

PART I

Business Strategy and Planning

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CHAPTER 1

A Look at the Landscape

To say the last decade was tumultuous is to understate the painful technology bust at the beginning of the twenty-first century, the subsequent housing boom, and the subprime crisis, which spurred one of the worst recessionary environments since the Great Depression.

Where We Stand Today

Today, markets around the world are far more interdependent and interlinked than they were in the past. Financial strains span the globe, keeping markets locked in a state of unprecedented volatility. And advisors have to struggle to drive growth and profitability, while serving clients well and building long-term value.

One of the nonfinancial by-products of this tumultuous time is a sharp decline in the trusted part of the trusted advisor relationship. In the wake of the financial crisis, consumers struggle to discern the difference between the next Bernie Madoff and an advisor with the best of intentions.

While banks and wirehouse brokerages still significantly outpace independent advisors in assets and number of advisors, there has been a steady migration of captive advisors to independent status. There are two key reasons for this transition to the independent channel. The first, less publicized driver is that brokerage firms are pushing lower-performing advisors out of the system. The second, widely known reason for the transition is that advisors are looking for freedom from proprietary products, so they can act in what they feel is the best interest of their clients, build their own businesses with distinct brands, and, ultimately, realize business value—not for some large Wall Street enterprise, but for themselves.

In the process, advisors face mounting challenges. The cost of doing business continues to rise, driven largely by increases in labor and health care costs and

the ever more demanding and complex requirements of regulatory compliance. Moreover, the days are gone when advisors could simply service clients well and wait for the phone to ring. The next generation of growth will not be driven so easily by the same happy trifecta as the last. Advisors can no longer rely solely on passive growth to fuel their future growth; they now recognize the need to warm up and exercise their atrophied marketing muscles.

Consumers, too, have been unintended passengers on this roller-coaster ride. Baby Boomers are hitting key transitions in their working lives, with the first Boomers having turned 65 in 2011. An estimated 76 million Baby Boomers need to plan for critical turning points that lie ahead. With the decline starting in 2007 of their home and 401(k) values, many Boomers' needs—and the resulting demand—for financial advice is likely to rise as quickly as the numbers applying for Social Security.

No one knows exactly what the future holds; however, many lessons have emerged from the recent past. Chief among them is that managing investments and clients is only a part of what advisors need to do to be successful.

