

HUB²⁴



THE SEARCH FOR EFFICIENCIES –
BETTER BY CHANGE, NOT BY CHANCE

Part 1: Entrepreneurialism
Takes Centre Stage



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1. ENTREPRENEURIALISM A REQUIREMENT, NOT A NICE TO HAVE

Advice businesses get better by change, not by chance. Unlocking more efficient and productive ways to run their businesses, while creating value for clients is increasingly key to advisers' success.

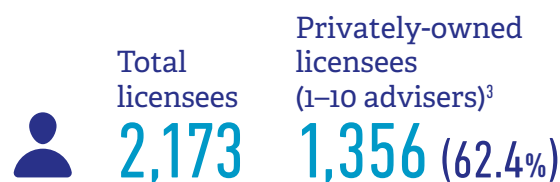
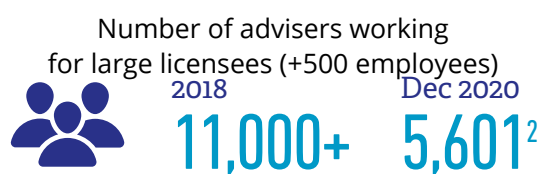
To build a sustainable advice practice requires a focus on adapting and renewing value propositions while managing compliance obligations and the complex needs of clients. This juggling act is the source of much frustration but also serves as an inflection point for innovation and new thinking.

To discuss what innovative and adaptive changes they are seeing across the advice landscape, HUB24 got together some of the leaders of the advice industry for a webinar – AZ Next Generation Advisory (AZ NGA) CEO Paul Barrett, Viridian Advisory CEO Glenn Calder and Clearview Financial Advice and Matrix Planning Solutions CEO Allison Dummett. We also gathered commentary from advisers Nicole Heales and Dwayne Hameister to create a series of articles based on what successful advice practices are doing to adapt and thrive amongst industry disruption.

Driven by the rising costs and increased administration associated with meeting regulatory and compliance requirements, this process of change takes time and resources at a time when advisers report heightened levels of anxiety and mental fatigue.¹

The structural change that has occurred in the advice industry over the past two years with the dismantling of a number of institutionally-

owned licensed groups and the impact of vertical integration has facilitated the growth of new industry participants, such as mid-tier licensees and privately-owned advice collectives like AZ NGA, who are helping shape the future of advice.



In 2018, more than 11,000 advisers worked for large licensees made up of more than 500 people. By December 2020, this number had reduced to 5,601 advisers.² Further, of the 2,173 licensees in the Australian financial advice market, privately-owned licensees (made up of 1–10 advisers) account for 62.4% or 1,356 of these licensees.³

However, the significant restructure of the advice industry and the impacts of the Royal Commission have paved the way for transformation and an opportunity to generate better client outcomes using business efficiencies and innovative product solutions to develop advice propositions for different client segments.

2. OPTIMISTIC AND EAGER TO EVOLVE AND TRANSFORM

At the recent HUB24 webinar “Success in Advice in 2021 and Beyond”, advice leaders commented on the energy and optimism they are seeing in the advice industry now.

“Our 80-year old clients are doing Zooms with us now, so our clients are evolving,” said Calder. “We are seeing some advisers also evolving, particularly where their background may have been more institutionalised previously. It’s shining the light on evolution, and we are starting to see some of the entrepreneurship coming out.”

Barrett agreed: “We’re seeing more innovation. During a period of enormous structural and regulatory change, great advice businesses are popping up everywhere.”

According to Allison Dummett, CEO of both Clearview Financial Advice and Matrix Planning Solutions, the questions being asked by advisers reflect a new future.

“For many of them their major assets are themselves, their skills and their very valuable client relationships. One of the things I am finding quite exciting is businesses starting to ask, ‘Armed with what I’ve got, where do I go?’”

For Nicole Heales of Nicole Heales Financial in Adelaide, this has meant moving to a platform and adopting managed portfolios to facilitate the delivery of their value proposition.

“I run a lean business,” said Heales. “I have no intention of putting on another adviser. I need to make sure there are business efficiencies with all the providers I use.”

