

# Resilience in uncertain times

2011 Benchmarking Report – financial planning practices

Macquarie Practice Consulting



**FORWARD** thinking

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# Introduction

Macquarie Practice Consulting works with financial planning practices to help define strategic direction and improve business performance. We work with a wide range of firms across Australia, from sole practitioners to larger diversified practices, putting us in a unique position to observe how the financial planning industry is evolving and to understand the opportunities and challenges facing individual firms.

The 2011 Financial Planning Benchmarking Report is designed to provide you with insights into the latest business trends and best practice benchmarks for financial planning firms. Together with these insights and Macquarie's expert industry knowledge, this report will help you to benchmark your business and highlight those areas where there may be scope to improve your business performance.

Looking at the results this year, what stands out is the resilience of financial planning firms. Many firms have managed modest improvements in a number of key benchmarks despite continued tough markets. There are indications of pressure on future profit margins from regulatory changes, client trends and sticky overhead costs. Nevertheless, advisers continue to be optimistic about growth opportunities for their individual businesses.

We look forward to sharing further insights with you throughout the year. To ensure you get the most out of this report, we encourage you to discuss these findings in more detail with your Macquarie Business Development Manager, or call 1800 005 056 to speak with a Macquarie representative in your region.

**Fiona Mackenzie**

Associate Director  
Macquarie Practice Consulting

# Executive summary

Advisers have shown resilience, however the squeeze on profitability looks set to continue. This year's results highlight improvements in cost management on previous years, and also that advisers have dedicated time to re-connecting with clients. The major indicator of this is slightly improved earnings, though earnings are yet to return to the levels seen prior to the financial crisis.

The improvement has been achieved predominantly by maintaining healthy gross profit margins, which has provided a buffer against high fixed overheads.

Many firms have attempted to drive down these expenses, which account for about half of revenue, but there is yet to be any real reduction in these relatively high costs.

In terms of growing revenue, firms have opted for conservative strategies. Most firms have focused on growing client numbers and actively managing their existing client base.

With four years of data, there's validation of how adviser business models are changing. There continues to be increasing interest from clients in direct equities and self managed super funds (SMSFs) while the move away from managed funds looks set to continue.

With more than half of all clients aged over 55 there will be further changes to adviser business models in the years to come, impacting both the services offered by firms but also Funds Under Advice (FUA) and revenue.

Many firms are planning to diversify their sources of revenue by offering mortgages, insurance and accounting in the next three years.

Referral continues to be the most important source of new clients with advisers developing closer referral relationships with accountants, most likely as a result of an increased focus on SMSF investments.

Looking to the year ahead, regulatory uncertainty and continued pressures on profitability remain key concerns, but firms are optimistic about the future and expect to grow their revenues in FY2011.

Until this year, the survey focused solely on firms who held their own Australian Financial Services Licence. This year, we've expanded the report to include smaller firms operating under a dealer group's licence. Already, we can pinpoint some differences between the two groups and it will be interesting to monitor these benchmarks to see what trends unfold in future years.

# About this report

Financial planning firms across Australia completed the 2011 Financial Planning Practices Benchmarking Survey.

Now in its fourth year, the annual survey establishes industry benchmarks for financial performance as well as other key business practices.

In previous years all survey participants held their own Australian Financial Services Licence (AFSL). This year, to provide a broader industry perspective, the survey was extended to include small firms who operate under a dealer group's licence. To distinguish between the two business models, the group referred to in previous reports as 'boutiques' will now be referred to as 'Own AFSL' firms. The firms operating under a dealer group's licence will be referred to as 'Dealer AFSL' firms.

## Who responded?

60%

60 per cent of practices held their own AFSL with the remainder authorised by a dealer group holding an AFSL.

79%

### Respondents

79 per cent were principals

89%

89 per cent were male

Almost half were aged between 40–54.

40-54

74%

### Practices

74 per cent of participants have operated for more than six years

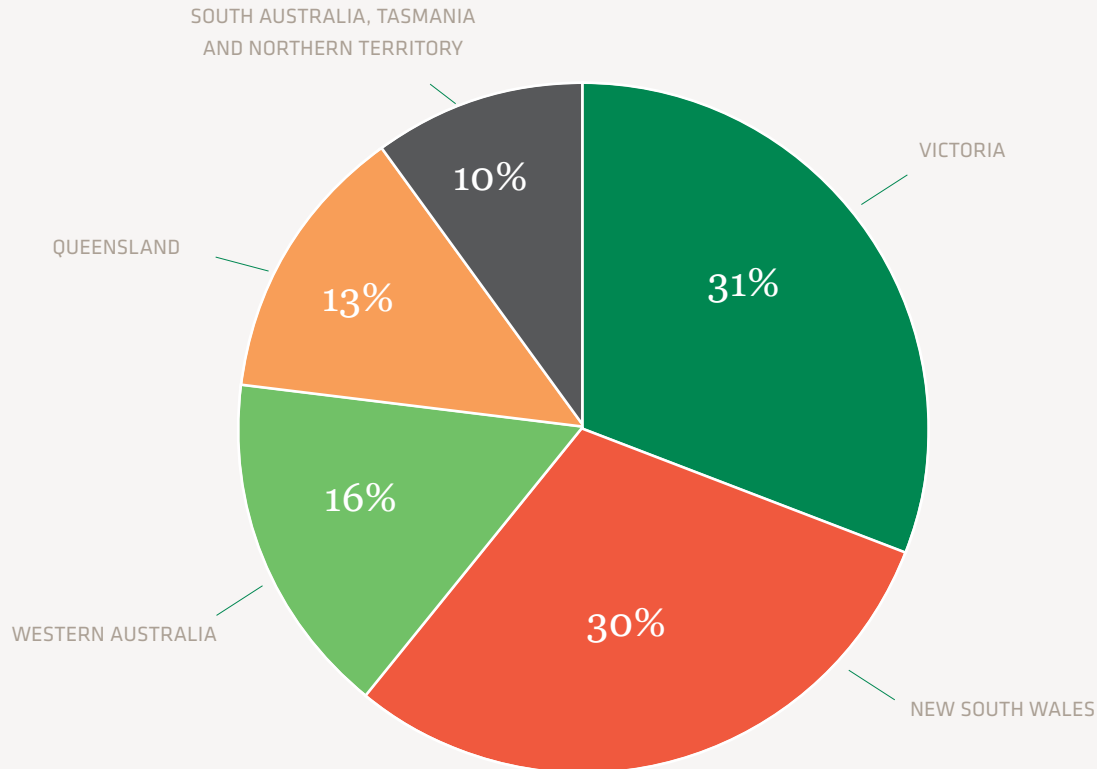
78%

78 per cent operate from a single location

12-13

The average business age was 12–13 years.

## PERCENTAGE OF PARTICIPANTS IN EACH STATE



61 per cent described their business model as financial planning, with the remaining participants offering a mix of financial planning and accounting services or other services such as stockbroking and mortgage broking.

The financial information for the year (eg 2011) is based on the prior year's financial year results (eg FY2010).

When working with sample data from quantitative surveys it is crucial to be aware of the sample size to ensure that any conclusions derived from the results are robust and not the result of outliers in the results. Throughout the following research we have strived to ensure that there is sufficient sample size to draw conclusions from each question, and where there are any concerns about the sample size, these will be flagged as such.

# Key results

Despite challenging market conditions in recent years, slight improvements on a number of financial metrics demonstrate the resilience of advisers.

