Bringing the Value Back into Your Business While Improving Client Outcomes

A DISCUSSION PAPER

BLACKFINCH
ASSET MANAGEMENT

Contents

The wealth management and financial advice industry in the UK is worth circa £6.3bn in revenue per annum and continues to grow at over 3% per annum, with industry forecasters predicting compound annual growth to 2027 of nearer 6%.[1]

Tapping into this growth potential through dynamic, forward-thinking solutions could be a key path to success for financial advisers wanting to both increase their business value and provide better expected outcomes for their clients.

This paper has been written to highlight how we see firms adapting to the current landscape to thrive – whether that's increasing value for being acquired, improving on business efficiency, or increasing the fees a firm can charge, all while ensuring firms meet client objectives at a reduced cost.

[1]Johnston Carmichael - The wealth management and IFA industry in the UK

The Current Situation

There has been an evolution of advice over the last 30 years or so, and this is highlighted in the chart below.

THE EVOLUTION OF ADVICE BUSINESSES

There has been a shift away from the traditional one-person businesses, multi-adviser firms, partnerships and networks, and it feels like this has evolved into a two-tiered approach that is divided into consolidators/ Discretionary Fund Managers (DFMs) and other acquirers alongside Profitable Regional Businesses that can also be acquisitive in their search for increasing growth and profits.

Consolidators and other acquirers primarily funded by private equity (PE) money are looking to reduce a fragmented industry into fewer parties and this means that the value of a firm is constantly at question by the acquisition market. These scale-up plans have a number of benefits for advisers and clients – improved operational efficiency and a stronger bargaining position with vendors to name just two, but all of these potential improvements should also result in better outcomes for clients.

This state of play seems to be here to stay. As reported by Mayer Brown, the number of acquisitions involving UK financial advice firms has risen by 11% from 398 to a record high of 440 in the last year.[1]

Similarly, the more Profitable Regional Businesses highlighted in the graphic are also focusing on improving client outcomes by using their presence in more localised areas, their scale and relationships. These firms can also be acquisitive but typically tend to buy one to two firms a year, which represents a vastly different trajectory to the PE-backed consolidators and the larger-scale DFMs.

In summary, financial advice growth remains highly exciting and this is resulting in an acquisitive market. It is therefore really important that these businesses optimise themselves to ensure their companies are valued highly as possible – whether they are looking to sell or not.

Before exploring how value could be recaptured, it is important to explore current estimates of the business valuations.

Examples of Consolidation in the 2022 news:

One Four Nine
hits £1bn assets
with acquisition of HFL Financial Adviser Ltd.[2]

Amber River planning
further acquisitions
in their year plan.[3]

Solomon Capital
acquiring
Gale and Phillipson[4]

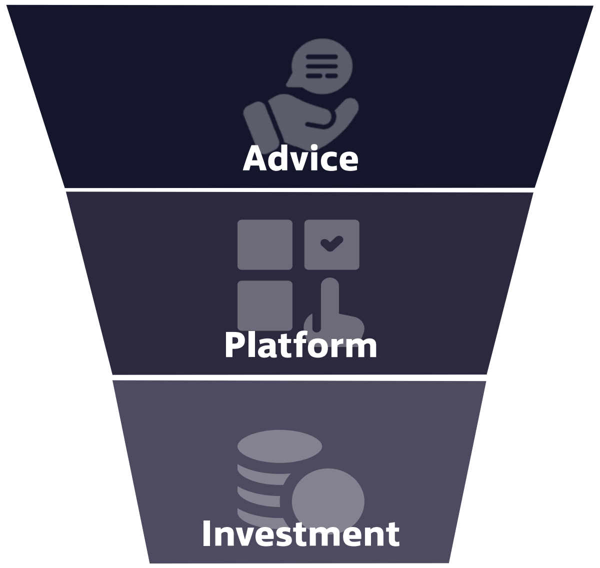
Lumin Wealth completes
acquisition
of Ashridge Financial Management[5]

[1]https://bit.ly/3L6J3Ra [2]https://bit.ly/3ApJ3qh [3]https://bit.ly/41ATVxu [4]https://bit.ly/3ArwevC [5]https://bit.ly/43W3XuO

Understanding Valuations Within Financial Services

The financial advice value chain is formed of three key components: The advice is at the core, keeping the chain together, alongside the platform and the investment solution. Each area takes a percentage of the money generated by investments – with advice, platform and investment taking different negotiated fees, typically splitting a pie of no more than 2%.