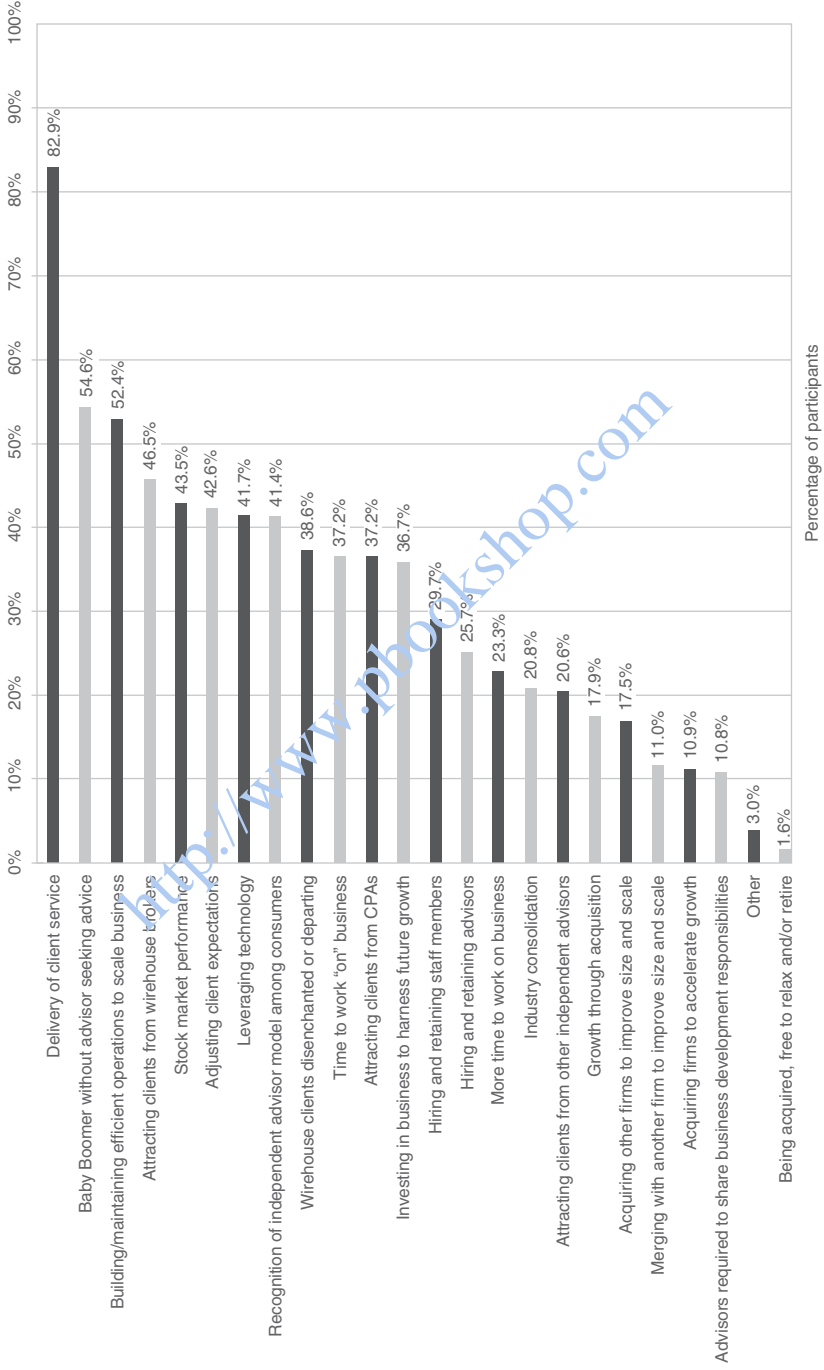
A Peek into the Future

Advisors now realize that market returns alone aren't sufficient to drive the growth of their firms. Given worldwide financial problems, ongoing market volatility, and weak economic growth, it isn't surprising that advisors we've surveyed viewed stock market performance as their top challenge in the next three years. Other nonbusiness challenges cited were managing client expectations and industry regulation, which has become a moving target since the meltdown.

Almost all other challenges that advisors foresee fall squarely into the practice-management box. Most advisors struggle to manage their time, and often, their profitability. They lack coherent brand and marketing strategies to assure a steady flow of appropriate and higher-paying prospects, and they struggle with finding and managing qualified staff. They need to master their work lives by creating business systems: developing specific goals and road maps to reach them, managing their own financial growth, and creating more effective operations and more efficient ways to use staff and technology. In addition, by mastering these issues to build the value of their businesses, they can sell or transition out of the practice with something to show for all of the hard work. All of these issues can be addressed by implementing best-practice management strategies.

More than ever, the advisory business is about client service. More than market returns, selling products, or designing financial plans, firms that provide predictable, high-quality service, and do so profitably, will see greater growth and value premiums. Most advisors rank client service as the number one business opportunity during the next three years (see Figure 1.1).

FIGURE 1.1 Opportunities for Advisors during the Next Three Years



Advisors frequently rank tapping into the Baby Boomer market as the number two opportunity in the near future. As mentioned earlier, the first Baby Boomers hit 65 in 2011; today, almost one-quarter of the population is between 45 and 63 years old, the primary age range for asset accumulation. Although we've all heard that client referrals drop when the markets do, if some 76 million Baby Boomers needed financial advice before the financial crisis, they're more likely to need it afterward.

Interestingly, "building/maintaining efficient operations to scale business" is a third opportunity many advisors wish to realize. Yet many firms still are reluctant to invest in human capital. Businesses willing to invest in staffing now to develop capacity down the road, while investing in business development, will be well positioned to take advantage of the growth opportunities ahead.

