73,333	130	9
31	FuturePlus Financial Services Pty. Ltd.	14	0.9	60,714	118	8
32	Partnership Planning Limited	104	10.9	104,375	800	8
33	Total Financial Solutions Australia Pty Ltd	30	1.4	46,667	220	7
34	IFA SECURITIES	30	2.8	91,667	205	7
35	MLC Private Client Service	43	6.4	149,140	229	5
36	Count Wealth Accountants	1006	37.0	36,823	5,000	5
37	PROTAX Pty Ltd	89	4.0	45,079	412	5
38	Professional Investment Services	1109	45.7	41,208	4,200	4
39	Lifespan Financial Planning Pty Ltd	201	6.4	31,841	750	4
40	NOW Securities Pty Ltd	64	1.0	15,625	160	3
	TOTAL	**5,923**	**920.8**	**9,228,682**	**93,058**	**980**
	Average		$155,454		15.7	

39 Thanks to Tom Collins and Rainmaker for allowing us to reproduce a summary of this survey.

6.2 Top Dealer Groups by Number of Planners

Rank	Company	No. of FP's 2001	Gross Revenue $m	Gr Rev $ by planner	Rank by Gr Rev $ per planner	FUA $m	FUA $m by planner	Rank by FUA $m by planner
1	Professional Investment Services	1109	45.7	41,208	42	4,200	4	52
2	Count Wealth Accountants	1006	37.0	36,823	43	5,000	5	50
3	Westpac Financial Planning & Advice	703	135.0	192,034	18	9,500	14	38
4	Garvan Financial Planning	432	63.9	147,917	27	na	na	na
5	National Australia Financial Planning	358	70.0	195,531	16	10,000	28	21
6	Apogee Financial Planning	262	48.0	183,206	21	5,500	21	26
7	RetireInvest Pty Limited	249	66.3	266,454	10	9,547	38	11
8	MLC Financial Planning	233	35.1	150,644	23	na	na	na
9	SECURITOR	232	29.0	125,000	30	na	na	na
10	PACT	230	7.2	31,130	45	na	na	na
11	Hartley Poynton	214	74.6	348,598	9	2,455	11	40
12	Lifespan Financial Planning Pty Ltd	201	6.4	31,841	44	750	4	53
13	Hillross Financial Services Limited	196	36.8	187,658	20	5,000	26	22
14	Godfrey Pembroke Financial Consultants	187	43.0	229,947	13	7,500	40	9
15	Associated Planners Financial Services Limited	173	43.0	248,555	12	3,500	20	28
16	Lynx Financial Services Pty Ltd	170	3.9	23,224	46	na	na	na
17	St.George Bank Limited	153	na	na	na	1,630	11	42
18	Lonsdale Financial Group Limited	122	na	na	na	4,000	33	15
19	Garrisons	106	37.2	350,749	8	2,500	24	23
20	Partnership Planning Limited	104	10.9	104,375	31	800	8	46
21	Australian Financial Services	103	20.0	194,175	17	1,340	13	39
22	State Super Financial Services Limited	102	46.8	459,216	4	3,393	33	14
23	Winchcombe Carson Financial Planning Pty Ltd	102	na	na	na	1,800	18	32
24	Bridges Financial Services Pty Ltd	96	na	na	na	4,700	49	7
25	PROTAX Pty Ltd	89	4.0	45,079	40	412	5	51
26	Bongiorno Financial Advisers Pty Ltd	72	na	na	na	1,100	15	35
27	Stockford Financial Services Pty Ltd	70	10.5	150,000	24	2,200	31	16
28	NOW Securities Pty Ltd	64	1.0	15,625	47	160	3	56
29	Matrix Planning Solutions Pty Ltd	56	12.0	214,286	14	800	14	37
30	Premium Accounting Group	50	2.5	50,000	38	940	19	30
31	Mercer Financial Planning	49	19.2	391,000	7	2,200	45	8
32	Aon Financial Planning & Protection	48	na	na	na	150	3	55
33	AustAccount Securities Pty Ltd	48	0.4	8,125	48	na	na	na
34	Grosvenor Securities	45	6.0	133,333	29	na	na	na
35	MLC Private Client Service	43	6.4	149,140	25	229	5	49
36	Macquarie Strategic Financial Planning	42	na	na	na	1,500	36	12
37	Avenue Capital Management Limited	36	2.3	64,583	35	650	18	31
38	ipac securities limited	36	55.0	1,527,778	1	5,746	160	1
39	Western Pacific Portfolio Planning Pty Ltd	35	5.2	148,571	26	550	16	34
40	Glenhurst Corporation Pty Ltd	34	1.5	44,118	41	na	na	na
41	Chifley Financial Services Limited	31	na	na	na	248	8	45
42	IFA SECURITIES	30	2.8	91,667	32	205	7	48
43	Total Financial Solutions Australia Pty Ltd	30	1.4	46,667	39	220	7	47
44	Australian Central Credit Union Limited	29	1.5	51,724	37	310	11	41
45	Perpetual Private Clients	29	24.0	827,586	2	1,663	57	4
46	Monitor Money Corporation Pty Limited	28	6.0	214,286	14	576	21	27
47	Undisclosed	28	10.0	0.4	49	1,500	53.6	5

48	Wilson HTM Investment Group	27	na	na	na	445	16	33
49	Managed Investment Services Ltd	24	na	na	na	750	31	17
50	AW Financial	22	3.1	140,909	28	na	na	na
51	Whittaker Macnaught Pty Ltd	22	na	na	na	870	40	10
52	Madison Financial Group	21	na	na	na	600	29	20
53	Bendigo Investment Services Limited	20	na	na	na	400	20	29
54	FYG Planners Pty Ltd	20	5.0	250,000	11	460	23	24
55	The Salisbury Group	20	na	na	na	70	4	54
56	Tynan Mackenzie	20	11.0	550,000	3	1,000	50	6
57	Ozplan Financial Services	18	3.0	166,667	22	410	23	25
58	Benwest Investment Services Pty Ltd	17	1.1	64,706	34	250	15	36
59	Bodinnars Personal Financial Planners	17	3.2	188,235	19	500	29	19
60	Integrity Financial Planners Pty Ltd	15	1.1	73,333	33	130	9	43
61	Investor Security Group	15	6.0	400,000	6	444	30	18
62	FuturePlus Financial Services Pty. Ltd.	14	0.9	60,714	36	118	8	44
63	JPMorgan	12	5.0	416,667	5	400	33	13
64	Wilson Dilworth Limited	12	na	na	na	1,000	83	2
65	Gannon Growden Schonell Pty Ltd	11	na	na	na	750	68	3