DEVELOPING A WINNING BUSINESS STRATEGY

A guide for modern advice businesses

FORTNUM
PRIVATE WEALTH

FOREWORD

Change and progress generally takes time, but not in modern day financial services.

In our industry it's happening at breakneck speed, right in front of us.

It is structural, regulatory, cultural, economic and demographic, and it is transforming how organisations operate.

But we're not alone. Almost every sector is being disrupted in some way or the other. Consider the changes in retail, media and manufacturing.

If you accept that commerce will look markedly different in the future, then every participant must rethink their strategy.

In financial services, product manufacturers can't own and control Australian Financial Services Licensees (AFSLs) to flog product. Licensees can't distribute product to prop up their revenue, and financial advice can't be about access to financial products.

The separation of product and advice is accelerating, meaning licensees and advisers can no longer depend on product-related payments and financial benefits.

This is placing extreme pressure on business models.

The question then is; what is your organisation's strategy for future growth?

If you run a boutique financial advisory practice, chances are you don't have one.

At least not one that's written down and socialised across your company. It's probably all in your head.

Very few small-to-medium enterprises (SME) have a clear, well understood and documented strategy. They tend to make it up as they go and make decisions on the fly.

This is a vastly different approach to how institutions and big businesses approach strategy.

In institutional land, where I spent 25 years before joining Fortnum, strategy is paramount.

It is formal and deliberate.

Chief executives lead strategy workshops and off-sites, facilitated by external consultants, where an organisation's senior leaders talk through their value proposition and unique selling points. There is debate about their strengths, weaknesses, opportunities and threats, and the segments of the market to pursue or abandon.

There are dedicated strategy roles and teams who are responsible for managing the strategic planning process, developing a company's strategic objectives and formalising the strategy to achieve those objectives.

Of course, being big does not guarantee success. It does not even guarantee the right strategy.

No matter your size, the purpose of this paper is to encourage you to spend time thinking about your organisation's strategy.

Reflecting on my experience working in organisations of different sizes, one of the advantages smaller companies have over larger organisations is their ability to be bold and decisive. This is important because strategy is ultimately about making hard choices.

It is about choosing where to play and how to win, as former Procter & Gamble chief executive, A.G. Lafley and former management consultant Roger L Martin point out in their book, *Playing to win: How strategy really works.*

According to Lafley and Martin, strategy requires a crystal-clear vision about what winning means for your organisation and then "uniquely positioning a firm in its industry, creating sustainable advantage and delivering superior value versus the competition".

In order to get all three elements right, business leaders must make the necessary choices.

In the next 12 months, financial advisers have some tough choices to make. Firstly, they need to decide if they're going to do the required study, under the Financial Adviser Standards and Ethics Authority (FASEA) regime. Already 2825 advisers have relinquished their authorisation and exited the industry this year, according to Adviser Ratings^.

Those who continue to run advice businesses will need to determine the number and type of clients they want to serve; how they will charge; and the business resources, systems and investment needed to succeed.

Neil Younger

Managing Director and Group CEO
Fortnum Private Wealth Limited.

WHY NOW?

Clients feel they have a greater understanding and are more demanding. Regulation is mounting, revenue is falling and costs are rising in the future.

The competition is fierce and other formidable digital competitors are coming.

Advisers and licensees need a clear understanding of what it will take to succeed in the new landscape. What does success really look like?

As a starting point, organisations need to know their exact destination in order to set the course, determine the mode of transport, estimate arrival, navigate potential roadblocks and identify milestones along the way.

Vision is an input into strategy but a good vision can also fall out of a clear strategy.

1 SECTION — Section 1 of this paper discusses the importance of having a clear vision and mission.

2 SECTION — Section 2 touches on the key inputs into strategy.

3 SECTION — Section 3 details three fundamental elements of a winning strategy for licensees and advice businesses.

4 SECTION — Section 4 touches on what it means to have a corporatised business model and sums up the benefits of strategy.

Over the past 12 months, Fortnum's senior leadership team has spent considerable time refining our strategy in light of current demographic, regulatory and structural changes.

