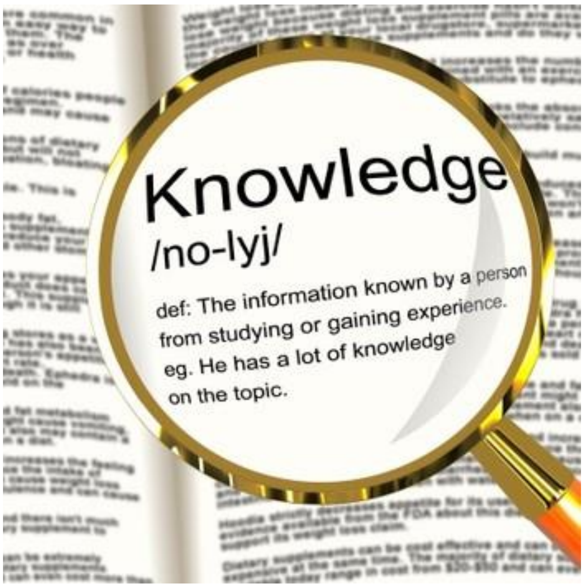
DOES THE INDUSTRY KNOW WHAT IT KNOWS?

As a frequent traveller across the Tasman, I have the luxury of comparing and contrasting the evolution of both the Australian and New Zealand financial services industries. On a recent trip to Sydney I was fortunate to attend a conference comprising the leading minds in Australia's financial services industry – all of whom willingly shared their secrets of success. Like many of the delegates I was in awe of those funds managers who shared their insights into the direction of the world's financial markets, and how they intended to capitalise on the various fluctuations ahead. During the less formal conference moments, I learnt more about the capabilities of these funds managers, their measures of success, and some of their product innovations on the near horizon.



I also heard a number of high profile Australian financial advisors who had embraced the *Gerber Principle* of "working on their business rather than working in their business", with delegates learning about the necessary steps in transitioning their financial planning proprietorships into financial planning businesses. All of the advisory speakers agreed that delegates must convert their businesses, keeping in mind the ultimate purchaser when it comes time to sell. The content of the conference is a lifesaver for the New Zealand industry which is arguably a decade behind the evolution of Australia's financial planning industry. Although, more about that later.

Upon reflecting on the conference, there were a number of items that jumped out me. Firstly – none of the presenters (whether funds managers or advisers) had made any reference to the expectations of the investor…. you know: the client. One financial adviser came perilously close to discussing their clients when noting that their financial planning business was coming up to their annual culling of non-suitable clients (i.e.: those who are unable or unwilling to pay appropriately for their services). Aside from that moment, all of the presenters talked about the business of providing intermediation and how they maximised their profits from these activities. I couldn't help wondering how a client would feel upon being advised that they were no longer suitable for their "trusted advisor", and learning that their relationship had been sold to another financial advisory entity. I likened this experience to learning that your doctor no longer saw relevance with your relationship, and had sold your files to another more compatible medical professional. Whilst this occurs, it doesn't make you feel overly excited as the recipient of such news, and can be a catalyst for investigating alternative solutions.

I was curious about the constant references throughout the conference as to how platforms made the role of the industry more efficient and profitable, and wondered what additional benefits the client was really receiving from this. Whilst the concept of consolidated reporting is no doubt appealing (after all – who really wants to manage a box full of financial statements each year), I wondered how often the client would use this service, and whether they really had an appreciation for the cost savings that it delivered to the industry.

The final element that I pondered on was in relation to the products that the financial services community continues to roll out for the clients. Over the years I've attend many industry events that recognise the achievements of the product manufacturers – primarily for their investment performance and the assets that they have managed to gather. I likened the experience of investing into industry products, to the purchasing of a new car. For those who have recently purchased a car, I wondered how many took any real interest in how the engine worked (aside from us blokes who have a brief testosterone moment), and ultimately brought that car because of the enhanced utility that the colour, style, seats etc was going to deliver. If we apply this analogy to the development of financial services products, I wonder whether the client really cares about how the product works (i.e.: its performance relative to a benchmark, the portfolio construction process, what the big themes are) compared to being mostly interested in what the product will do for them. I'm always fascinated by where the inspiration comes from for product developers, and how much effort is put into understanding the expectations of the client.

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So what does all this mean? In recent years, the Australian financial services industry has reached a unique impasse where many industry participants are rightly concerned about their future asset gathering strategies. Many are looking at the explosive growth of the self-managed superfund community, and attempting to communicate using outdated intermediation philosophies and products. The SMSF statistics and surveys that signal the growth of this market, reflects a conscious vote against the financial services industry, with the majority of investments being self-managed or direct. Whilst some financial advisors are enjoying marginal success, no one has captured significant SMSF market share, with the industry competing against resentment, ageing demographics, and the resulting risk aversion of investors. In other words – the SMSF horse has well and truly bolted.

On its current course, I suspect that the Australian financial services manufacturers will continue to consolidate, with the larger institutional investors offering a high beta, commoditised solution that is only differentiated by brand and price. Any unique talents or capabilities within the industry will continue to expand the growth of boutique managers – albeit that many of them will face asset gathering challenges despite their real or past performance.

In this lower return environment, consumers will increasingly question the value proposition of intermediation, delivering increased margin pressures for platforms and consolidated reporting schemes. Financial advisors will continue to feel the sharp end of Regulatory and media confrontations, with consumers (rightly or wrongly) feeling increasingly empowered to manage their own financial affairs.

In Australia, the current model of manufacturing and dispensing financial intermediation is broken, with many industry participants unable to recognise and respond to the writing on the wall. As consumers increase their pursuit of value (in a price sense, not an investment style sense), they will increasingly unbundle the intermediated model. For those who are keen to make an ongoing living from the financial services industry, it would be wise to recognise that they are in the relationship service industry. This may mean that there is a considerable premium to be charged for relationship albeit that advisors will be unlikely to sell these when they decide to retire from the industry.

So what are the lessons that can be learnt by the New Zealand financial services industry? Well, the obvious one is to have a clear value proposition that enables each member of the value chain to charge (and justify) a premium being charged against their services. Due to the absence of any real tax or superannuation complexity, this limits many advice dispensers to portfolio construction and investment planning. For some, the ideological belief that markets are efficient, and therefore a passive approach to investing is appropriate – they may struggle to justify their presence in the near term (especially as volatility in markets is predicted to increase).

As the New Zealand financial services industry matures, elements will become increasingly more commoditised (ie: differentiated by price and / or brand), meaning that industry participants will need to differentiate themselves through a clear promotion of their comparative advantages. Specifically at the advisor level, I'm not yet convinced that the majority of financial advisors really have a business to sell (as distinct from a book of business), nor that there is a queue of willing-and-able buyers waiting to relieve them of their businesses. As many in the New Zealand advisory community near retirement age, I wonder whether their most appropriate exit from the industry is to simply close their doors and encourage their clients to seek alternative advice or fend for themselves.