Let's take a look at the broader industry trends that studies, demographics, and experience suggest advisors will face going forward:

- Clearly, the Baby Boomers will represent a big opportunity in the decade ahead. Being a huge and vocal cohort, their search for financial advisors may create greater consumer awareness for the industry, increasing the demand for financial advisory services.
- Client bases are aging along with the population, driving a transition from accumulation to distribution. A study of a major institutional client firm found that the size of client accounts within that firm peaked when account holders reached age 64 and began to decline steadily thereafter. Our work with advisory firms supports this assertion. An increase in attrition related to client deaths is also on the rise. Add to this the fact that fewer clients are coming on board to offset these aging trends, and new client acquisition is becoming increasingly important.
- Advisors will focus more on building and realizing value for their firms so they can expand or contract. Some advisors will want to ease out of the business; others will be looking to grow larger, whether organically by hiring more advisors and staff, scaling up their processes, or through mergers or acquisitions.
- In order to realize the value in their businesses, advisors will need some kind of workable succession plan, whether that means finding and hiring a successor advisor in a solo practice, creating appropriate partnership and ownership agreements in an ensemble firm, or selling outright to another company. This will likely lead to increasing competition for qualified next-generation advisors, those who can successfully help transition the founders out, while leading the firm into the future.

Key Trends in the Advisory Business

We've seen a growth in these trends during the past few years and expect them to continue as advisory firms increasingly shift their focus from pure sales and

service to driving improved business performance. Here are some of the issues that firms are facing and the solutions we will focus on throughout this book:

- *Focus on growth.* The financial fallout since 2008 has left many firms realizing that while good client service is a client acquisition strategy, it's a passive one and cannot be the only source of new business if firms want to control their growth.

Client referrals will undoubtedly continue to drive the acquisition of new clients, but that won't be enough. We will explore in the business development section the options for advisors to take proactive action to create a prospect-and-client pipeline. This may include hiring a business development officer or reengineering the firm's brand to create a culture of client referrals as part of a disciplined marketing plan.

To survive and thrive, regardless of market circumstances, firms will need to evolve from a founder-reliant culture dominated by personal brand to more formalized, firm-driven strategies for driving growth. Findings from a Genworth Wealth Management/Quantuvis Best Practices study highlight that top-performing firms are more focused and more disciplined in their business development efforts. The firms that best manage their business development strategies will have their choice of the most satisfying, most profitable client relationships in the future.

- *Creating a compelling value proposition.* When we ask advisors what they do, more often than not, they say financial planning, investment management, or wealth management. Given these answers, it's not hard to imagine why the average consumer doesn't claw his or her way to an advisory firm's doorsteps. The reality is that advisory services are needed by many but sought by few.

To create a compelling value proposition for new clients, advisory firms need to take a hard look at how they brand and position their services in the marketplace. Firms have an overwhelming tendency to sell features, benefits, and attributes, such as being objective, knowledgeable, expert, caring, and service driven. Consumers expect and deserve these behaviors from any advisor, which means they are not differentiators.

Advisors are realizing that it is the outcomes they deliver to clients and, more particularly, how they package and present these outcomes that position and differentiate them in the marketplace.

- *Managing financial performance.* Advisory firms have disciplined processes for reporting and managing the performance of their clients' financial health, yet few but the largest and most sophisticated firms proactively manage their own financial performance.

Financial reporting and performance benchmarking help advisors objectively gauge the health, performance, and value of their firms. A disciplined process for gathering and using financial reports and benchmarking data can also help firms identify where their challenges and opportunities lie.

Advisors need to establish effective financial reporting processes and define the type of reports to review, decide on a schedule for uncovering problems, and make changes that will get them closer to their financial goals. For example, firms that identify below-target revenue and/or profitability in their financial reports can look at benchmarking reports to find out which metrics, such as average client size and average fees, are driving this result. Armed with this information, advisors can evaluate their account minimums and conduct a competitive pricing scan to determine where they can make changes to increase revenue and profitability.