However, the starting point of any transformational journey is to understand what you have. “For businesses to continue their transformation in what has been a very different landscape to what they signed on for, I think the first thing they have to do is look at the assets they have,” said Dummett.

Barrett agreed. “The end outcome of that exercise is often a clearer, more focused strategy, value proposition and goals.” When establishing AZ NGA, Barrett undertook a similar exercise. He recalls writing down the various contacts he had, including his parents’ group.

For many practices, the answer to what assets are in the business will be the adviser themselves – their skills and the valuable relationships they have with their clients. Practices that do this exercise are creating different business models. “Generalists are recalibrating and sharpening their focus to become specialists because that is increasingly what consumers want.”

Barrett said this is because consumers are less willing to pay for general or vanilla advice and far more open to paying substantial fees for a specialised and deep area of expertise. “Many of our larger firms are actually recalibrating and coming back with a collection of specialisations. They are still servicing the general population but are doing so in a more focused way.”



3. ENTREPRENEURIALISM TAKES CENTRE STAGE

An entrepreneurial mindset is critical for financial advisers and practices seeking new and innovative ways to create efficiencies and value to build a sustainable business, however there is some disagreement over how much the institutionally-owned structure supported that entrepreneurial mindset.

“Looking back at the past 20 years, the traditional licensee model and regulation has stifled innovation and entrepreneurship in advice,” said Barrett. He added: “Advisers have been repeatedly told, ‘You can’t do this, you can’t do that’. In that context, it is easy to see why innovation has stalled. That said, structural change and fragmentation is creating an opportunity for advisers to think differently and expand their capability and capacity.”

Overcoming key challenges requires a flexible approach so practices can adapt their value propositions to meet client trends and expectations.

For example, last year a practice in Melbourne saw the need for assistance with applications for COVID subsidies, such as JobKeeper and Jobseeker. The practice hired a professional to assist them, investing in a grants capability so they could fill this need. “Advisers have been conditioned to operate inside the narrow flags set by the industry and their licensee. Few stray beyond life insurance, superannuation, and traditional investments. That said, we’re increasingly seeing advice businesses strive to understand their clients’ needs and preferences faster and better than the competition in order

to deliver the right products and services,” concluded Barrett.

Dummett agreed: “Flags have to change so we can enable that sort of strategic, non-product advice while still complying with regulations. We have supported our advisers for some time to provide quality strategic advice outlining options and strategies, not just product.”

With the focus on the client, Calder said regulation often comes in after that fact, but does not agree it stifles innovation. “I am not sure that it stops innovation, and it shouldn’t stifle innovation because if we are dealing directly with the client and their needs and wants, and they are changing all the time, and if we are slow, we become irrelevant.”

Using property as an example, Barrett argues advisers are missing a big opportunity if they aren’t able to advise on it given property represents most clients’ largest asset. Practices should not look to their licensees for all the answers. “Historically, licensees have been very good at a number of things, and they provide a valuable proposition, however, if a licensee is preventing an adviser from meeting their clients’ needs, they should pursue other propositions for the client. Compliance and governance are critically important, but entrepreneurs prioritise their clients’ needs and find a way to make stuff happen.”

Barrett provides an example of an advice practice in Queensland which has a property advisory capability with a residential property licence that sits outside what is provided by its retail licensee. “The retail licensee still plays a valuable role, but when it comes to property advice, that is delivered under a different licence, through a separate entity,” explained Barrett. “Same brand but a different entity.”



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4. COST TO SERVE AND EBIT MARGINS – BIGGER NOT NECESSARILY BETTER

It is often assumed that a bigger business with scale will result in better profit margins, however this is not always the case. Instead, they may encounter revenue creep and increasing complexity.

According to Dummett, the findings of a recent cost-to-service project for over 100 practices emphasised this point. “So many epiphanies happen – one of which is a realisation that they are giving away services too cheaply, but another is they are spending time on things that aren’t of value to their clients.”

Delegating to a less expensive resource or automating processes are two viable solutions to reduce the cost to serve. But this process also lays the basis for defining and expressing the real value of services provided.