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## 1. Financials

### Own AFSL firms (“boutiques”)

**Revenue improved for Own AFSL firms though it is yet to return to pre-GFC levels.** In FY2007 average revenue was \$1.17 million, before dropping to its lowest point of \$0.99 million in FY2009. Revenue is now up to almost \$1.08 million for FY2010.

**Gross profit margins remained healthy.** Both Own AFSL and Dealer AFSL firms reported healthy gross profit margins of at least 67 per cent of revenues. For Own AFSL firms, this has dropped slightly during the past few years from 72 per cent in FY2007 to 68 per cent.

**Overheads were high, impacting profitability.** The key impediment to profitability appears to be overhead expenses, which consistently account for approximately half of revenue. Despite concerted efforts by some firms to reduce these costs, they've remained high.

**Operating profit levels improved slightly for Own AFSL firms.** At an average of \$208,000 for FY2010 (from \$157,000 in FY2009) operating profits moved up, however they still fell short of FY2008 levels of \$235,000.

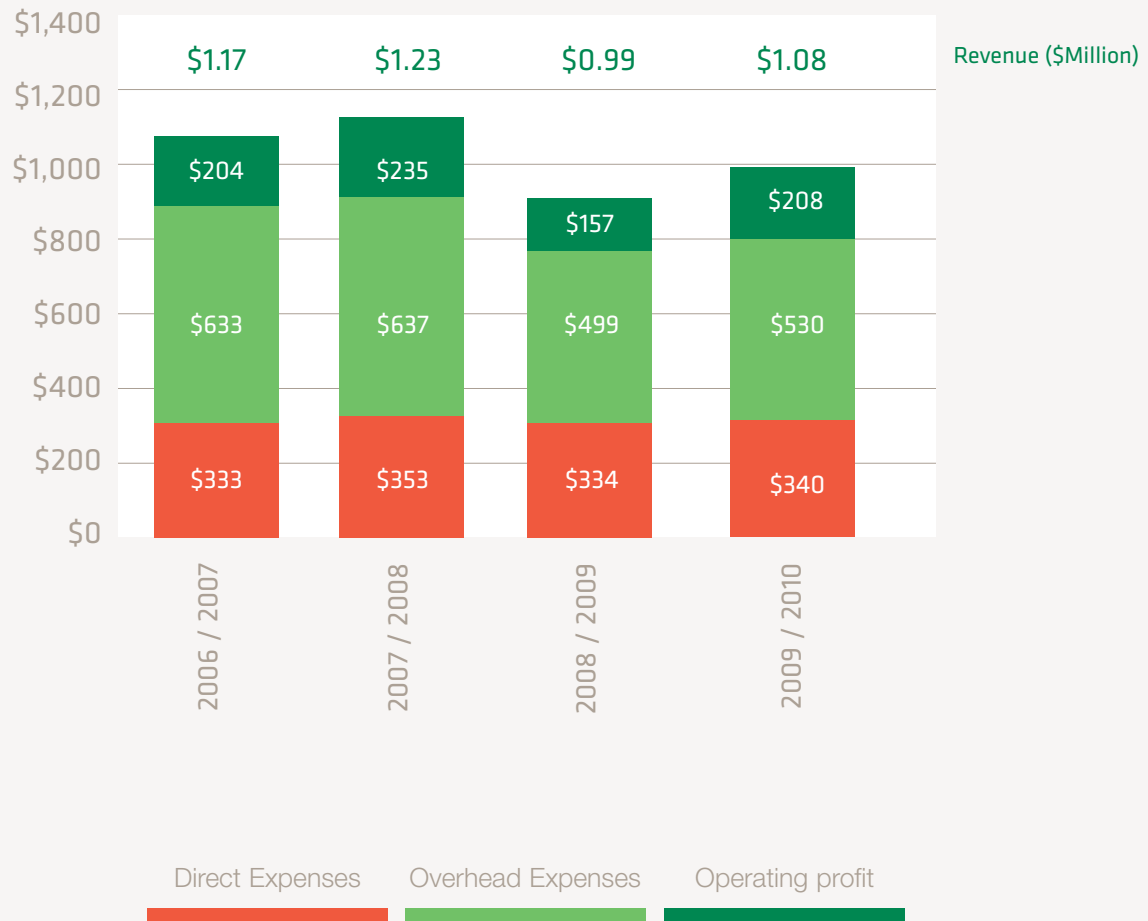
### How is operating profit calculated?

Profitability numbers in this report were estimated based on data provided by survey participants. This enables the profitability numbers of firms to be compared using a consistent method.

#### The method used in this report is:

- **revenues** – provided by participants
- **direct expenses** – number of advisers multiplied by average salaries (including super) paid for different levels of adviser (including market rates for principals)
- **overhead expenses** – percentage of business expenses multiplied by revenue, less salaries paid to advisers.

## PRACTICE FINANCIALS – KEY FINANCIALS





## Financial results compared by licence type

### How are financial results impacted?

**Revenue for Dealer AFSL firms was somewhat lower than revenue of Own AFSL firms.** The average Dealer AFSL firm revenue was \$0.66m in FY2010 compared to a significantly higher average for Own AFSL firms of almost \$1.08 million. This disparity can largely be attributed to the difference in scale between the average Own AFSL and Dealer AFSL practice in this sample.

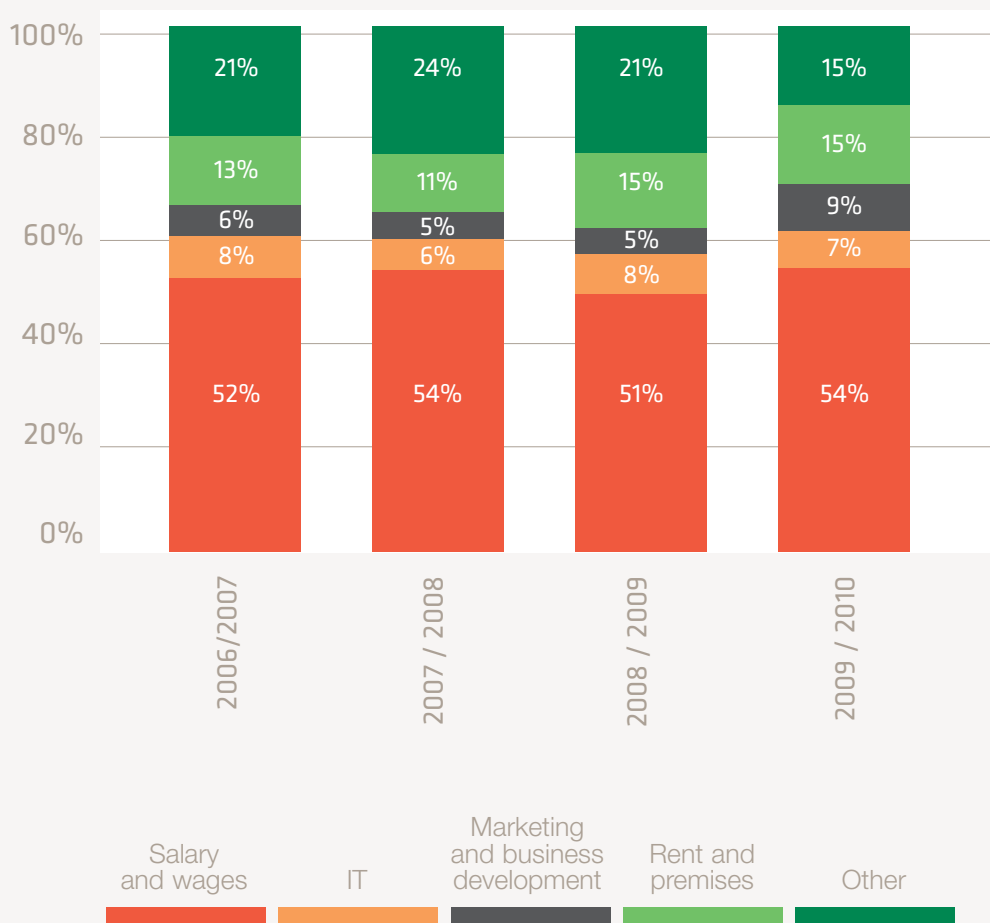
**Gross profit margins on average were healthy, and very similar for Dealer AFSL firms (67 per cent) and Own AFSL firms (68 per cent).**

