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"He who chases two rabbits catches neither" Confucius

The last chapter stressed the benefit of creating clear personal goals or a picture of a desired lifestyle as a means of maintaining motivation and commitment. Time taken to consider such issues reminds many principals of their purpose for being in business.

This chapter:

- emphasises the importance of pro-active business design and leadership
- examines factors which drive the value of a business in a positive direction
- outlines a framework for designing a business model to achieve owners' goals

Your business is your vehicle

Income from, and their stake in, a business is, for many people, the sole or primary means of securing the funding required to fulfil their personal goals.

- Salary and dividends fund today's needs and long term investment strategies.
- For a significant proportion of their funding requirements, many owners rely upon the creation of capital or an "annuity" from the sale or succession of their stake.
- Others run their company as a "lifestyle business", aiming to generate income up to the time they choose to stop working. Capital or income generated from a sale on retirement would be regarded as a "bonus".

Businesses can be regarded as a vehicle for the:

- delivery of services for which clients are willing to pay transparent, profitable fees
- regular earnings of all those employed in the business – owners included
- "contribution", whether charitable or socially responsible etc. the owner wants to make to the community in which their business operates

- legitimate extraction of financial value as a return on the owner's investment of time, effort, expertise, management, capital and a number of sleepless nights

Is the vehicle being steered by you or by events?

Principals of advisory firms tend to take one of two approaches to running their business as a means towards funding the achievement of their desired lifestyle

The first approach can be labelled as the "let the fates decide" approach. This entails running a business as best you can and dealing with events as they arise.
It doesn't mean the quality of advice or service provided is below par, nor does it mean the business is destined to make a loss.

However, the predominantly reactive, short term nature of decision-making required to steer the business absorbs time, effort and expertise which might otherwise be spent more productively or enjoyably.

Owners adopting this approach usually realise too late what they could have achieved with a little more foresight and longer term ambition built into their planning. They tend not to feel in control of the direction in which the vehicle they own is heading.

The alternative, more effective and productive approach is to lead the business towards a state which is capable of generating the right:

- type of clients and means of engaging them
- quality of staff
- advice, investment and service proposition
- systems and processes
- levels and "stick-ability" of fee income
- profitability ratio
- potential capital value to owners

Without this pro-active approach, decisions taken in the short term may solve today's headaches, but are unlikely to steer the business towards its desired state and value.

Factors that drive value

The precise value of a business will be determined either by market forces at the time of a sale or, in cases of pre-determined succession plans, by defined criteria or targets.

However, value is enhanced by effective management of a range of factors.

Profitability

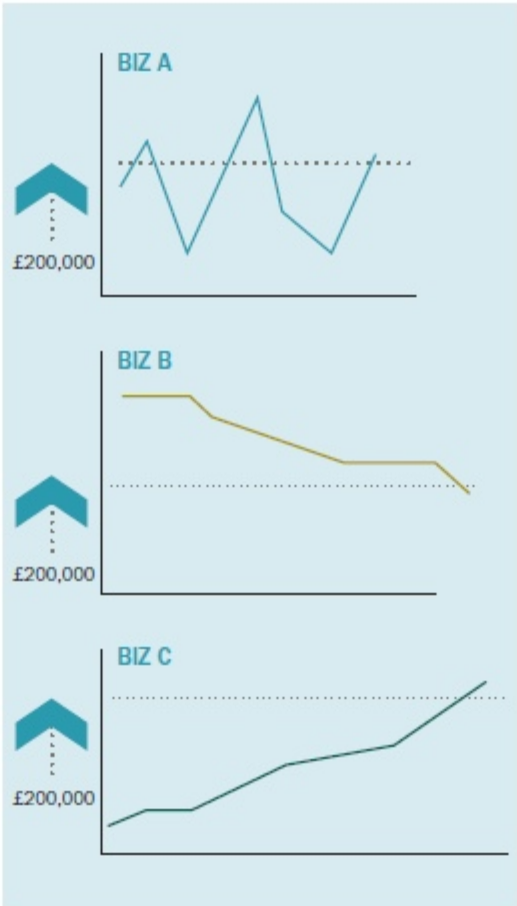
A healthy, sustainable level of profit helps a business:

- generate confidence in its continuity,
- create contingency funds for periods when cash flow takes a step backwards
- reinvest to improve, innovate and develop services
- keep pace with market changes
- motivate staff and owners to maintain faith and commitment to the business
- remain available as a source of long term value to its clients and strategic partners
- reward its stakeholders and investors in the enterprise

Turnover is vanity, profit is sanity!

Profitability trends

Which of these three profit profiles is likely to be more attractive to a potential purchaser?



A. is indicative of a business which has little control over profitability, it is either exposed to external market influences or is poorly run.
B. looks like it has lost its way and could be slowly dying.
C. is on the upward curve and would look attractive to potential purchasers as long as they could see how this consistent growth in profits was being achieved and believe it as a model that they could sustain.