THE VALUE CHAIN OF ADVICE



What is typically less well-known is how these businesses are valued. There are, of course, many ways of calculating the value, but the two dominant calculation metrics are:

Multiples of EBITDA
(Earnings Before Interest, Tax, Depreciation and Amortisation) or Profit

Multiples of Revenue
This is typically the annually recurring revenue

Ahead of outlining the specific valuation ranges in more detail, it is important to emphasise the role of advisers.

A central element of the thinking behind this paper is the belief that financial advisers perform the three hardest tasks in financial services:

1. **New client acquisition** – most advisers are continually getting referrals (even when they do not want them) and have experienced consistent growth over time
2. **Long-term client retention** – most financial advice businesses have clients for ten, 20 and even 30 years and very rarely lose clients
3. **Run compliant businesses** – Almost all firms consistently and successfully comply with ever-changing financial regulation.

It would be fair to say many companies in the financial sector – including fintech, robo-advice, banks, platforms, DFMs and investment companies – all struggle with at least one (and most typically all three) of the above tasks but financial advisers have been consistent in their resilience for many years. It might be expected that this would result in a higher multiple for advice firms, but this is not the case.

The table below highlights ranges of valuations. These ranges are taken from our experienced team, who have personally been involved in a number of acquisitions of advice businesses and networks, and also of having conducted extensive research in this area. Of course there have been transactions at a higher and lower level, but these ranges are a broad representation.

INDICATIVE VALUATIONS THROUGH THE VALUE CHAIN

Advisers	6-8 x EBITDA or 3-4 x Revenue
Platforms	4-6 x Revenue
DFMs	9-12 x EBITDA
Fund Managers	12-16 x EBITDA

It is clear from this that advisers actually have the lowest valuation multiple, but what about risk?

To assess where the risk sits, a good example to highlight is Defined Benefit (DB) transfers. There were 26,619 in 2021/22[1], and this posed some challenges for financial advisers as these were subsequently deemed as high risk for potential claims of unsuitable advice.

The result was that professional indemnity insurance costs rose significantly and those businesses with large numbers of DB transfers effectively became unsellable as acquirers had little to no desire to take on the potential risks. Platforms and investment managers simply acquired billions in flows but have actually ended up with negligible risk exposure to the defined benefit transfer situation.

So, advisers find the clients, onboard the clients, take full responsibility for the advice, transfer the client assets but have the lowest market valuation compared to the other businesses in the value chain. This seems like a mismatch...

'It feels like there is an imbalance in the value chain of financial services. Financial advisers provide new client acquisition for the other elements but are the lowest in terms of market valuations while holding the majority of the risks'.

[1]Source: FCA, 6th October 2020.

Optimising the Business

Financial advisers may explore multiple strategies to solve this conundrum, including their choice of investment solutions and platforms. This paper will not cover this topic other than to say that there are a number of benefits to launching a platform, and consolidating to fewer platforms also offers significant benefits for advisers and their clients, including increased operational efficiency and lower costs.

The focus here will be on investment solutions and will explore the benefits of optimising Centralised Investment Propositions (CIPs). This is where an adviser articulates the investment solutions that are appropriate for types of clients.

This could involve an adviser selecting individual funds to create portfolios or a range of outsourced solutions from DFMs like Blackfinch – often these are Model Portfolio Services (MPS).

With an MPS, DFMs provide advisers with a ready-made and diversified portfolio that offers clients exposure to equity and bond markets, combining passive and active funds where appropriate, while also introducing certain alternatives strategies to bring another element of diversification.

With a CIP approach, you have more time to focus on clients, by saving time from the administrative burden of running in-house investment portfolios on an advisory basis. By selecting lots of DFMs, advisers promote a form of independence with regular reviews and consistent due diligence. However, at times this will overload a CIP with too many DFMs that are often pulling in different directions, resulting in very different outcomes for clients.

'Most advisers have successful businesses already, with too many clients, and would more significantly increase their profitability by focusing on optimising the business they have rather than attracting new clients or advisers'.

The key challenges of this involve mitigating risk: requiring advisers to oversee DFMs; assess if they are managing in line with their mandate; and analysing complicated client reviews.

This can involve observing:

Regulatory challenges: are the requirements being met from a compliance perspective?

Reporting: multiple outsourced solutions mean challenges in aggregating reporting and onerous administrative burdens

Consistency: monitoring multiple solutions can be complex and time-consuming and multiple similar offerings can result in identical clients situations leading to different client outcomes

Complaints: how are these resolved and who handles resolutions and outcomes?

Contracts: how is the relationship set up and who is responsible for what? What happens if things go wrong?

Perception: where does the client perceive the value to be added?

Reputational risk: what happens if the DFMs underperform?