**Overheads were a slightly higher proportion of revenue for Dealer AFSL firms (53 per cent) than Own AFSL firms (49 per cent).**

**Operating profit was quite slim for Dealer AFSL firms.** At only 14 per cent, this was driven by a higher percentage of overhead expenses.

FY10 key financial benchmarks				
\$'000	Own AFSL		Dealer AFSL	
Revenue	\$1,077	100%	\$664	100%
Direct expenses	\$340	32%	\$221	33%
Gross profit	\$737	68%	\$443	67%
Overhead expenses	\$530	49%	\$349	53%
Operating profit	\$208	19%	\$94	14%

# STAFFING COSTS DOMINATE BUSINESS EXPENSES



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## Business expenses

### Minimal change to salary and wages costs.

The percentage attributed to this expense category has been fairly consistent during recent years, hovering just above 50 per cent, despite evidence of small reductions in staff numbers.

### Reduced discretionary spending for Own

**AFSL firms.** There is some evidence to suggest that during the past year Own AFSLs have reduced discretionary spending. The expense category “Other” has decreased from 21 per cent to 17 per cent for Own AFSL firms. Dealer AFSL firms had a lower proportion at 12 per cent.

## Drivers of profit improvements

### Conservative growth strategies drove slight

**improvements to operating profit for Own AFSL**

**firms.** The top three reasons given for increases in profit were *increase in revenue per client* (50 per cent), followed by *increase in referrals from existing clients* (48 per cent) and *greater productivity per adviser* (37 per cent). By contrast, very few practices have acquired new advisers or additional firms. Given the market conditions experienced during the past few years, it's not surprising that firms favoured more conservative growth strategies and sought to lift earnings through operational efficiency improvements.

## 2. Practice size metrics

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### Funds under advice (FUA)

**FUA levels for Own AFSL firms have started to rise again.** After several years of falling, FUA has increased to \$152 million, from an average of \$136 million last year. Dealer AFSL firms reported an average of \$70 million per practice.

### Staff

**Headcount down slightly.** In past years, Own AFSL firms had six to seven employees, this year headcount was down to 6.2 and the savings have mainly been in terms of administrative staff.

**Own AFSL firms had slightly more employees.** Dealer AFSL firms had fewer employees per practice across all categories. Dealer AFSLs had two advisers compared to an average of 2.6 for Own AFSL firms, reflecting different practice sizes.

### Clients

**More than half of the clients are 55 or older.** For many firms, more than half of their clients are in, or approaching the drawdown phase of their planning strategy. This highlights the need for firms to be appropriately resourced in areas such as estate planning, aged care and intergenerational wealth transfer. At the same time, it's important for firms to focus on growing other client segments in the accumulation and retirement planning phases to offset the impact of an aging client base.

**Very few clients are under 30.** Despite a lot of talk in the industry about needing to attract younger clients this does not appear to have translated to a change in the age demographic of clients, with just six per cent of clients aged under 30.

## *Have you considered offering staff more non-financial benefits?*

Not everyone is interested in a bigger pay packet. For some employees lifestyle can be more important than more money. These employees may value flexible working arrangements.

If you do offer such arrangements, make sure you clearly set expectations with your staff to ensure there is no impact to business performance.

## Checklist

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### Are you actively managing your aging client base?

- ☐ Are you talking to your older clients about their changing needs?
- ☐ Are you discussing aged care and estate planning with older clients?
- ☐ Have you asked to be introduced to the adult children of older clients?
- ☐ Have you started educating the adult children on how their parents' needs will change and how to prepare?
- ☐ Do you have appropriate solutions in place to diversify revenue sources such as insurance, mortgages and cashflow management?
- ☐ What strategies do you have in place to attract younger clients?

# Pricing

Most practices have prepared as far as they can for anticipated regulations.

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**Most practices charge plan fees and ongoing fees.**

Only around half charged an implementation fee, and about one fifth charged separate review fees.

**Minimal change in the type of fees charged.** By far the most common fee types charged were for creating a financial plan and the ongoing fee to manage the strategy. The proportion of firms charging these fees has remained stable since the survey began four years ago.

**Fees are growing as a portion of revenue.** Fees accounted for 69 per cent of revenues for Own AFSL firms. The contribution from fees has steadily increased year on year and is up from 57 per cent three years ago. Fees were a lower proportion of revenue for Dealer AFSL firms at 55 per cent.

**A combined fee was most popular method of charging.** 50 per cent of firms used a *mix of asset based and either hourly or set dollar*. Slightly more firms (54 per cent) expect to move to this method next year.

**Set dollar fees were less common.**

Surprisingly 17 per cent of firms charged a pure set dollar fee and 3 per cent charged an hourly rate only.

**No significant increase in the number of firms rebating commissions.** There was little change in the number of firms who rebated commissions to their clients. There was a small rise in the proportion of practices who rebated product commissions, from 41 per cent to 50 per cent.

**Fewer Own AFSL firms increased fees.**

Only 41 per cent of Own AFSL firms raised fees compared to 46 per cent in the prior year. By contrast, 50 per cent of Dealer AFSL firms raised their fees.

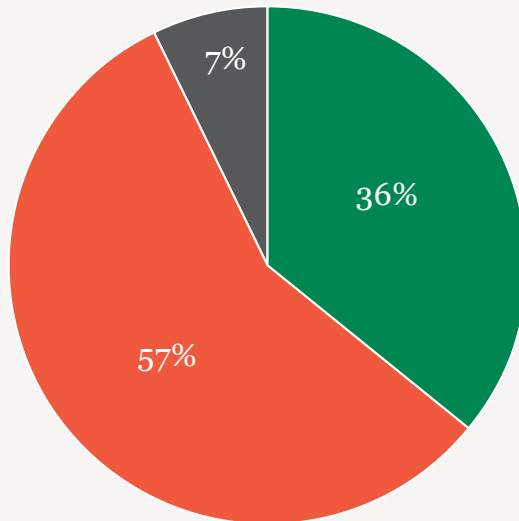
**There was less concern and more acceptance of the inevitable.** Around 90 per cent of firms were either not worried or saw regulatory changes as a minor concern suggesting firms prepared as well as they could at that stage.

Given that this research was carried out in March 2011, before the Government's release of the FOFA reforms in April, these views may have since changed.