Our goal is to share some of our learnings because a strong, vibrant and collaborative advice industry will attract talented people, boost competition and innovation, and ultimately see more Australians seek professional advice.

According to research by Investment Trends, 48 per cent of Australians need professional advice but only 2.6 million received professional advice last year.

This is despite evidence that those who seek professional advice are significantly better off at retirement.

According to research by Rice Warner Actuaries^^, key benefits of financial advice include:

- Reduced debt - increasing disposable income for more productive purposes;
- Higher rates of return on investments over long periods - building wealth;
- Insurance protection - preventing people and their families from being forced to rely on social security in the event of a premature death, injury, accident or illness;
- Higher levels of savings – reducing reliance on government benefits during and after retirement;
- A more financially literate and conscientious society, able to make better long-term decisions.

Clearly, there is enormous need and opportunity.
Licensees and advice practices need the right strategy to capture this opportunity.

^https://www.professionalplanner.com.au/2019/07/2825-advisers-gone-as-migration-patterns-emerge/
^^https://www.pc.gov.au/__data/assets/pdf_file/0020/221870/sub026-financial-system.pdf

SECTION 1

Getting clear on vision and mission

1
SECTION

Getting clear on vision and mission

FIRST, A SHORT NOTE OF VISION

Next year marks Fortnum's 10-year anniversary. We have achieved a lot since 2010 when a small team, led by Ray Miles, formed Fortnum Financial Group with a vision to build a highly sustainable professional services advice business; recognised as Australia's pre-eminent licensee. Importantly, free of product distribution-related payments like rebates and margins with the scale and technology.

Over the years, Fortnum has been criticised by some competitors because the business was initially backed by ANZ, received platform rebates and had an interest in a research and asset consulting firm.

Fortnum bought out ANZ's 20 per cent stake in 2014, divested its interest in the research business in 2018.

The business is profitable but there's still plenty of work to do to achieve requisite scale, deliver greater value to shareholders and secure long-term, sustainable growth.

I'm sharing this information to illustrate the difference between vision and mission.

Our mission is to partner with like-minded, professional financial advisers to help them deliver quality advice and grow their businesses.

This broadly describes what we do every day, which is different to our ambitious vision for tomorrow. Fortnum is still a long way off realising our vision, but that's the point.

A vision is an ambitious goal for the future.

What is the vision for your business?

Recently, I heard another adviser's vision described as; to make geography irrelevant by utilising technology to efficiently deliver advice.

To highlight the difference between vision and mission, it is sometimes helpful to look at businesses in other sectors and industries.

Uber

MISSION

"Bring transportation – for everyone, everywhere."

VISION

"Smarter transportation with fewer cars and greater access. Transportation that's safer, cheaper, and more reliable; transportation that creates more job opportunities and higher incomes for drivers".

Amazon

MISSION

"To offer customers the lowest possible prices, the best available selection and the utmost convenience."

VISION

"To be the Earth's most customer-centric company, where customers can find and discover anything they might want to buy online."

Service NSW

MISSION

"To simplify the way customers do business with government."

VISION

"To be recognised as the distinctive leader in the provision of government services."

IT'S PERSONAL

Vision is personal and bold.

It can't be copied or emulated.

The late Steve Jobs, co-founder of Apple, described his personal vision and ethos as "to make a contribution to the world by making tools for the mind that advance humankind".

By contrast, Apple's corporate mission statement is more matter of fact:

> *"Apple designs Macs, the best personal computers in the world, along with OS X, iLife, iWork and professional software. Apple leads the digital music revolution with its iPods and iTunes online store. Apple has reinvented the mobile phone with its revolutionary iPhone and App store, and is defining the future of mobile media and computing devices with iPad."*

A clear vision is critical because the starting point of any strategy is to consider: What is my business trying to achieve? What does success look like?

Star-gazing and navel-gazing

2
SECTION

PUTTING THE ROADMAP TOGETHER

The framework for defining and creating a strategy can be distilled into three questions: why, who and how?

1) Why does your business exist?

2) Who are you doing it for?

3) How do you succeed?

It is also fundamental that all three are consistent with your values.