Despite these potential challenges, MPS solutions have become one of the fastest-growing investment services used by financial advisers. MPS assets totalled a little over £80bn at the end of 2021, according to recent wealth management research. That equates to around 8% of financial advice firms' total investment assets. A continued annual growth rate of 25% would hit around £200bn in four years' time, which doesn't sound unreasonable[1].

In an effort to solve some of the challenges outlined above, and to ensure the value can be brought back to advisers, we see the next evolution to be Tailored Portfolio Services (TPS).

[1]Source: Platforum, 24th June 2022

So, what is a TPS?

TPS solutions are a way for adviser firms to offer a customised own-brand set of portfolio solutions, accessing diversified assets, while reducing the risk, time and effort required for advisers to meet client objectives and regulatory requirements.

It is when an adviser chooses **ONE** key investment partner for the majority of clients. TPS solutions are focused on genuine partnerships with advisers to deliver unique product ranges.

These TPS offerings are flexible in design, for example, focusing on both capital preservation and growth, or a range of portfolios that address a specific risk profile or brand value – using understandable ways of communicating the portfolio, with regulatory requirements and client outcomes in mind.

TPS is a service where advisers set the specifications and the investment partner provides the resources to deliver the strategy. When a firm is looking to create a uniquely defined offering it's important to identify key factors to ensure the needs are met across the solution, for example adviser-specific:

- **Client objectives**
- **Charges**
- **Investment strategy**
- **Risk profiles**
- **Branded portfolios**
- **Platform availability**
- **Desired involvement**

'Tailored Portfolio Services are a clear example of a situation that, by thinking strategically, results in significant improvements for clients in terms of lower charges and improved experience but also ensures the long-term viability of those advice businesses that want to support families for generations'.

The key aspect of these solutions is their tailored nature, covering asset allocation, styles, active blending and costs, allowing an adviser to supply the best possible fit for their clients while using a sole DFM for support, reducing the reporting and review complications caused by a multi-DFM approach. One of the key areas of flexibility provided with TPS solutions is the ability to target a specific pricing point. There are many implications of this that will be explored in more detail later in the paper.

Another element typical of TPS providers is that they can enhance the offering by the creation of specific literature than can elevate the service given to clients. As well as designing brochures and providing customised reporting, TPS providers can also provide a fully comprehensive suite of literature and content including:

Ad-hoc Market Commentaries

Thought Leadership Pieces

Monthly Factsheets

Quarterly Investment Reports

Investment Analysis Reports

Monthly Market Moves

These materials are typically co-branded, showcasing the partnership and ensuring clients understand the importance of their adviser in the delivery of material and services. We also offer support in launching your strategy to your teams.

So, what are the benefits of a TPS?

By consolidating all clients' investments into one service, you can increase operational efficiency, provide better outcomes for your clients, and ultimately increase the value of your financial advice business.

TPS solutions are also beneficial because they can:

Support the demonstration of compliance with Consumer Duty legislation:

The Duty means consumers should get communications they can understand, products and services that meet their needs and offer fair value, and they get the customer support they need, when they need it[1]. TPS solutions can result in improved and specifically targeted communications, a closer relationship with their chosen provider and the scale of the opportunity should also result in a greater negotiating position to ensure fair value for clients.

Demonstrate the focus on clients' best interests and can help lower overall fees

Using the scale that advisers have built over the years and choosing a key investment partner means that they will be able to negotiate lower fees but also get increased access and support from those investment teams – which boosts the service provided and offers potential reductions in fees for the clients.

Support company values and investment philosophy

During the process of developing a TPS, it is important to understand the beliefs of the adviser business so that this can be represented in the solutions and service provided. This ensures there is alignment from end to end within the advice process.

[1]Source: FCA, 25th January 2023

Branding and improvements to client experience

Working together with an investment partner to build a suite of high quality co-branded materials means that there is more emphasis and clarity on the involvement of the adviser business in the investment solutions. It allows advisers to benefit from the scale of the marketing teams of their chosen provider, which means that there can be an immediate uplift in the timeliness and frequency of communication, greater flexibility on the type of information sent out, and greater involvement in the creation of future documentation. All of this is clearly highlighting the importance of the adviser and can significantly improve the client experience. TPS solutions also support clear communication, which is a key pillar of the Consumer Duty objectives.

"The one thing for certain is that great financial advisers have a great impact on their clients and this leads to great outcomes – something we can all agree on.'

A business becomes more attractive to an acquirer and this means there could be a premium applied to the valuation.

Imagine you are an acquirer looking to buy an advice firm. You have one firm using eight outsourced providers, there is a complex structure in place, clients have multiple solutions, and substantial amounts of time is used on repetitive and frustrating tasks to aggregate all that information.

