Achieving profitable and sustainable business growth and performance

OVERVIEW

The most successful businesses realise that as the world changes, some things stay the same. Improving your chances of profitable and sustainable growth in any environment comes from being incredibly adaptable to change, being relentless about knowing what the future looks like and staying focused on getting there and, furthermore, remaining vigilant when it comes to addressing the fundamentals required to build and grow a successful business.

For a profitable and sustainable business, it is advisable to not stray too far from the fundamentals, while maintaining an element of what is most current and up to date.

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LEARNING OBJECTIVES

After reading this article you should be able to:

- Explain the financial fundamentals crucial to business success
- Identify the necessary steps to turn a business into a viable entity
- Evaluate strategies to increase client retention and satisfaction
- Outline practices that contribute to business success.

KNOWLEDGE AREAS AND ACCREDITATION

Knowledge area: Practice Management (30 minutes).

FPA CPD points 0.5 Dimension: Capability (FPA 005985).

AFA CPD points 0.5 (AFA 01022009).

FBAA CPD points 0.5.

THE ADVICE WORLD AS IT IS TODAY

In 2005, research and findings in the study *Back to the Future: The Continuing Evolution of the Financial Advisory Business*, predicted that the advice industry would be shaped by forces that would mean over the next decade smaller businesses would struggle in a market that would undergo the following:

- Enormous legislative change
- Increasing demand from more sophisticated clients
- Rising operating costs
- Shortage of demand for talented professionals
- Rising expectations of employees
- Insatiable demand for growth
- Consolidation and the ageing demographic of business owners.

Now, in 2013 and with the benefit of hindsight, all of these predictions have come true. What is most interesting is observing the characteristics of the businesses that have been able to withstand such change and continue to strive, profitably, throughout these years.

In their book *Practice Made Perfect: the Discipline of Business Management for Financial Advisers*, Mark Tibergien and Rebecca Pomering listed the top 10 challenges of advisory firms and commented that although these challenges haven't changed over the past 10 years, the order in which they appear is different year to year.

Consider

The challenges are:

1. Lack of capacity to serve clients
2. Building value in the practice
3. Improving efficiency
4. Getting better clients
5. Managing growth
6. Offering value-added services
7. Keeping pace with technology
8. Developing specific expertise internally
9. Maintaining a life outside the business
10. Time management.

What has also been observed is that the fundamentals of a profitable and sustainable business don't change over time. What does change is how businesses go about addressing and reacting to the changing environment around them.

WHAT DOES ALL THIS MEAN?

Business owners who want to ensure the long-term sustainability and profitability of their business need to focus on getting the foundations right in order to prepare themselves for the future.

They need to be acutely aware of the environment surrounding them and be positioned to adapt readily to accommodate and prosper regardless of what happens.

One of the biggest casualties over the last few years, in particular since the GFC, has been the impact on business profitability. Although there seems to be more positivity currently, the squeeze on profit margins has not recovered. Unless this is properly addressed, the future success of many advice businesses is under threat.

For a business to be sustainable, it is vital it experiences healthy profit year on year, for a number of reasons:

- It leads to sustainable cash flows
- It contributes to increased business value
- It enables investment back into the business to keep it growing
- It makes it easier to attract finance from outside sources
- It provides an attractive return for owning a business.

EVALUATING PROFITABLE REWARD

Unless an effective evaluation can be done around the return on ownership, over and above the reward for labour, then it is difficult to adequately assess the real return that a business provides its owner/s.

Tibergien and Pomering make an important comment about the reality of financial performance when they state, "Financial success is defined by profitability, strong cash flow, a healthy balance sheet, fair return for the owner and value that's transferrable".

Although this may seem obvious, many advisers are not adequately skilled in managing the financial performance of a business and delivering the results required to make ownership worthwhile.

Did you know?

The *Future Ready V* report from Business Health and Securitor found that average practice profitability had fallen to a low of 14.8%, down from 28.5% in their previous study conducted back in 2010. This is a dramatic fall and should be a good enough reason for business owners to take action and ensure this trend does not continue.

A disciplined approach to the financial management of the business should be a priority for any business owner who genuinely wants sustainable success.

Advisers generally do not go into business just to break even. They want to be rewarded over and above a market rate salary for the risk they assume and the responsibility associated with business ownership.