The first question has been addressed in Section 1.
Section 3 will address who and how but before launching into the detail, this section looks at the key internal and external inputs to strategy. It is important to understand how your business is currently positioned in order to move forward.

2
SECTION

Getting clear on vision and mission

INTERNAL AND EXTERNAL INPUTS TO STRATEGY

How licensees and advisory firms approach the next 12 months will either set them up for success, mediocrity or failure.

After an exhaustive few years, the temptation is to take a step back and wait for further clarity on things like the Royal Commission recommendations and the impact of recent consolidation.

But those who wait too long and act too slowly run the risk of being completely unprepared when the full force of changes hit.

Now is the time to actively plan for the future.

In order to do so, advisers need to examine every facet of their business and its competitive landscape.

In many ways, strategy is a bet on the future. It is the playbook for how your business will succeed in the future that you see.

While no one knows exactly what the future holds: current structural, regulatory, economic, consumer and demographic trends provide clues.

It is important to consider the potential impact of external trends and the opportunities they present, when developing your strategy.

EMERGING TRENDS TO CONSIDER

- Significantly higher consumer knowledge, expectations and community standards
- The disappearance of passive income
- The shift from ongoing fee arrangements to annual fee contracts
- Rising compliance and regulatory costs
- Digital disruption and mobile-first consumers
- Institutions retreating from personal advice
- Record high household debt, low levels of savings and a widening underinsurance gap
- Ultra-low interest rates
- Australia's ageing population and the imminent intergenerational wealth transfer with significantly different expectations from each generation
- Increasing complexity in superannuation, tax and social security
- Increasing political and economic uncertainty from continued global disorder

Based on their observations and experiences, companies can also make educated assumptions. For example, at Fortnum, we believe that consumers will demand high quality, unbiased advice on their terms. They will expect a dynamic advice experience that merges personal and digital.

We believe more people will look at financial advice as a fully-fledged profession and professional advisers seeking out a licensee that enables them to provide objective advice in their clients' best interest.

If you agree with these assumptions, then it's hard to fault the conclusion that the highly-educated, professional advisers of the future will want to partner with a licensee that is clear on the role it plays and has the resources and technology to facilitate the delivery of high quality advice.

The strategic planning process also requires internal reflection.

Businesses need to understand their capabilities and what they're distinctively good at in addition to their revenue and expenses.

Why do your clients use you? What is it about your business that makes them come back year-on-year? (Hopefully it's not inertia.) Is there anything that you're doing that your clients don't value?

This information should to be applied in the context of the future you envisage.

For example, an advice firm with beautiful offices in the middle of the city may be convenient for their professional clientbase today but if the majority of clients plan to retire in the next three years, should they also look to invest in video conference technology?

To stay ahead of the curve, businesses need to intimately know their clients today and pre-empt their needs tomorrow.

2
SECTION

Getting clear on vision and mission

TAKING STOCK: REVENUE AND EXPENSES

Across the industry, revenue is falling and costs are rising. No business is immune. For licensees and advice businesses, traditional sources of revenue are being turned off while the cost of doing business is increasing. Doing nothing is not an option.

Before a business can develop a vision and strategy for the future, it needs to understand its current position including key sources of revenue and the sustainability of those sources.

These questions pose a real dilemma for many licensees because they are dependent on grandfathered platform rebates and marketing allowances to stay afloat.

They need to determine the licensing fees they need to charge advisers to remain profitable. They need to understand how many practices, and what type of practices, they need to pay that fee.

If they don't have the scale, they need to get bigger faster but not so fast that they become exposed to unnecessary risks.

Similarly, advisers need to understand the breakdown of their revenue and expenses, and identify sources that are at risk.

They can't simply look at their clientbase in aggregate. They need to drill further and understand the revenue attached to each individual client. What level of service are they providing for the fees they collect?

They need to make a decision about the type of client they want to service and how much in advice fees they need to earn to turn the lights on and pay staff and suppliers.

On top of that, what margin do they need to make to continuously invest in their business and ensure adequate resources to deliver their value proposition?

Advisers also need to examine the costs in their business.

