ADVISORNEWS

Show Me the Value

Your practice is not a short-term investment

GUEST COLUMN

BY JEFF THORSTEINSON

I've covered value in a previous column – the value you deliver to clients through your services, your wisdom, and your timely advice. This is the bedrock of your practice, and the reason why your clients stay on board. This time, I'd like to talk about another type of value – the kind you build in your practice over the years: The value of your business.

Your practice is likely one of the largest assets you own. So it makes sense that building its value should be an important goal. After all, it's likely that one day you'll need to sell. And of course, you'll want top dollar. While I've seen many attempts, building value in a practice can't magically happen in a three month pre-sale facelift. It takes years.

There are three factors to focus on when building value: Systems, cash flow and growth management. Let's take a look at each:

1. BUILD YOUR SYSTEMS

Most successful businesses rely on standardized procedures and business processes. Such processes make it simpler to ensure customer satisfaction, keep a team focused on the right goals and monitor business progress.

Of course, solving financial problems for real people isn't like making widgets – every client is unique, so there will always be some part of your practice that needs to be customized. But there are several areas of your practice that can be systematized:

Wealth management

A disciplined approach to building client wealth not only enhances profitability, it makes it easier to "scale" your practice – you can take on more clients with little marginal cost. It also frees up your time to take on larger accounts, further increasing business value. Everyday advisors can't achieve this because they are trying to please everyone. But by doing so, they please no one.

Where to start: Segment your clients and assign each to a given service "tier." Develop different wealth management packages for the various tiers. Standardize the review, reporting and information management systems with respect to wealth management.

Client service

A standardized client service and contact system empowers your team so they know what to do, and why. With everyone doing what they do best, your practice becomes more efficient. That in turn enhances client satisfaction and loyalty.

Where to start: Set client service activities to the tiers as above. Plan out your service program one year in advance, and assign responsibilities to yourself and your team. Create an annual "task list" of critical duties for each team member. Set measurable performance targets and monitor progress.

You

It's a sad reality of all service businesses: The more dependent the business is on its owner, the lower its value will be. After all, when you eventually sell, the new owners won't be able to count on your help.

If you perform mission-critical tasks that no one else on your team can do, or if your clients are loyal to you rather than your practice, there is very little value in your business once you are taken out of the picture.

Where to start: Learn to delegate tasks you don't like to do. Empower team members to operate independently – invest in additional training if necessary. Hire external consultants to help you identify core strengths and weaknesses. Help clients understand that you follow a team approach and encourage them to discuss issues with other members of the team as well as yourself.

2. ENHANCE YOUR CASH FLOW

Cash flow is simply defined as the excess of monies after variable and overhead expenses are subtracted from your annual revenue. Free cash flow is a critical measure of your practice's financial health, and likely the easiest way to boost the value of your practice.

When it comes to cash flow, potential buyers will be looking at a number of things. The consistency of profits is a key concern: The more consistent the cash flow, the higher the business value. Cash flow is influenced by a number of factors you should be monitoring.

To name a few: Income mix, client base, business structure, cost structure, market conditions, good will, potential of your clients and prospects. Tackling any one of these can result in a dramatic improvement in the value of your practice.

Continued on page 10

ADVISORNEWS

Separate Value Continued from page 1

and in two areas in particular. One would be with their business agenda and the second would be with their regulatory obligations.

The third mandate, which flows out of the first two, is that we will strive to become the authoritative voice of the Canadian capital markets. Our membership is at the fulcrum of the capital markets as intermediaries engaged in underwriting, trading, advisory of corporate retail and in all aspects of the wealth management business.

The second component of the strategic plan is our commitment to providing value to our member firms. It is what we term our value proposition.

Q How are you going to add value?

A Let me give you a couple of examples. We will develop a generic [compliance] template and give it to you and you tweak it to fit your firm. It is going to save you a lot of time, a lot of money, a lot of effort [and] consulting fees, to have the industry provide that for you. [The same thing applies to] compliance manuals. Why can't we develop a generic compliance manual for all of our firms?

> "The regulator says, 'here are the rules, good luck, God bless.' "

There is an educational element as well. We will bring firms together and say, 'Look, we can help you at identifying how to develop best practices.' Every firm will get a surprise audit. They get regular scheduled audits and they get one surprise audit every year. How should they make sure that they are properly prepared for a surprise audit? One of the things that we can do is we can give firms advice on how to simulate a surprise audit. It's like testing a fire alarm system. Nobody does that now; the regulator says, 'Here are the rules, good luck, God bless.'

We've got 180 very small firms who have limited resources. Let's face it, you have a lot of growth in the business; you have a lot of new people coming into the business. These firms need help. They are not going to get it from the regulator, they are going to get it from their industry association.

Russell

Q Now that you are no longer part of the SRO do you have criticism of the way it operates?

A I would think that we are going to hold the SRO much more accountable for ensuring whatever new rules they are going to bring out are cost-effective, that they don't interfere with innovation and competition. We don't want to smother the competitiveness of our capital markets. We are going to hold them to a cost-benefit analysis, to say, 'OK, you've come out with a rule, now you justify, why we need that rule and why it is the most appropriate rule.' And I hope it will not only be on new rules, but that we will also be looking at the rule book and questioning the appropriateness of certain rules and regulations.

Q How are planning to grow your membership?

A We have lots of ideas of how we will grow in the future, but right now everybody who is an IDA member firm is a member of the association. That's who we are focusing our strategic vision on. Down the road, the Mutual Fund Dealers Association will probably merge into one SRO. That then raises the issue of the large number of financial planners. I can't say right now what the outcome might be.