USING FINANCIAL PERFORMANCE TO MANAGE BUSINESS SUCCESS

Being able to break down the numbers into simple categories, and refer to rules of thumb or benchmarks provides a great starting point for the financial management of a business.

Using this insight to identify pressure points and problem areas can offer the greatest opportunity to turn things around.

Some simple "rules of thumb" that Tibergien and Pomering suggest for an advisory business are:

- Direct expenses required to generate revenue in the vicinity of 40% of total revenue
- A gross profit margin (gross profit as a percentage of total revenue) of around 60%
- Operating expenses/overheads no more than 25–35% of total revenue
- An operating profit margin (operating profit as a percentage of total revenue) in the range of 25–35%.

These figures are rules of thumb only and the key is to ensure that business owners understand the economics of the business and the environment they are operating in.

Table 1 provides an example of what these percentages would look like, in theory, based on a business generating $1 million in revenue.

Table 1: Ideal business financial performance figures

	Dollar amount	Calculation	As a percentage of revenue
Revenue	$1,000,000	$1M/$1M	100%
– direct expenses	($400,000)	($400,000)/$1M	(40%)
= **Gross profit**	$600,000	$600,000/$1M	60%
– operating expenses	($300,000)	($300,000)/$1M	(30%)
= **Operating profit**	$300,000	$300,000/$1M	30%

Financial performance terminology

The meaning of the following terms must be understood.

Revenue
The money collected from all sources of business.

Direct expenses
The costs directly associated with the generation of revenue by all professional staff (including the owner if they are a revenue generator) and individuals responsible for the delivery of advice to clients or business development. This includes their salaries, bonuses and performance incentives. It also includes fees paid for referrals.

Gross profit
Total revenue less direct expenses. If the gross profit margin (gross profit as a percentage of revenue) is 60%, then the business is spending 40 cents per dollar of revenue generated on professional and direct expenses.

Operating expenses
All other overhead expenses and costs associated with running the business such as rent, IT, office equipment, stationery, business insurance, marketing, training, etc. Administrative and management position salaries and incentives are also included here.

Operating profit
The gross profit, less operating expenses. If the operating profit margin (operating profit divided by total revenue) is 30%, then for every dollar of revenue generated, the business is spending 30 cents on its operating expenses or overheads.

Today, we are finding that many advisers are experiencing healthy and positive revenue growth; however, their profit margins are suffering.

It is critical that business owners are able to understand and interpret their numbers and the signs they are showing. This insight can be then used to determine which parts of the business are profitable and which parts need attention, sooner rather than later.

A declining gross profit margin

If the gross profit margin in declining, then the four most common culprits for this include:

› Not pricing what you do properly

› Declining productivity

› The wrong mix of clients

› Being unclear on your promise (or offer).

Not pricing what you do properly

The biggest issue here is advisers not knowing what it costs to deliver the advice and service to their clients. Too often, the price being charged is not profitable, in many cases it does not even break even.

Declining productivity

In essence, productivity is about how much and how well we produce what we do from the resources we use. An increase in productivity comes when we produce more or there are improved outcomes from the same resources, or if we produce the same results from lesser resources.

The only way to effectively measure productivity is to look at all the components, input and output that are associated with delivering advice and service and seeing where the problem areas are.

Consider

Using key productivity ratios and measures is critical to properly assess and address what changes are required. They can also provide a snapshot of the business's performance and enable trends and warnings to be carefully observed. We discuss these in more detail later in the article.

The wrong mix of clients

This is about having too many clients on your books that are not ideal and are taking up resources that could be used more effectively in working with valuable, profitable clients.

A business that is committed to healthy financial performance needs to get the mix right. It is not business savvy to allow 20% of clients to subsidise the other 80%.

Being unclear on your promise (or offer)

In order to minimise the impact on the bottom line, advisers need to have a clearly defined advice and service offer in place that is aligned to addressing the specific needs of the different client groups. This is not being everything to everyone.

These four culprits of gross profit margin decay are what Tibergien and Pomering refers to as the "silent killers". They are often mismanaged and the implications of not addressing them are grossly underestimated. The Future of Financial Advice (FOFA) reforms have forced many advisers to step back and look at some of these issues, whether they like it or not.

Being able to uncover and address the problems that contribute to a declining gross profit margin is extremely powerful. However, this cannot be done in isolation. Giving each of these the attention required to improve the health of the gross profit margin needs to be attended to at the strategic level.