Until recently, many practices have been shielded from the true cost of the licensing and dealer services such as compliance, education, technology and PI insurance because these costs have been subsidised by product manufacturers.

As these subsidies are removed, practices will need to pay market rates for the services they consume.

Who do you love?

The majority of advisers pursue the same type of client.

Most target pre-retiree/post-retiree clients with reasonable superannuation balances.

Traditionally the ideal client was in the affluent category with at least $500,000 in investable assets.

This is isn't a deliberate decision based on strategy, it is the accidental outcome of the industry's product linkages. That's because advisers were primarily remunerated by product collection mechanisms like commissions or fees billed through superannuation accounts.

All clients regardless of their age, needs, means and income received largely the same value proposition: superannuation, insurance and investment advice, and an annual review. Perhaps the odd invitation to a generic client seminar or newsletter.

In a world where advice is not about access to financial product and clients are paying fees from their own pocket, professional advice needs to be uniquely tailored to each individual.

Advice becomes accessible to anyone who can pay for it which is an enormous opportunity for businesses that have a clearly-defined strategy and know their target market.

Businesses that can provide bespoke, customised advice based on a client's unique needs and expectations stand to benefit. The client of tomorrow will look very different to the client of today (see page XX). They will be focused on different things, and probably not retirement for a very long time. Advisers will need to have different conversations and provide a different type of advice experience.

For example, an advice business targeting cashed-up mobile-first millennials will need to provide a rich digital experience. They'll need to know the right questions to ask in order to get the necessary information to do their job.

3
SECTION

(Re)building a modern advisory business

3
SECTION

(Re)building a modern advisory business

STRATEGY'S THREE ESSENTIAL INGREDIENTS

Financial planning has historically been described as a cottage industry, characterised by small, sub-scale operations carried out in people's homes rather than dedicated offices.

The industry has changed a lot in the past decade but remnants of that cottage industry remain.

Many advice businesses are still run by sole practitioners on the smell of an oily rag. They may rent premises nowadays but they don't have the resources to invest in people, technology or growth; they don't have structured processes in place; and, at the end of the week, month or year, the principals draw an income from the majority of business revenue.
That is not the advice business of the future.

Fortnum has spent considerable time thinking about the fundamental building blocks of a winning licensee strategy. If we had a clean sheet of paper, what would be the foundational pillars and how, almost ten years since our inception, could Fortnum incorporate those principles into our strategy? Could the same principles be applied to advice businesses?

We believe that the key strategic pillars for Fortnum are:

1) Quality;

2) Sustainability; and

3) Value alignment.

Advice businesses may also consider these pillars or others for their strategy.

Business owners must ask themselves:

- Do we have the required resources to deliver high quality service?
- Are we dealing with the right clients and do we have sufficient scale to run a sustainable business?
- Are we successfully balancing the interests of our key stakeholders?

QUALITY

High quality capabilities (and people) are essential to a winning strategy because customers want high quality, professional advice and they are willing to pay for it. Anyone offering a sub-prime service that consumers don't want to pay for will need a refreshed strategy because 'price is only a factor in the absence of value'.

Very few companies set out to compete on price alone because this strategy requires significant scale. It also threatens profit margins and reputations.

For example, being Australia's cheapest dentist, plastic surgeon or financial adviser is hardly a unique selling proposition or a strong marketing campaign.

Cheap may be a strategy for companies that sell consumer goods and commoditised services like bookkeeping or a tax return, but when it comes to professional advice, quality is paramount.

Regardless of this, so many financial advice businesses offer fairly average service and advice, based largely on access to financial products (which are arguably commodities).

Businesses don't consciously set out to be average yet so many are because they don't have the required skill and expertise or the right quality control processes in place.

Lax standards were acceptable in the past because clients didn't know what they didn't know, and they weren't paying for advice out of their own pocket because the cost was covered by product commissions.

The shift to genuine fee-for-service has many implications for established advice firms.

Businesses without quality capabilities need an appropriate development agenda to get good fast, if they hope to win and retain clients.

Not only will the value proposition they take to market need to be higher quality, it'll need to be priced differently because quality products command a premium. As a result, advisers will need to target clients who are willing and able to pay a reasonable fee for advice. In many cases, that client will be different to the type of client they look after today.