We are also going to move out with affiliate associate memberships immediately. What that means is we are going to be looking for other participants in the capital markets other than dealers and some of the candidates would be buy-side firms, some of the inter-dealer brokers and the financial service companies who would be interested in participating in the IDA as an affiliate membership. They wouldn't engage directly in decision making on the national committees, but we haven't flushed out the program.

Q Do you still have to be a member of both the IDA and the SRO?

A You don't. To be a member of the SRO is compulsory if you want to do business. They can charge what they want. They are lucky. We have to demonstrate to our members every day that we are delivering value to them. The fees will be a revenue-based model so the larger firms will pay the larger fees. We haven't fixed the precise mechanism.

Q Are you expecting your membership will drop off?

A I think initially there will be a strong buy-in from the members. We have a real opportunity as well because we've hired an experienced, dedicated staff . . . and they are going to do things that the industry has never seen before. I am convinced that the members are going to see and recognize value from their trade association right from the beginning.

Q You have a lot on your plate, where do you begin?

A With structural issues. I think enforcement is really important. Whenever we are meeting with government and talking about structure I think it is a high priority in terms of enforcement. On the regulatory agenda where there are a million rules and regulations coming down the pipe, I think there are two policy areas that are our priority. The first one is the passport system. We have a real opportunity to make headway and I think the first part of that is the Canadian Securities Administrators didn't get Ontario buying into it unfortunately, but what they did do is they came up with a good start for a passport for brokers. The problem was it is very cautious. It put restrictions around the exemption. I think our priority is to work with the commission to try to build on that start.

> "We have to demonstrate to our members every day that we are delivering value to them."

The climate has really changed in the last six months. With David Wilson taking on the chair of the OSC, that's a huge plus. He recognizes the need for efficiency in the marketplace and the need for greater harmonization. That's the first step towards a more national system, which is where we want to go. The perception unfortunately is what really drives things, but Canada is a bit of a relic as a regulatory structure in the world. We've got to at least make it work better, and the passport is a first step. The second one that we think is long over due is the capital gains exemption.

Q Where do you see the growth coming from in the securities industry?

A I think the capital markets have demonstrated a resiliency that nobody ever expected. While the economy has been buoyant and continued to be fairly stable, capital markets activity has expanded continually year after year, in every aspect: wealth management, financing activity and trading activity. And it has happened not only in Canada, but Canada perhaps more than anywhere else. There are a number of reasons for that. The demographics has kicked in. That's been one of the reasons for it, but I think the most important reason is the return of the resource cycle that Canada has capitalized on in a big way. That's been the catalyst on all of the finance activity and a lot of the investing activity as well.

Q Do you still see consolidation of the smaller brokerages?

A I think things are going in a different direction. The reason why I think there is a long-term future for smaller firms is technology, and as well the third-party service providers who have become very sophisticated. The only constraint is that there is a limit to quality brokers out there. Those who were going to move and move for significant money have probably already gone. It's really slowed things down.

Q How has the product mix changed?

A The product mix in the last four years has changed dramatically. It has moved out across the spectrum from the simple traditional bread and butter products of debt and equity into derivative type products, which are the structured fixed income; 70% of the fixed income products sold to retail investors are a structured product in one form or another.

> "Canada is a bit of a relic as a regulatory structure in the world."

The small firms as well as the large firms can offer that wide array of everything from an income trust to a basic stock all the way out to these more sophisticated wrap products. While the investor has become more knowledgeable I think it has meant that investors have to rely more heavily than ever on the professional advice of their financial advisor. I know our industry has done a great job on that in terms of providing clients with a diversified high-yielding portfolio.

Q Are small firms still growing faster than the banks?

A If you looked at performance there has been a slow down. In '04 we saw the small firms really outperform the big firms in terms of earnings growth, in terms of revenue growth in particular. This past year what we saw was the small firms continue to perform well, but the integrated firms – the bank-owned firms – really came back strongly. It was simply because they have a lot of cylinders in the engine. They have the financing power, they've got the wealth management business that's done well, they've got the trading business and that's one of the turn around factors '04/'05 with the bank owned firms.

The fixed income trading business was pretty treacherous in '04 and there were significant losses in that business just because of the behaviour of interest rates. But '05 the firms adjusted very well and the fixed income business did very well, as did their other businesses. It's just been a phenomenal period of time. AER

Continued from page 8

Where to start: Increase high-margin, recurring revenue and minimize one-time transaction-based income. Monitor business profitability and identify areas to cut expenses. Monitor team performance and hourly profitability. Charge for your advice and your wisdom, not for your ability to sell. Compete on business process and solutions, not product and price.

3. MANAGE YOUR GROWTH

A growing business will be worth more than a stagnant or declining one – this much is obvious. But not all growth is created equal. If your growth is random, your practice will eventually end up with a number of unsuitable, unprofitable clients. These people don't appreciate the tremendous service they're receiving. They are not loyal, nor do they refer quality clients to you. For these reasons, you'll want to manage the growth of your practice. Be selective in your growth, and only take on those clients who fit your ideal client profile.

Where to start: Identify a target market – define it as narrowly as you can. Build a client screening system that ensures only qualified prospects can become clients. Define a vision for your practice: Where do you want to be three to five years from now? Sticking to your vision is what will keep you on track.

Don't wait until you need to sell before you build value in your practice. Follow the above suggestions and you'll be ready to make the sale on your own schedule, at a price of your choosing. AER

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