Top-performing firms also tend to rely on performance benchmarking to gauge their financial progress at the bottom line, rather than using less meaningful top-line measures of revenue and assets under management. This empowers firms to better understand what's happening to their profitability and why. Advisors will have a distinct advantage if they can grasp how their business behavior drives their business outcomes and what specific elements of their business can be improved to drive better overall performance.

- *Optimizing operational performance.* As firms become more relationship focused, delivering predictable high-quality client services is a greater priority. To offer consistent, reliable, and superior service, advisory firms will need to standardize their processes and manage their people, technology, and outsourcing relationships so the firm can function more efficiently and effectively. This will allow for a dramatic increase in scalability as well, which is critical in growth companies.

In other words, firms must develop their operational infrastructures to maximize advisors' client-facing time. Yet our experience with firms of every size and type suggests that the average firm grows faster than its investment in infrastructure. As a result, the back office that services clients struggles to keep pace.

Our findings indicate that top-performing firms invest, on average, two times more in operational infrastructure than their peers and yield profits that are five times greater. To improve operational performance, firms need to assess their business strategy and goals, then reengineer every aspect of their business to ensure complete alignment between the two. This entails developing and adopting a plan to capitalize on strategic uses of processes, people, technology, and outsourcing.

- *Institutionalizing the business.* Founders/owners are realizing that they can't take care of everything personally and, at the same time, provide more and better client service while turning a healthy profit. Institutionalizing the business starts with defining all of the key business systems in the organization, evaluating those systems, and then identifying and making improvements. Next comes documenting the steps in the system with a level of detail that ensures they can be independently repeated by a new owner(s) and staff with the same results on a consistent basis.

Institutionalization is the holy grail of business performance, elusive to all but a select few advisory firms. This isn't because the club is members only, but rather because it requires a great deal of work. Yet in order to offer regularly superior service, ensure scalability, and create lasting business value that lives beyond the founder/owner, firms need to systematize and scale business practices.

- *Harnessing human capital.* While operational infrastructure, technology, and outsourcing can support a firm's goals for driving growth and institutionalizing operations, the delivery of financial advice remains a people business built on service and relationships. Although solo practitioners with no staff, or small firms with only a few staff members, may believe themselves exempt from this discussion, our experience and our research suggest otherwise. These firms have just as much to gain from better harnessing their human capital as do their midsize, large, and fast-growing counterparts.

For one, advisory firms are likely to find that acquiring and retaining talent will be increasingly challenging and costly in the future. And the younger-generation advisors who will presumably carry on these firms are few and far between. Firms would do well to develop new advisors and capable staff internally through effective employee management.

Moreover, advisors often struggle to hire and maintain productive team members. They need to learn how to manage their people effectively, so they can spend more of their own time with clients.

- *Developing a systematic service model.* Advisory firms tend to do one thing with remarkable consistency: take on any and all clients who come their way, regardless of size, situation, or fit. This happens for two historical reasons. First, many small-business owners take the view that the best way to grow revenue to ensure their firm's existence is to gather as many clients as possible. Second, our profession has its roots in the sales culture of the 1970s and the 1980s, when the goal of financial advisors was selling products and meeting quotas. Since then, the advisory profession has become far more focused on relationships than on sales, yet the mind-set of attracting and accepting any and all comers has changed little. The result is that the average advisor has a mosaic of clients, ranging from those with less than \$100,000 to those with millions, and many in between. This is not a recipe for client profitability. Servicing such a disparate group of clients with so many diverse issues and needs is exceedingly difficult to do well and nearly impossible to do profitably.

Advisors often claim they must treat every client differently. In chapters that follow, we suggest that advisors are confusing experience with process. As a result, they dilute both client service and profitability. In our view, the goal is to develop a standardized way to deliver specialized, systematized services based on specific client segments. There needs to be a clear process to determine which clients receive which services from whom, when, and how. This

is a total game changer that dramatically increases the quality of client services, advisor and staff productivity, and ultimately the bottom line.

