Bottom line: The GFC wiped out a large percentage of the fee base for many planners

FINANCIAL PLANNING

A FUTURE IN ADVICE

There is a huge efficiency dividend in financial planning, perhaps the only industry still to value businesses on multiples of revenue, not earnings. **Report: Michael Bailey**

Entrepreneurs seeking a relatively simple turnaround opportunity could do worse than buy a financial planning practice, many of which are still run extremely inefficiently yet are in hot demand from banks hungry for access to individual investors.

This was the lesson drawn by Hunts' Group, a strategic consultant to the wealth management industry, after it ran a tender that saw a four-planner practice in Sydney's Chatswood, StrategyOne, sell a 25 per cent stake to DKN Financial Group, which runs the Lonsdale group of licensed financial planners.

The principal of Hunts' Group, Anthony Hunt, says it is astounding how many wealth management groups, including divisions of the major banks, valued StrategyOne according to a multiple of recurrent revenue.

It's a quirk of financial planning, as most other businesses out there are valued on a multiple of earnings

Anthony Hunt, Hunts' Group

"It's a quirk of financial planning, because most businesses out there are valued on a multiple of earnings," Hunt says.

Financial planners historically never had to worry too much about earnings before interest and tax (EBIT) because 20 years of compulsory superannuation and trailing commissions meant their practices did not have to be efficient to be profitable.

"Nobody in wealth management had to do anything to look OK because there was money falling from the ceiling," says Wayne Wilson, a senior consultant for Hunts' who used to run the Asgard and Advance investment platforms for BT Financial Group.

Then along came the global financial crisis, which wiped out 30 to 40 per cent of a planning practice's fee base overnight because it erased 30 to 40 per cent of the client assets upon which the practice was receiving a commission.

"Your profit went out the door and you probably sacked some staff if you had any to sack because they were your only variable costs," Wilson says. Suddenly, efficiency mattered and began to matter even more when the federal government began its Future Of Financial Advice (FOFA) reforms.

Actuaries traditionally have valued financial planning practices using a benchmark length for a financial services contract – in the past, it's been just over seven years.

However, a controversial FOFA reform would require planners to resell their services to clients every year, meaning a financial plan might be considered only as valuable as a single completed tax return is to an accountancy practice.

Even if the reform forcing a planner's clients to opt-in every year is scuttled in the short term – independent federal MP Bob Katter opposes it, after intense lobbying from planners in Cairns, Innisfail and Mt Isa, in Queensland – Wilson says it will inevitably become law, because it represents the "final barrier" to financial planning being regarded as a profession.

"When [annual renewal] does come in, your valuation based on recurrent revenue will go down, so the only way to increase the value of your business is to reduce your fixed costs, and boost that EBIT multiple on the same revenue."

The process of selling the stake in StrategyOne revealed a woeful lack of understanding of how wealth management could be made more efficient, Wilson says.

"The [potential buyers] all concentrated on price, and the terms of trade StrategyOne had with its existing [investment and administration] platforms," he says.

"When we asked them how many hours their system could save a planner in producing a statement of advice, most of them didn't answer half the questions – irrespective of the fact that we knew their systems actually did a lot of what they didn't know themselves."

A quick way to boost a planning practice's bottom line is to reduce the number of platforms it uses, preferably to one, Hunt says. The industry average is more than three.

Rather than a fully tailored portfolio for every client, offering a set choice of bundled investment products would also carve costs, according to Wilson. BRW

Jessica Shapiro