A declining operating profit margin

Sustainable businesses operate with an operating profit margin in the vicinity of 25–35%, on average. It is important that this figure is kept at front of mind and that business owners understand the factors and trends that cause this operating profit margin to fall. They include the following:

› A decline in the gross profit margin (as outlined earlier in the article)

› Ineffective expense management. This is a red flag in today's environment and catches out many business owners. It comes back to attitude and approach. Sticking to a well thought out budget and spending within the business's means is a discipline which needs to come back into favour or the future health and sustainability of businesses will be at risk. The challenge is being able to uncover the waste in the business and closely manage costs, without compromising the quality of the advice, the service or the client experience

› Insufficient revenue volume to support the infrastructure expenses.

Some other profitability ratios that are useful to track business performance include:

› Gross profit margin and operating profit margin

› Net margin percentage: Profit after tax as a percentage of total revenue

- EBIT margin percentage: Earning before interest and tax as a percentage of total revenue
- EBITDA margin percentage: Earning before interest, tax, depreciation and amortisation as a percentage of total revenue.

Knowing that business performance is wavering is one thing, knowing what to do to turn it around is another.

WHAT CAN BE DONE TO TURN THIS AROUND?

The first step is to understand the numbers, then work out what to do with the information. The challenge is being able to identify the difference between a symptom and a cause. As with anything, addressing the root cause of any problem will provide a more appropriate solution with longer-term benefits.

Over time, the financial management of a business becomes easier as business owners recognise and understand what the numbers are telling them. The relative trends and benchmarks that are established are of most value in diagnosing the problems and executing appropriate solutions. Analysing at least three to five years worth of data provides the most meaningful results.

In their 2012 release *Study by Advisory Firms: Growth by Design*, FA Insight found that the businesses that not only achieved better profitability, but were also on a course of steady increase in business value, adhered to the following practices:

Market focus: Tailoring and consistently implementing the client's value proposition and experience to meet the needs of a clearly defined target market.

Sound management practices: Managing people, technology, and processes in such a way that it maximises efficiency and productivity.

Discipline: Consistently implementing and reviewing processes.

Additionally, they found that sustainable growth firms are more likely to proactively manage technology; their business to client processes are well documented and understood by staff; they have mechanisms in place for ongoing process improvement; and most importantly, they are deliberate in their approach to growing their business.

The irony is all these characteristics focus on getting back to the basics and embedding the fundamentals required to build and grow a successful business. The only difference is the way they are implemented today.

Consider

The key fundamentals that make the biggest impact today include:

- **Start from the top**: the strategic view
- **Clients**: the golden opportunity
- **Productivity**: an unchallengeable necessity
- **The power of the people**: the human elements
- **Results**: the process way.

Start from the top: the strategic view

At a strategic level, it is critical that the owners of a business have clarity of their ideal vision and have a well thought out and documented plan in place. The key to getting results from any planning process is to ensure relentless execution and a disciplined approach to the ongoing management of achieving it.

An effective decision-making process needs to be adopted to ensure that the key financial, business and personal objectives are being achieved.

A focus on profitability and sound performance management needs to be a priority and the right business structures and entities need to be utilised to foster future growth plans and initiatives.

▶For example

Just imagine a team of the greatest soccer players in the world trying to win a match without a strategic game plan in place. Even if they had one, if it was not being scrutinised, assessed, adapted, and without a disciplined approach, the probability of their success would be seriously limited.

The link between increasing profit and effective planning is demonstrated in the *Future Ready V* whitepaper. The whitepaper highlighted that those businesses with a documented three to five year strategic plan that was effectively implemented, experienced, on average, an increase in their profit of 246% since 2010.

The key to this result is that these businesses had in place a three- to five-year strategic plan, a fully documented and comprehensive operational plan, and they had reviewed it in the past six months with monthly progress to plan reporting.

Table 2 records this result compared to businesses that have not undergone the same diligence in planning.

Table 2: Profit results according to the implementation of business plan

Key value driver — documented business plan	Increase in profit*
No	–
Partially	4%
Yes	41%
Fully implemented (as described above)	246%

* *Future Ready V* notes that the profit calculations contained in their report assume a notional salary of $100,000 for each principal working in the practice.

However, a fully effective and implemented strategic plan alone is not going to produce a sustainable and profitable result each time. There is a lot more to it.

Clients: the golden opportunity

Sustainable businesses are characterised by an obsessive client focus and a relentless dedication to understanding their target markets.