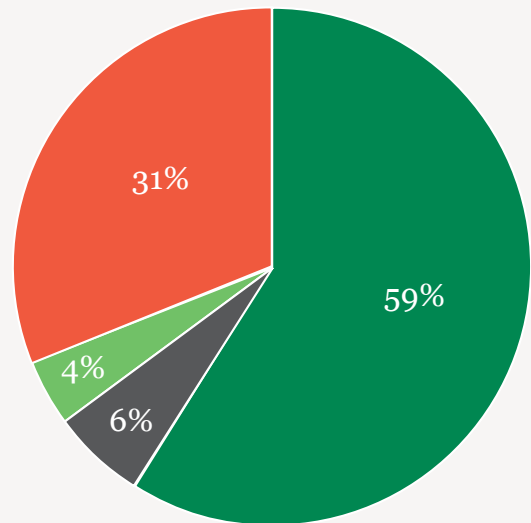
## WHAT IS YOUR ATTITUDE TO THE REGULATORY CHANGES PROPOSED TO THE FEE ENVIRONMENT?

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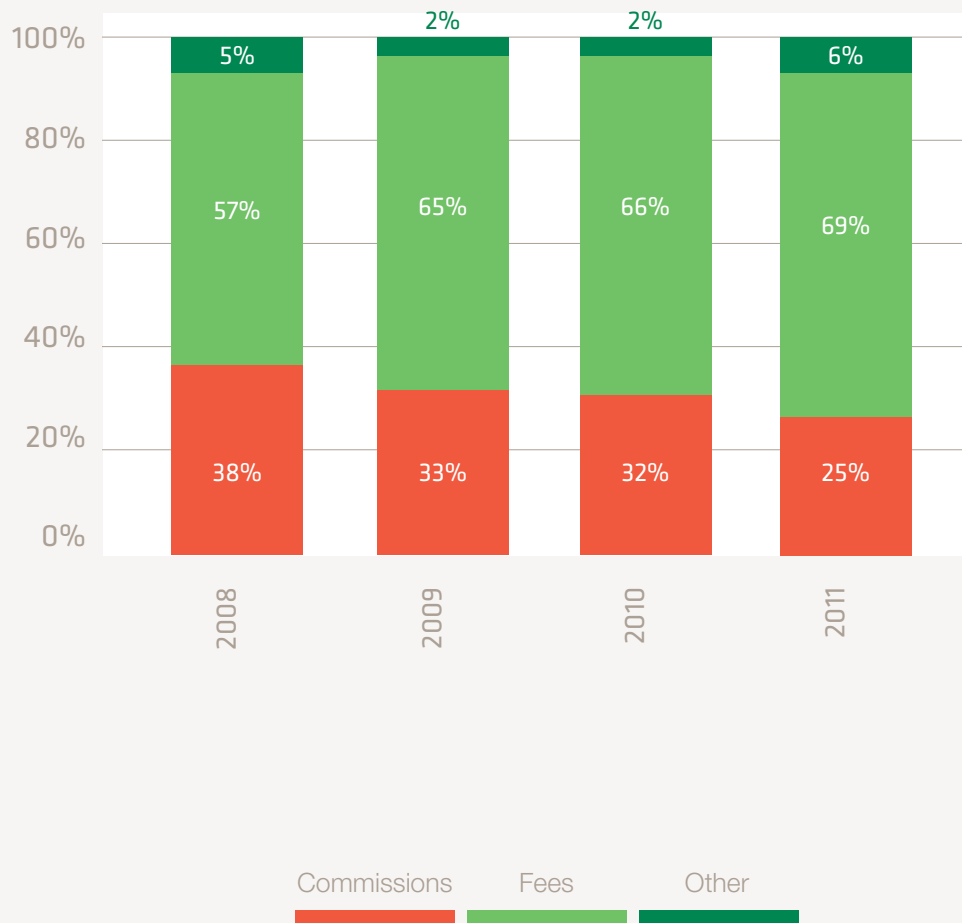
2010



2011



## WHAT PROPORTION OF YOUR REVENUE IS DERIVED FROM FEES, COMMISSIONS AND OTHER SOURCES? (OWN AFSL ONLY)





# Effective practice management

Advisers are concerned about cornerstone issues, highlighting the impact ongoing uncertainty has on firms.

## Good practice management

**It's all about value.** For the third consecutive year, articulation of value to clients was seen as the number one attribute of good practice management.

## Client value proposition

**Advisers rank relationship as the primary foundation of their client value proposition.**

They believe it accounts for around half of the value. Technical specialisation and investment selection are ranked second and third respectively, with price a distant fourth. This is consistent with our experience; in our conversations with advisers most view the client relationships as the key component of their value proposition.

## Managing staff

**Recruiting staff is the greatest challenge in people management.** Recruiting the right people, developing staff, effective delegation and managing employee performance were rated as the top four challenges facing firms. Remuneration and engaging employees were rated significantly lower down the list.

**Administration staff are held to account.** It was more common for firms to have formal HR practices in places for administrative staff and paraplanners than it was to have formalised KPIs, reviews and job descriptions for principals and advisers.

## Setting your value proposition

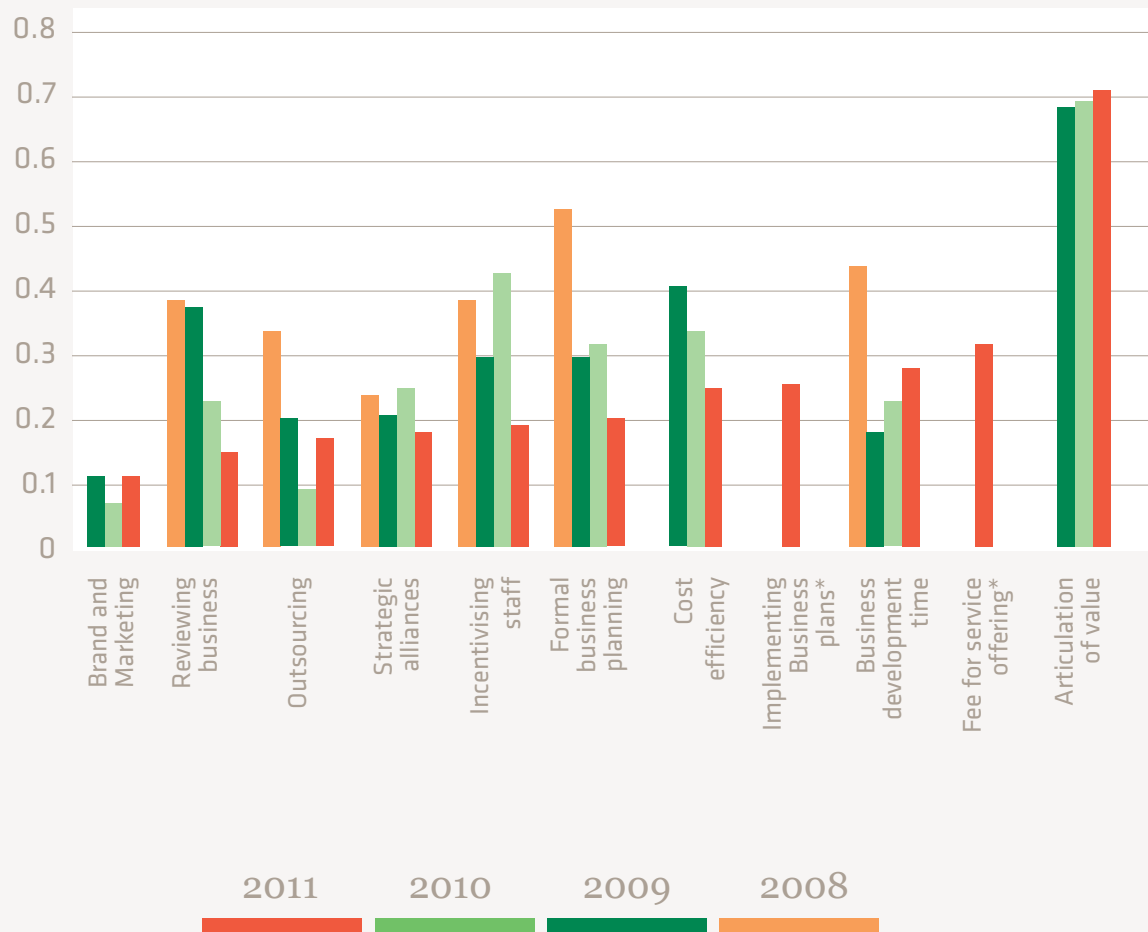
- Have you considered how clear and compelling your value proposition is to your target market?
- Have you reviewed and refreshed it recently to reflect the current environment and the needs of your clients?
- Can your staff explain the value your firm offers to clients?