- *Increased reliance on outsourcing.* Outsourcing parts of their businesses allows advisors to scale up their operations, spend more time with clients, and give their staffs more time to support client service. A growing trend is the outsourcing of asset management services. Back in a 2009 study, 31 percent of advisory firms were already reporting outsourcing asset management and another 21 percent were considering doing so. Today, outsourcing of this once-sacred function continues to be on the rise.¹

The rising popularity of outsourcing may be partly due to the burden of balancing money management with client management, especially during a downturn when an advisor's time may be better spent deepening client relationships and developing new ones. Advisors also view investment management services, unlike the delivery of financial advice, to be more easily commoditized, sensitive to pricing competition, and not requiring a relationship to be effectively performed. Outsourcing investment management and other business functions can appreciably increase a firm's capacity and revenue, especially for smaller to midsize practices.

- *Better and/or professional management.* Advisory firms are realizing that better business management is as important to ongoing success as rainmaking and client service. For many advisors, with competition for their time increasing and their capacity constrained, the demands of working "in" the business are constantly competing with the need to work "on" the business. The multiple facets of running a business, which include business strategy and planning, sales and marketing, human capital, financial management, operations, client services, financial planning, investment management, compliance, and more, are simply overwhelming.

In addition, most advisors prefer managing client relationships to managing the business, so firm owners often find themselves at a crossroads: they either choose to spend more time on business management, at the expense of advising and acquiring clients, or they turn to professional managers to take over these functions so they can focus on revenue-producing activities.

The conclusions of "Mission Impossible II," a 2009 white paper released by Pershing Advisory Solutions, still ring true. It shows that as firms increase in size, so does their reliance on dedicated management roles. The Pershing white paper noted that 14 percent of advisory firms with more than \$1 million in annual revenue added dedicated management; 76 percent of firms with \$3 million to \$5 million in revenue did so; and 86 percent of firms with \$5 million in revenue had such positions.²

Do dedicated managers drive firm growth, or does firm growth produce the need for dedicated managers? The answer is likely both. Our experience consulting with growing firms to develop professional management roles suggests two things. First, that the previous findings are true, and second, that

even firms with as little as \$1 million in revenue can realize significant benefits from hiring a professional business manager.

Sharing control with a nonowner who is not, in most cases, an advisor can be difficult. Nevertheless, for advisory firms that are committed to growth, improved productivity, and increased profitability and value, as well as operational excellence and sustainability, the benefits of professional management can far outweigh the challenges. Regardless of size, advisory firms are recognizing that the mom-and-pop shop mind-set that got them into business is insufficient to tap into their full potential.

- *Building business value.* Advisors need to recognize the difference between selling a book of business and selling a business. Many advisors sell their book of business for a decent return, but this model hardly maximizes the value that advisors can receive for years of hard work.

Beyond fancy formulas, value is ultimately defined by the predictability of future cash flows, proven profitability, scalable operations and service models, and a systematic approach to generating new business. As advisors realize the importance of monetizing what may well be their greatest asset, building business value is of growing importance.

Too often, advisors don't plan ahead for selling their firms. As a result, those who make the decision on short notice look to multiples of revenue as an easy way to estimate and establish firm value. Yet this approach represents an aggregate average of sales reported and doesn't account for the underlying fundamentals of the firms. It also fails to account for the many private transactions that never make the radar.

Such an informal method for establishing value often leads to disconnects between motivated sellers and knowledgeable buyers. If two firms both have \$1 million in annual revenues, but one has a profit margin of 25 percent, and the other a profit margin of 5 percent, they are hardly worth the same multiple of revenue. Or if two firms have the same revenues and profit margins, but one firm has an average client age of 50, with clients well in the accumulation phase, and another firm has an average client age of 65, with clients transitioning into the distribution phase, are the future cash flow and value of these businesses the same? Advisors need first to understand how to create firms with value, and then determine what is involved in realizing that value.

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