Whether we acknowledge it or not, clients now play the lead role in dictating the nature of the relationship they have with their advisers, although, they may not fully comprehend their influence or bargaining power.

It is imperative that advisers adapt to their clients' changing needs and importantly help them understand that they are the best provider for them, now and throughout their life cycles.

At the end of the day, clients pay the bills. Without them, the business won't get paid.

To grab the "golden opportunity", there are a number of actions that need to be incorporated into "business as usual".

Consider

These include:

› Being selective

› Understanding clients

› Targeting the solution

- Positioning the value
- Pricing it profitably.

Being selective

It is not a competitive advantage for a business to be all things to all people. The most successful approach is when there is clarity around the target markets that are most commercial and valuable for a business.

This enables a deliberate approach to attract more clients, engage them and work with them now and into the future. This is a must for assuring a consistent and appealing client experience and to win the number of relationships required for future growth and profitability.

Understanding clients

Know them inside out, what keeps them up at night, their “pain” points and the nuances they value. Real understanding comes when it seems like someone is reading their minds.

Targeting the solution

An advice and service offer that is aligned to addressing the specific needs of the ideal client helps promote that the business understands them and that they have solutions clients can’t live without. This targeted approach enables a business to more effectively attract and retain the optimum number of profitable clients.

Positioning the value

Clients need to understand the perceived value that they will experience before committing to a relationship with a business.

As a result, one of the most important questions a business needs to answer is, “What does our client value?” Yet, there are many great advisers out there who are still not convincing when it comes to both understanding and articulating value. If used properly, “value” can be one of the greatest weapons for sustainable growth, now and in the future.

However, this involves more than just having a client value proposition (CVP). Many advisers have a CVP yet are still unable to clearly explain why a client should work with them, stay with them, pay them and refer them. To be able to do this effectively, you need a compelling “value story”.

A value story provides the content for all client conversations, queries and objections. It explains the value a client will experience through a relationship with the business, now and in the future. It is a framework for shaping all communications and it equips everyone to ensure “value” is the focus of everything they say and do.

A powerful value story is dynamic and changes over time. It is always relevant and contemporary. It anticipates clients’ preferences, their nuances and current trends.

The onus is on each and every person in the business to carefully communicate and position their value and ensure it is distinct from their competitors’.

Pricing it profitably

Recognising the impact that price has on the influencing people’s perception of value should be considered when deciding on an approach to pricing.

One of the biggest challenges to pricing intangibles such as advice and service is being able to determine an appropriate and profitable fee to charge. You can’t make a sensible pricing decision without all the facts. It is vital that businesses work out a minimum price that covers all costs and builds in a margin for profit.

Sustainable businesses also use value to help drive their pricing decisions. They review their pricing on a regular basis and update it according to the ongoing needs of the business and the clients.

Productivity: an unchallengeable necessity

As clients become increasingly more sophisticated and their expectations rise, the increased time and cost required to not only maintain, but enhance these relationships will require businesses to better leverage their operational capabilities, eliminate unnecessary inefficiency and improve overall productivity.

There is a direct correlation between businesses that have greater productivity and sustainable growth, as FA Insight's *Study by Advisory Firms: Growth by Design* reports. Tracking and measuring productivity takes a concerted effort and one of the easiest ways to do it is to use productivity ratios or metrics.

Like any analysis using ratios or metrics, the real value is captured in the relative performance measured on an ongoing basis. Using technology to track and measure these numbers is critical from a validity and efficiency perspective.

Consider

The most common productivity measures include:

- Revenue per adviser and revenue per full-time equivalent (FTE)
- Revenue per client and revenue per active client (at reporting period end)
- Clients per adviser and clients per FTE
- Operating profit per adviser and operating profit per FTE
- Operating profit per client and operating profit per active client (at reporting period end)
- Assets under management (AUM) per adviser and AUM per FTE (depending on your business model)
- Turnaround times such as: time to on-board clients, time to deliver the advice, time to implement the recommendations, to get paid, to service clients, etc.

The power of the people: the human elements

In their paper *Unchartered Waters: Navigating the forces that shape the financial advisory industry*, Pershing Advisor Solutions LLC make a reference that the quality of the adviser remains a powerful and lasting competitive advantage.

They go on to say that focusing on a business's culture and the people, and how they are inextricably linked plays a major role in the strength of client loyalty.