## Tip!

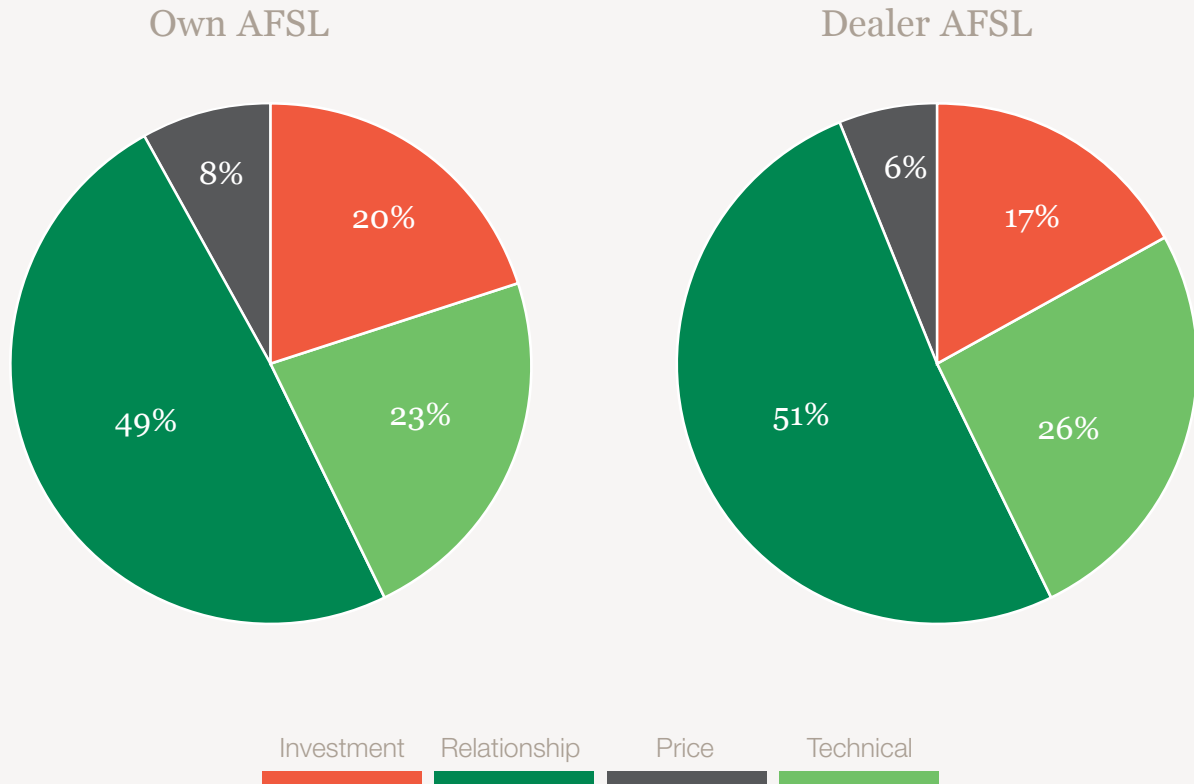
As a principal of a firm, have you considered setting performance targets for yourself?

It can be difficult to impose formal performance measures on yourself, and then hold yourself to account. But when it's done well, it sets a positive example for staff and can be powerful in driving real change and success.

## ATTRIBUTES OF GOOD PRACTICE MANAGEMENT

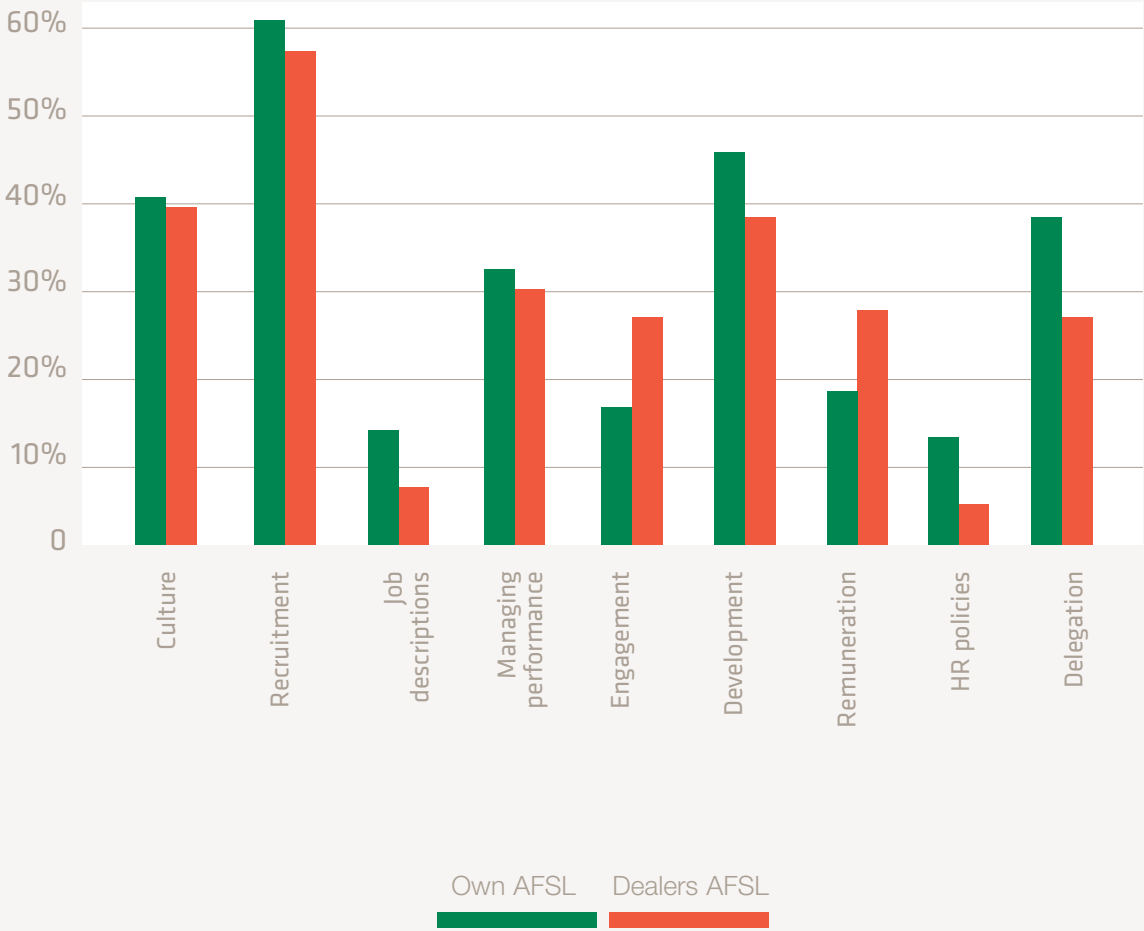


## ADVISER VALUE PROPOSITIONS EMPHASISE RELATIONSHIP OVER OTHER VALUE DRIVERS



Advisers were asked to allocate 100 points across four key value drivers to indicate their relative importance in what your business offers its clients.