Importantly, a sharper focus on providing quality advice will protect firms against the potential risk of client complaints, regulatory action and media scrutiny.

3
SECTION

(Re)building a modern advisory business

SUSTAINABILITY

A sustainable business model is one that generates enough profit to comfortably cover expenses and manage risk, with some margin for unexpected costs and ongoing investment in business growth. It requires scale to execute on quality.

It boils down to steadily growing profitability by increasing fee revenue and building to scale to reduce costs.

First and foremost, advisers need to charge an appropriate fee for their services in order to make a sufficient margin.

It sounds simple enough and yet advice fees typically don't cover the true cost of delivering advice (let alone factor in a profit margin).

This unsustainable model has come about because product manufacturers historically set the price of product advice via commission rates.

Commissions paid to advisers were a distribution cost, similar to advertising and marketing.

The rate reflected what a product manufacturer determined was a fair price for distribution.

As the advice industry evolved, commission rates became so far removed from the real cost of providing personal advice but they continued to act as a proxy for advice fees and what consumers were prepared to pay.

This legacy thinking, which is not based on any market research or data, continues to suppress the profitability of advice businesses.

Similarly, institutions treat the cost of owning and running a dealer group as a distribution expense. Their manufacturing arms subsidise their licensees, which in turn subsidise the true cost of providing dealer services.

In non-institutional licensee land, kickbacks from manufacturers have also enabled AFSLs to subsidise their dealer services but the breakdown of vertical integration and the imminent ban of grandfathered platform rebates has exposed unsustainable pricing and unsustainable business models.

The knee-jerk response from licensees has been to jack up fees, without much thought given to enhancing their value proposition or longer-term strategy.

The Band-Aid solution for advisers isn't as clear cut.

Many advice businesses have long tails of underserviced clients from which they effectively collect a passive income from. Regulatory change is forcing advisers to service (or sell) these client-books.

It is clear that many practices will need to lift their game and their fees.

But accurately pricing your value proposition it is only part of the answer. Getting the right type of client, and enough of them, to pay is critical to achieving scale.

Scale is basically the efficient use of a company's fixed cost-base.

In any business, there are fixed and variable costs. Fixed costs are stable, irrespective of a business' size. They generally include rent, infrastructure and managerial staff.

On the other hand, variable costs like client-facing staff and marketing, can fluctuate based on a company's size, workload and priorities.

Spreading fixed costs across a larger clientbase (or a smaller clientbase with higher fees) delivers economies of scale. It allows a company to take on more clients without adding costs, lowering the cost of providing advice per client.

Scale enables business growth.

At Fortnum, the areas where we can dial up and dial down our resources against adviser numbers include practice development support, however, the intellectual property at the heart of our business is a material fixed cost.

Our strategy is focused on building to scale to spread our fixed costs across a larger population. This will deliver a greater return on investment and, ultimately, greater shareholder value, which is important because our shareholders comprise of advisers and staff.

3
SECTION

(Re)building a modern advisory business

VALUE ALIGNMENT

In a professional advisory business, advisers are often also partners, which guarantees a strong alignment between ownership and execution. However, a business' stakeholders extend well beyond advisers and also its shareholders and clients.

For an advisory business, they also include staff, regulators and their AFSL. In other sectors, stakeholders may also include other government departments, media and suppliers.

A company's long term business strategy should balance the interests of key stakeholders. However, the Financial Services Royal Commission demonstrated that financial services companies have failed miserably at this.

Both aligned and non-aligned licensees have been guilty of pandering to the interests of shareholders/product manufacturers because they were dependent on them for revenue. Often the interests of advisers and their clients took a backseat, as a result.

Advisers commonly complain about their licensee while licensees say advisers are impossible to please. This is because many licensees are trying to satisfy the opposing interests of an institutional master and their clients (advisers). They end up failing at both.

Advisers are also guilty of not treating licensees as a valuable stakeholder.

At Fortnum, we value and appreciate our suppliers, be they technology providers, PI insurers or product manufacturers, because good business partners are extremely valuable. Strong relationships with our suppliers enable us to do our job better.