Then imagine an acquirer looking at an independent financial advice (IFA) firm which has a tailored range of portfolios. This IFA firm has clients slotting in perfectly, across two or three platforms in a neat package, and communication that fits directly for Consumer Duty compliance and client understanding. Which business is going to make more sense to buy? Likely, the financial adviser that works around a TPS structure, because they have demonstrated best working practices and genuine commitment to helping clients achieve the best, and most appropriate, outcomes.

Future business valuation improvement

There are two key ways that a TPS can improve the valuation of an adviser business – operational efficiencies lowering costs (or providing more opportunities for growth through time savings) and possible improvements in revenue and profit.

Advisers that have adopted more tailored solutions report that they have seen a significant improvement in efficiencies within their business, with preparation time for reports significantly reduced, and with improved client communications that increase client understanding and also reduces inbound queries. In the long term, these could result in cost savings that could be directly attributable to the bottom line of the business, but even in the short term it can free up adviser time to attract more clients.

It is worth noting if there are improvements to the bottom line on an annualised basis this has a multiplication factor on the valuation of the business. For example, if costs were reduced and x number of new clients were onboarded and this had a positive impact of net £50,000 this would – based on current adviser multiples – add £350,000 to the valuation.

Most advisers that choose a TPS make significant reductions in the costs to clients. This is usually a combination of building solutions with a cost budget target in mind but also, because of the scale of the opportunity, it means they are able to negotiate strong discounts with their providers. Often, but not exclusively, this is done in tandem with a similar discussion with platform providers in an effort to reduce the overall total cost of ownership for the client.

Although there are significant cost reduction opportunities by adopting this approach (outlined above), advisers now have a specific role that should be articulated to their clients. There is the advice fee but some advisers are now adding an Investment Oversight Fee in the region of 10 basis points to their ongoing fees to clients for the investment oversight, due diligence, investment committee attendance and continual overall review. It is important to stress that in the scenarios where this has been observed the total cost of ownership for clients has been significantly reduced.

In this situation there are huge implications for future valuations of adviser businesses.

For example: assuming an adviser is able to reduce the total cost of the investment solution from 0.9% to 0.65%, reduce the platform fee from 0.30% to 0.20% but also adds an Investment Oversight Fee as a separately articulated line item of 0.10% (within the terms of business), this therefore increases the Overall Advice Fee from 0.50% to 0.60%.

Following through this scenario, if an adviser firm had £100m and has used its scale to negotiate these fees the clients have benefited in an overall cost reduction of 0.20% per annum, which is extremely important to demonstrate fair value in line with Consumer Duty rules. While at the same time, the advice business has clearly articulated the additional value being providing by conducting very detailed investment oversight.

As we have discussed earlier in this piece, there's a strong relationship between the revenue of a business and it's valuation. If you are interested in exploring some worked examples, which show typical fee structures, revenues generated, and valuations, then do get in touch as we would be happy to discuss these with you.

Bringing the Value Back into Your Business

As mentioned earlier, financial advice is thriving and clients of advisers are as happy as ever. (A survey by Embark in April 2022 highlighted 85% of advised investors surveyed were satisfied with their financial adviser).

There are exciting developments from consolidators and acquirers that are helping to further enhance the propositions for clients and advisers. They are bringing some of the value back into advice businesses by utilising their scale and backing to negotiate well with existing vendors, or invest heavily in technology and systems to improve operational efficiency.

This paper has focused on ensuring advisers recapture some of the value that has been transferred to other parts of the value chain. By focusing on optimising the CIP it means all parts of this ecosystem can benefit:

- Advisers can benefit by improving operational efficiencies, use their scale to negotiate discounts and potentially boost both their revenue and overall valuation
- Platforms can benefit by having key partner relationships with adviser firms that have larger pools of assets all run in a simplified way allowing for improved efficiencies and better servicing
- Investment companies can also benefit by having strong relationships with key distributors to ensure greater flows and they are also able to focus their sizeable resource on the right firms instead of everyone

In Summary

Hopefully this paper has highlighted that it does not matter whether you are a consolidator, an adviser looking to sell now, thinking about selling in the future or just embarking on the advice journey. Focusing on efficiency and the impact of future valuations should always be the focus to ensure the ongoing viability of high quality advice.

Next Steps

Optimising your CIP by using a TPS is designed to bring back the value to financial advisers, but does that mean it is the right solution for your business? For an informed discussion, it is best to speak to one of our team to understand your firm's needs and how you might best use TPS.

Find out more →

Contact Us →