# GREATEST CHALLENGES MANAGING STAFF



## Client referral sources

**Most client referrals came from existing clients and accountants.** Consistent with previous years, client referrals primarily came from these two sources. Use of accountants as a referral source increased to eight out of every ten practices, while use of client referrals fell slightly. This may reflect stronger relationships with accountants resulting from an increased use of SMSFs.

### Tip!

#### Have you considered building a formal referral partner program?

It's important to spend time upfront with your referral partners to formally agree and document referral targets. This helps you to plan which activities your firm should spend time on and then allows you to track performance against these targets. Your time is valuable, so make sure your investment in referral relationships is worthwhile.

## Business plans

**Most firms conduct business planning at least once a year.** The number of Own AFSL firms completing business planning at least once a year rose from 77 per cent to 90 per cent. Slightly less Dealer AFSL firms (79 per cent) completed business planning at least once a year.

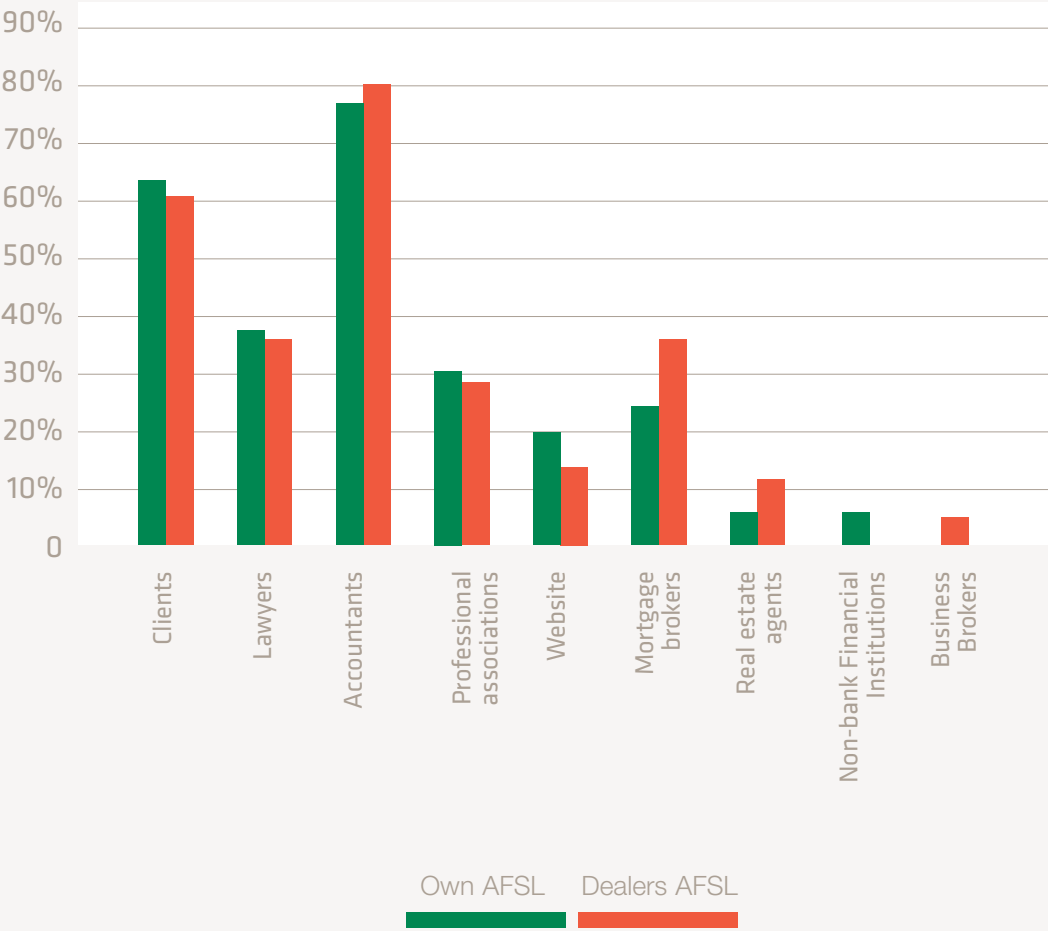
**More firms revisited their business plans throughout the year.** The frequency of reviewing plans has increased on previous years. The number of Own AFSL firms reviewing their plans *at least quarterly* has risen from 40 per cent to 48 per cent, while 41 per cent of Dealer AFSL firms reviewed their plans at the same frequency.

For both groups this is significantly less than the numbers conducting business planning each year, suggesting that firms see it as an annual event rather than an ongoing process.

#### Have you updated your business plan?

Business plans are dynamic documents which should evolve strategically with your business. Your plan should be thoroughly reviewed at least once a year to ensure that the objectives you are working towards, and the strategies you are using, are still relevant for your business.

# CLIENT REFERRAL SOURCES



# Trends in business models

There is considerable evidence that adviser business models are evolving.

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Clear trends have been identified in the use of investment products and vehicles, which are most likely driven by changing client expectations, the introduction of new technologies, anticipated regulatory change and the fallout from the global financial crisis. As we move forward, the challenge for advisers will be to make clear choices about which clients they will service and ensuring their offer is tailored around their needs and also profitable over time.

## Investment vehicles

**Super drives growth.** Super rather than discretionary investment was the growth engine up from 66 per cent to 74 per cent of FUA for Own AFSL firms. This is consistent with the broader market trends and as expected, given SG contributions are mandated.

The trend away from managed funds continues. This year managed funds accounted for just under half of FUA, down from 62 per cent in 2008. By contrast 45 per cent of firms actively managed their clients share portfolios and 41 per cent used ETFs to gain inexpensive share exposure for clients.

Self Managed Super Funds were the most common off platform vehicle. Most firms used SMSFs (82 per cent) and on average they represented 33 per cent of FUA. Slightly more than 30 per cent of clients had SMSFs.