Once practices factored in their actual costs, a basic ongoing service fee of \$3,300 was quite common, with practices then charging more for complexities, additional strategies, or consideration of other entities. However, if you overlay this with the desire to find more efficiencies so advisers can move the price down, the price margin is a challenge.

Practices at the top of the EBIT curve at approximately 55% have very clear value propositions and a clear client strategy. At the bottom of the curve at around 12% EBIT, everything is a bit confused, including value propositions and structures with levels of decentralisation.

“There’s a bit of a paradox here because there is a scale trap as well,” said Barrett. Firms with the higher EBIT ratios aren’t the biggest firms,

rather the medium-sized firms. However, once a business’ wage bill increases to over \$1.7 million, the EBIT margin starts to decline quickly. “Our research shows that medium-sized businesses paying between \$500,000 and \$1.7million in wages are outperforming,” he said.

“There’s an assumption that bigger businesses are more profitable but, based on our benchmarking analysis, large practices grow at around 13% per annum, a much slower rate than medium-sized practices which clock in at 26%.”

According to AZ NGA’s analysis, as businesses grow, headline revenue typically creeps up, and they tend to become more complex. Complexity demands more investment, more highly-skilled staff and better systems and processes. The associated costs impact on profitability.

“A close examination of large businesses reveals they often end up operating like a collection of small businesses. By employing pod structures and adviser-centric teams they become more and more inefficient and complex,” said Barrett.

He added: “So, the challenge we have is as we grow our firms, how do we avoid falling into the scale trap? The answer lies in how we use technology and improve our processes as well as investing in people to sustain growth.”

5. PROFITABILITY – IS THERE A SWEET SPOT?

According to CoreData, while licensees have reported practice profitability as generally remaining stable compared to the same period last year (52.6%), 10.5% said profit in practices had generally fallen somewhat (up to 30%). Interestingly, 15.8% reported profit generally increasing somewhat (up to 30%).²

Further, 73.7% of licensees estimated they would be profitable in their own right in the current financial year without remaining subsidies or grandfathered sources of revenue, while 26.3% did not.²

Profitability is top of mind for anyone who runs a practice, but according to Dummett, it is not well understood. “I think there is definitely a myth about the percentage profit that is out there,”

she said. “Those people that pride themselves on the percentage profit they are making may well be putting themselves at risk if they are cutting corners on staff costs, for example. Future buyers or investors will look both at profit and sustainability.” Whilst Barrett said a practice with an EBITA margin of 30–35% is the sweet spot of profitability.

Calder also agreed optimum profitability is 35%. “If we actually got far above that and I think we are actually getting too much into the maturity and not investing into our future growth, we would actually look to push that down.”

Australian Financial Advisers Managing Partner of the Darwin office, Dwayne Hameister agrees. “If someone can get 100–150 clients paying \$5,000 fee for service, that is \$750,000 total revenue and with one adviser and one support staff, that is 35–40% EBITA.”

Risk is another important consideration with profitability. The panel agreed if a business has higher profitability, it may not be investing back into reducing risk.

Licensees’ reporting on profit FY21



Stable
52.6%

Falling
10.5%

Increasing
15.8%

Profitable in own right
73.7%

6. CONCLUSION

Licensee leaders and practitioners report a healthy appetite for change, as advisers are actively seeking new ways to deliver their value propositions and grow their businesses.

An entrepreneurial mindset is critical to identify and implement opportunities. Also critical is a flexible approach so practices and advisers can adapt their value propositions to make the most of these opportunities.

Maintaining profitability is critical to practice success, however percentage profitability is not a measurement that reflects the big picture. Practice sustainability that is built on the right levels of resourcing and risk considerations is just as important. These will be critical factors for future buyers of the business.

*This paper is part one of a three part series. Part One and Part Two can be accessed at www.hub24.com.au

1 Investment Trends Feb 2021 Managed Accounts Report

2 CoreData Five forces that will shape financial advice April 2021 – ASIC's Financial Adviser Register December 2020

3 Adviser Musical Chairs Report Q1 2021 AdviserRatings



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