Going forward, licensees and advisory firms need to ensure that they get the value alignment right.

Quality, sustainability and value alignment are principles that underpin our strategy at Fortnum and these same principles can be adopted and applied to most businesses.

Whether you're a licensee or an advisory firm, you must be able to deliver a quality service to your target client and get enough of them to pay a reasonable fee for it.

Your value proposition and how you deliver it needs to satisfy your client's needs and withstand regulatory scrutiny. Your business model also needs to be strong enough to withstand headwinds like changing client preferences.

This will ensure the interests of all stakeholders including clients, shareholders and staff are balanced appropriately.

4

SECTION

Benefits of strategy

4
SECTION

Benefits of strategy

THE NEXT STEP: CORPORATISATION

Armed with a long-term business strategy built around the three critical success factors of quality, sustainability and value alignment, entrepreneurs need to decide how big they want their business to be.

Looking at the changes coming down the line, staying small is not an option. Already industry commentators are predicting the end of the sole practitioner.

Advice firms that want to be around for the long-term need to get big and corporatise their business.

A corporatised structure with the right resources and processes can facilitate growth and help an organisation build to scale. But what does it really mean to be corporatised?

A corporatised business is one where management and advice delivery are two separate functions. It isn't key-person dependent. There are systems and disciplines in place to make sure basic tasks are performed correctly like paying staff and suppliers, collecting fees and updating client data.

Implementing a corporatised structure doesn't necessarily mean turning the delivery of advice into a mechanical based process. Advisers can – and should – keep the unique aspects of their style but they need to put infrastructure and quality controls in place to ensure that the advice process and service offer is consistent and can be delivered in an effective manner.

While corporatised businesses require a diverse skill set and greater resources, they benefit from the capacity to improve their service proposition and plan for the future.

Management spend time thinking about strategy, innovation and other big picture things like brand and marketing, culture and team development, which can really lift overall performance.

This is important because consumer preferences are not static. They are constantly changing therefore advice businesses need the flexibility to keep up with the times.

Running a successful, corporatised business is definitely hard work and principals who choose to go down this route are exposed to more risk. However, they stand to be rewarded if they can execute their strategy. Arguably, running a small self-employed operation these days is riskier.

Sub-scale advice operations are highly key person dependent. Principals are responsible for advising clients as well as winning new clients, compliance, operations, marketing and answering phones. They are too busy working in the business, rather than on the business.

Small businesses are extremely sensitive to revenue shocks such as the loss of a major client, an increase in rent and expenses, or a staff member getting ill or taking unexpected leave.

Regulatory changes such as the end of grandfathered commissions or life insurance commission caps have the potential to wipe-out the profitability of these practices.

While it is hard for small businesses to implement a corporate structure, principals can start by trying to have a corporate mindset.

They need to be multi-dimensional and see themselves as both adviser and CEO.

4
SECTION

Benefits of strategy

Benefits of strategy

A clearly-defined strategy yields many benefits. For Fortnum, the top three benefits have been:

1. Clarity
2. Purpose
3. Reduced wastage

Having clarity on our strategy, strategic objectives and end goal has provided clear direction and made the decision-making process easier.

So many times, I've seen businesses pursue opportunities that end up being a major distraction for no real benefit.

A clear strategy can prevent this from happening because management and staff understand the business' purpose and their own purpose within the organisation.

At Fortnum, we are clear that we are an advice services business. We are not a technology company and we are not in product manufacturing nor distribution. This clarity of purpose resulted in the business divesting all non-core assets.

As an organisation, we are clear about who we are, who we work with and where we are going.

As a result, we are purposeful and proactive about the areas of the business we seek to develop and focus on.

It stops us from wasting time and resources on tasks and opportunities that don't align with our values, vision and strategy so we can focus on getting on with the task of building a highly sustainable professional services advice business.

FORTNUM
PRIVATE WEALTH

Fortnum Private Wealth Ltd.

Suite 2, Level 6,
111 Pacific Highway,
North Sydney NSW 2060

P.O. Box 1988,
North Sydney NSW 2059

www.fortnum.com.au