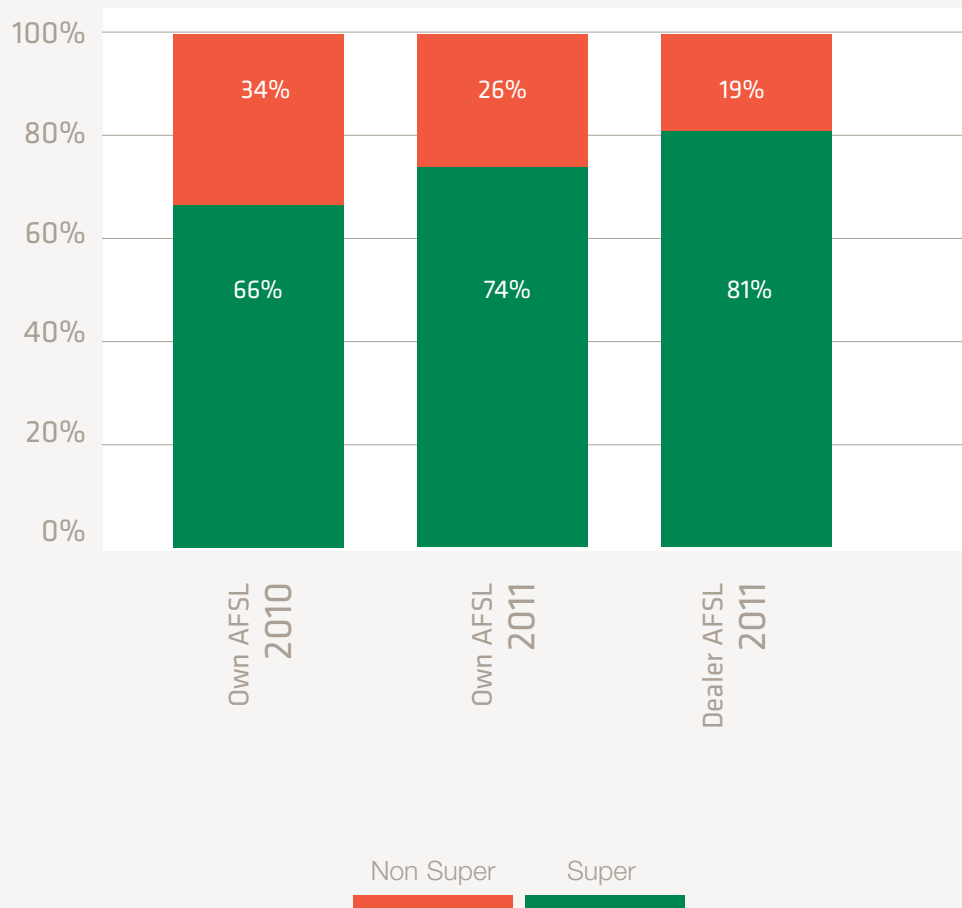
### **Small take-up of new investment vehicles.**

Other new forms of investment vehicles are still in their infancy, with only one in ten advisers using SMAs, one in ten advisers using IMAs and one in five using alternative investments.

### **Managed Discretionary Accounts use was low.**

Only 14 per cent of Own AFSL firms (and just nine per cent of Dealer AFSL firms) used an MDA structure to any extent (defined as for more than 20 per cent of FUA).

## WHAT PROPORTION OF YOUR TOTAL PRACTICE FUA IS INVESTED IN THE FOLLOWING:





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## Fees

### **Increased contribution from fee for service income.**

The share of revenue from fee for service has steadily increased for Own AFSL firms in recent years, from 57 per cent in the 2008 survey to 69 per cent in 2011.

## Additional services

**New services planned.** During the next three years most firms intend to diversify their business and income by adding new services. The top three being mortgages, insurance and accounting.

## Succession planning

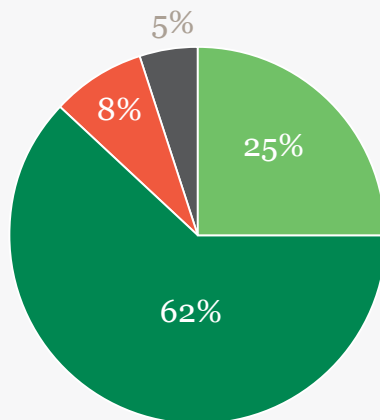
**Fewer Own AFSL firms now have a succession plan in place.** This has dropped from 55 per cent to 44 per cent of firms.

The decrease may reflect the uncertainty in the industry about how to appropriately value financial planning firms, resulting in potential buyers sitting on the sidelines until these issues are resolved. Hence without potential buyers, practices may not feel like they actually have an exit strategy in place, irrespective of having previously developed a succession plan.

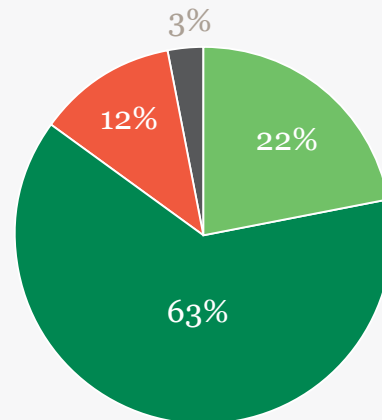
## Acquisitions

**Around half the firms plan to make an acquisition within the next five years.** More Own AFSL firms (56 per cent) plan to pursue this path than Dealer AFSL firms (45 per cent).

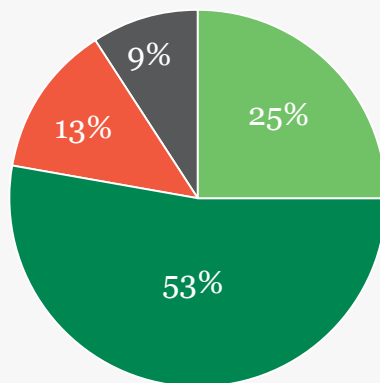
PLEASE INDICATE THE PROPORTION OF YOUR TOTAL PRACTICE FUA THAT FALLS INTO EACH OF THE FOLLOWING INVESTMENT TYPES:



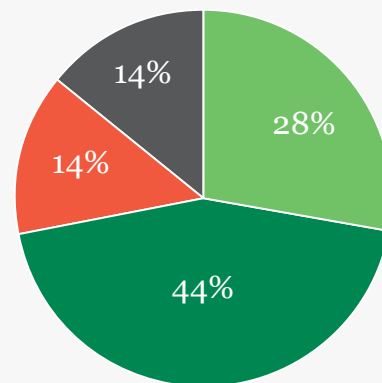
2008



2009



2010



2011



# OFF PLATFORM VEHICLES USED



# Looking ahead: the future

Advisers remain optimistic about the future, even though there continues to be uncertainty.

## Profit expectations

**The majority of firms expect FY2011 profits to be more than 10 per cent higher than FY2010 profits.**

Despite the structural issues facing both revenue and expense lines which will likely lead to significant challenges in maintaining profitability over the next few years, Dealer AFSL firms are particularly optimistic with 73 per cent of firms expecting profits to be up more than 10 per cent.

## Key issues for 2012

**Firms can prepare for the inevitable but not the unknown.** With continued uncertainty about looming legislation changes, it's not surprising that increased legislative requirements rated as one of the key issues for the year ahead.

**Maintaining and growing profitability.** More participants are concerned about maintaining and improving profitability (47 per cent up from 34 per cent in the prior year).