A or B may still be more attractive than C to a purchaser bringing the relevant skills / resources to turn those businesses around.

However, a business demonstrating consistent and growing profitability, based on properly managed business processes, is highly likely to attract premium valuations.

Loyal client base

Some purchasers seek a high average value client base in terms of net worth & track record of commitment to pay retainers for a service. Others seeking to transact with a mass market, will be looking for large data-bases that have a propensity to buy product every now and again, with limited demands for a service. In either event a certain degree of evidence of client loyalty will enhance the value, be it paying fees for a service or purchasing products frequently at regular intervals.

Effectively what a purchaser is seeking is evidence that the client base is loyal and able to deliver consistent revenue streams. So, it is important to have good quality management information that illustrates client loyalty to your business.

Predictable revenue / cash-flow

Purchasers will want to be assured that the means to recover their investment are in place. Trail and renewal income may be a more predictable recovery mechanism than income from initial fees. However, fixed fees are a stronger indicator of a commitment to pay for a service.

In addition, fund-based income may not always be a profitable reward to the business for the service it delivers. Fund-based income is also subject to stock market fluctuations movements and client disinvestment.

Properly and profitably priced retainers linked to transparent service commitments is a strong demonstration of "sticky" on-going income.

A business that does not focus on service particularly, but has proven ability to implement new solutions for existing customers can be attractive to the right purchaser, but the market for purchasers of this type of business is likely to be more limited.

Brand – are clients loyal to the business or just their adviser?

If the reputation of a business is based primarily on an advising owner, then what value remains when he or she exits the business after a sale?

Obviously, not as high as a business with a distinctive “corporate” brand and an infrastructure to sustain it beyond the departure of the owner. The best demonstration of value to a purchaser in this respect is an owner who no longer needs to deal with clients.

A good manager can walk away from the business for a while and know it can run like clockwork without him. The business will have effective systems and processes in place, operated by a team of people with the right skills and knowledge. The ultimate aim of any business owner should be to create a model that they can walk away from and know it will continue to run without them.

Staff capability & stability

If a business is to be offered for sale as a going concern, the capability of its staff will also influence the value achieved. The degree to which the most influential & valuable staff are committed to the future of the business will also be of interest to potential purchasers. Individual productivity, high standards of quality and competence will add weight to the argument that the business is capable of continued performance.

Tidiness – this relates to the house-keeping of the business.

How orderly are files, past records and databases?

Any extra effort a purchaser has to expend to access data regarding clients, revenue, expenses & staffing will reduce the amount offered for purchase. Where information is not forthcoming, contradictory or scant, the purchaser may even feel it is not a risk worth taking. So, taking time to sort out the paperwork, prepare accurate and meaningful M.I, getting clients loaded onto databases accurately is very important to achieving a good value.

How efficiently can client investments be managed from a cost and risk perspective? For example, are assets administered through a manageable range of platforms / providers or by means of a multiple pick ‘n mix product and platform strategy?

Is there a clear and consistently applied investment proposition that can be maintained or is it bespoke to each client and dependent upon limited in-house expertise? If the “expert” source of this investment proposition is the person looking to exit the business, potential purchasers will factor the loss of the resource in considering their offer.

Automation wherever feasible

Employees are an expensive, but highly capable and flexible asset to a business. It is vital to ensure, as far as possible, they only spend time on activities which cannot be automated or even out-sourced. Make sure your people are adding as much value as possible to the experience your clients receive when dealing with your business.

Liabilities - the risk of future claims on advice given in the past is playing a major part in depressing business values.

Strong compliance processes, good management and careful recruiting may take more time and expense in the short term. However, the effect of complaints and defending claims on profits and long term capital value make preventative quality assurance methods a worthwhile investment.

In summary, there are several aspects which need to be reviewed to ensure a business has the best chance possible of achieving the legitimate aims of its clients, staff and owners.

In vehicle-buying terms, is yours ready to drive away or will the new owners pay less, or even be put off altogether because of its history of accidents and the repair and renovation work required?

What method can be assumed when estimating potential business value?

The simplest and traditional means of valuing a business or client bank for sale has been based upon a multiple of turnover. Typically, a client bank would be purchased, and agencies "novated", for payment of a multiple of 3 or 4 times the recurring income stream associated with the client bank. A carefully worded purchase agreement would ensure liability for advice given by the original adviser did not transfer with the client bank.

The purchaser would hope to recover their outlay by way of the added trail commissions, with no added servicing obligations, over say 4 years. There was also potential to earn additional fees from at least some of the clients “purchased”.

Buyers beware – sellers be mindful

If applied to the purchase of a business as a going concern, the “multiple of turnover” approach has many bear-traps of which purchasers have grown wary. e.g. the costs of fulfilling any inherited obligation to deliver on-going service

When considering the “purchase” of a client bank, buyers have been segmenting which clients they would like to adopt and rejecting or paying below par for those who would bring little or no current or future value. Pareto’s principle is a useful mechanism to bear in mind – the old 80:20 rule.