In order to address the specific needs of clients and capture the golden opportunity (as discussed earlier), businesses need to readily access the appropriate levels of skill, expertise and capability.

Depending on the business model, sourcing these skills is essential regardless of whether they are cultivated in-house or provided through outsourcing or joint venture/business partnership type of arrangements.

Investing in the training and development of the right people for a business is crucial. People no longer feel compelled to show loyalty unless all their needs — personal, emotional, financial and professional — are being met. Job hopping has become a common practice and can be extremely expensive, disruptive and not least of all, frustrating for everyone.

A sustainable business takes the management of its people seriously. Some of the key functions that should be a "given" in any business that expects to catch and keep the right people include:

- The organisational structure leverages critical adviser positions, using operational, management, technical specialists, client service and administrative roles effectively
- Everyone has clarity of their role and how it contributes to the bigger picture

- They are fully accountable and have ownership of their outcomes
- They are allocated across the business according to their value contribution
- They are a right fit for the culture of the business
- There is clear career path in place
- They are rewarded based on their performance
- They have adequate training and development so they are able to perform to their optimum in their current and future roles within the business.

On that note, culture is one of the key elements helping people decide where they want to work and dictates if and when they stay or go. It is the "soul" or the life blood of a business.

The right culture for one business may not be right for another. However, in their book *Built to Last*, Jim Collins and Jerry Porras noted "companies that consistently focused on building strong corporate cultures over a period of several decades outperformed companies that did not by a factor of six".

Culture is managed through leading by example. Its foundations are shared values and it is the guiding force for all recruitment and retention decisions. Businesses that recognise this will invest heavily in preserving the right culture and ensuring that it supports their vision for the future.

Results: the process way

The forces operating in the current landscape of uncertainty and change threaten the survival of businesses with inherent inefficiencies.

It is not just about getting business processes right or buying the latest technology, there are many other issues that need to be considered in conjunction with processes and technology to ensure survival in the future.

FA Insights found that in "no other area do sustainable business stand out more than being able to deliver value to clients with a solid operating infrastructure that is designed around the client's needs".

As clients become more sophisticated and more demanding businesses will need to make sure that their processes effectively deliver the outcomes that the client values along with an impressive client experience.

Their processes will be client-centric or client-focused. They will consider the client experience first, how they will be feeling and how the business wants them to feel before constructing the ideal process.

Importantly, to be instrumental in reaping the benefits of client-focused processes is to ensure they are well documented. All staff need to be aware of and understand them, they need to be consistently implemented and a culture of continuous improvement should exist across the business.

Putting the back office on a "process diet" to reduce any excess capacity, limit wasted time, remove duplication and simplify complication is the bare minimum that businesses need to address.

Then it is about stripping back the layers and thinking about everything that can be done to make clients feel acknowledged, appreciated, heard and understood. Today, it can be small things that make the biggest impact.

Taking the time and effort to get this right is vital for the profitability and sustainability of a business.

Technology: a disciplined approach

Technology, if deployed appropriately can be a major contributor to operational efficiency. If real efficiency gains are to be achieved, there needs to be a carefully thought out technology and IT strategy in place — one that supports the strategic vision and allocates any required dollars to be accounted for in the annual budget.

While technology represents tremendous potential for improving productivity and efficiencies, advisers must carefully consider why they need it and ensure any time or money spent incorporates the required training and ongoing support for all its users.

Outsourcing: an alternative allocation of resources

As businesses try to remain competitive and rein in increasing operating costs, they can segment their activities into two distinct functions: high value and non-revenue generating.

Businesses would continue to own and develop activities where they can add significant value to their clients, while those activities that are non-revenue generating or lower value-add such as report preparation, compliance, IT support, implementation, administration, marketing, design, etc, will be more effectively outsourced.

This generally involves engaging specialist companies to provide the function on a contract basis. Whether it be outsourcing in domestic markets or outsourcing overseas, it will become a trend for those wishing to streamline their business. Different outsourcing models are emerging as businesses already have embraced this mentality.

IN CONCLUSION

To ensure the long-term sustainability and profitability of a business, the owners need to focus on the fundamentals in order to prepare the business for the future. At the same time, they need to be very aware of the environment they operate in and be positioned to adapt regardless of what happens.

Business profitability has been a recent casualty, particularly since the GFC and profit margins have not yet recovered. A disciplined approach to the financial management of the business needs to be a priority of the business owner.

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