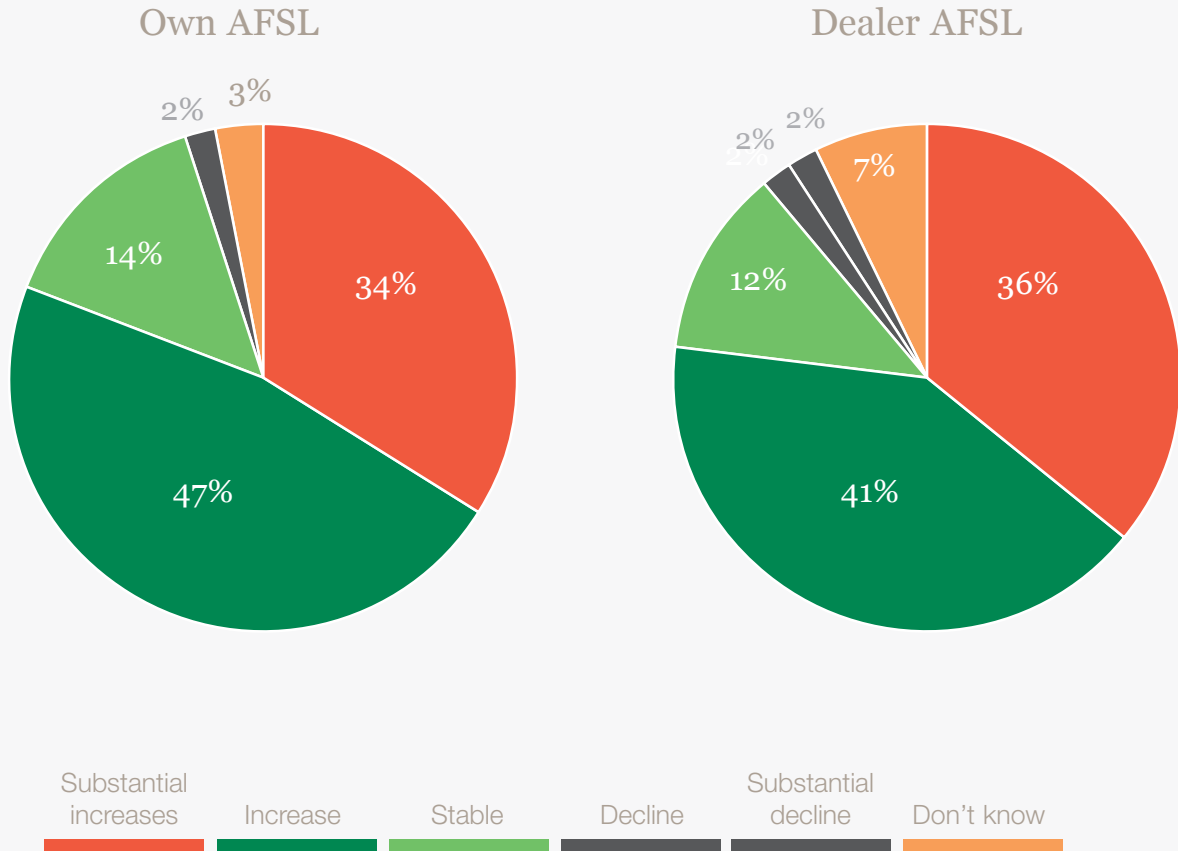
**Attracting new clients.** As in prior years, attracting sufficient numbers of new clients continues to be an ongoing challenge for participants. With firms having around half of their clients over the age of 55 and little growth in the younger client segments it makes sense that attracting new clients is top of mind.

**Recruiting and retaining key staff is becoming more of an issue.** After two years as a low priority, staffing is again rising as a significant issue and highlights a risk many firms may face. During the financial crisis prospects for alternative employment were limited so staffing was not a key focus for many firms. Firms will now need to turn their attention again to retaining and incentivising their best staff or risk losing them as the employment market becomes more competitive.

## Adviser sentiment

Advisers feel optimistic about the future. Own AFSL firms were particularly positive about the future with 87 per cent either positive or very positive, while 72 per cent of Dealer AFSL firms expressed similar sentiment.

# WHAT CHANGE, IF ANY, DO YOU EXPECT IN YOUR 2010/2011 PROFIT COMPARED TO 2009/2010

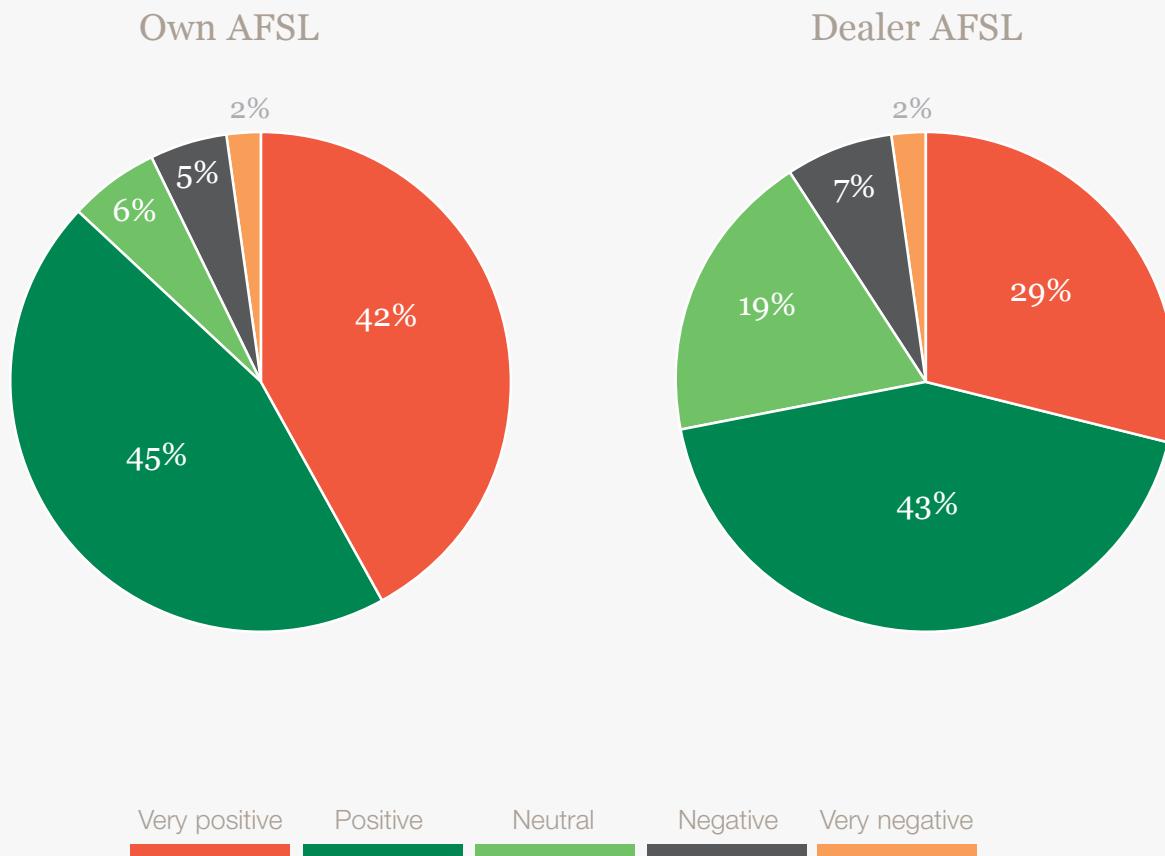


The majority of firms expect FY2011 profits to be more than 10 per cent higher than FY2010 profits.

## WHICH OF THE FOLLOWING DO YOU SEE AS ISSUES THAT WILL SIGNIFICANTLY IMPACT ON YOUR PRACTICE IN THE COMING 12 MONTHS?



## ADVISER SENTIMENT



Advisers feel optimistic about the future. Own AFSL firms were particularly positive about the future with 87 per cent either positive or very positive, while 72 per cent of Dealer AFSL firms expressed similar sentiment.

## Macquarie Practice Consulting

Want to know more about what makes financial practices successful?

Macquarie Adviser Services will be working closely with advisers throughout 2011 to understand how these survey results relate to their business, and to help advisers develop strategies to improve business performance and profitability.

To discuss this Financial Planning Practices Benchmarking Report in more detail, please contact your Macquarie Business Development Manager, or call 1800 005 056 to be connected with a Macquarie Business Development Manager in your region.

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