Greater attention is being paid to the profitability and efficiency of businesses being valued and to the potential for new fee payments within client banks being reviewed.

All medium to long term estimates of the value of a business can only ever be based upon a considered and flexible set of assumptions. Clearly, the assumptions and estimated outcomes need to be reviewed regularly.

Designing the vehicle you will steer towards success

Up to this point, this and previous chapters have hopefully helped you:

- appreciate the sense of purpose engendered by a clear set of personal goals
  and
- embrace the need for a proactive approach to creating an efficient and productive business generating value for its clients, its staff and its owners

From this point onwards, each chapter will provide practical and pragmatic insight and tips on how to design and build a business based on your vision of how it should perform.

Begin with an end in mind

Results can go for you or against you – but the effort expended is the same either way

Achievement of a valuable business is the ultimate goal for most business owners. Even if they do not intend selling the business, their time in the business will be more productive if they operate the effective and productive lines of those owners who will seek to sell.

For the sake of creating a reference point, the ultimate business value to aim for can be based upon the ambition and funding requirements of the business owner's personal goals.

For instance, £500,000 may be a target sum to be achieved from the sale of a stake-holding.

Other results achieved on a year by year basis will be the ones which occupy attention as it is the combination of these results which will determine the ultimate business value.

- **Profit** - level of profit and ratio of profit to turnover?
- **Costs** - are they under control and is cash-flow sufficient to meet them?
- **Income** - size and "shape" - how much of it is predictable and sustainable?
- **Risk** - are there quality assurance and Compliance systems in place?

Results - Profit objectives

Profit expectations will be based around the capacity of the business to generate fees of sufficient size to not only break even, but to reach a monetary profit target required.

Establishing a profit objective is a bit like the "chicken and egg" riddle. In a perfect world, you could make an assumption that means an efficient business characterised by all the positive traits summarised above might attract a sale price of say 10 x its average profit margin over a 3 year period. Therefore, to achieve a sale price of £500,000, the business would need to achieve average annual profit of £50,000.

A simple rule of thumb to at least get the ball rolling would be to inflate the conservatively estimated running costs of the business by a profitability ratio to arrive at a target turnover number for the period in question.

This means a business with running costs, including owners' salaries (see below) of say £200,000 and a desired profitability of 20% x Turnover, would need to aim for turnover of £250,000. Hitting its profitability ratio would generate a margin of £50,000.

Using a profitability ratio rather than a monetary target margin ensures the profit a business aims for does not reduce as a percentage of its turnover. It also acts as a prompt for pricing reviews to ensure margins are maintained. For businesses with a very tightly controlled and low cost base, a monetary profit margin target may of course be more relevant. An important factor either way is that the income required by the owners is built into the cost base and not left to chance.

Profit – avoiding the impact of the adviser-owner salary syndrome

Many owners of smaller businesses take their income from whatever surplus cash is left over after bills and other staff and advisers have been paid. They rationalise this approach by referring to the ultimate pay-out they will receive when the business is sold. This is otherwise known as the "when the boat comes in" approach to earnings.

This flawed approach means budgeting and forecasting plans exclude allowance for a proper working wage for the owner.

In turn, this deflates the price at which services need to be delivered in order to create a true profit margin. Consequently, the business risks continual under-funding problems.

To establish a working number for the rewards an owner should build into their planning, a simple examination of the roles and commensurate rewards can be carried out.

The table below illustrates how an assumed market salary for various roles in a business can be applied to the proportion of his or her time an adviser/owner spends on them.

It assumes fees generated as an adviser generate a payment out of 50%, but this could easily be expressed as a salary.

Role	Fees Generated	% Paid as Adviser	National Payment
Adviser	£100,000	50%	£50,000
	Annual Salary	% of time on role	
Manager	£60,000	40%	£24,000
Director	£80,000	5%	£4,000
	Business Value	Dividend Rate	
Shareholder	£250,000	5%	£12,500
TOTAL			**£90,500**

Try this simple exercise for yourself. If these sorts of numbers are not factored into your budgeting and pricing strategy, then you will set goals for the business below the levels required to deliver a fair and meaningful level of income during your working life. How does the true cost of this accumulate over the years?

Results – Income objectives

This is about the business revenue and the mix of income types. If turnover is weighted towards sustainable recurring income, this provides a platform for greater confidence when taking decisions regarding expenditure.

Anecdotal evidence suggests the business would be valued more favourably than one with similar overall turnover, but a smaller percentage recurring. For some purchasers this income profile may represent an opportunity for growing recurring income, but one which requires greater effort to exploit.

Results – Cost objectives

What are the maximum fixed and total costs, expressed as a percentage of turn-over, you want to cater for? Do you have mechanisms in place to monitor and control costs?

Business development initiatives may require capital injections. You will need to anticipate how much will be required, when and from what source the funds will arise. If from cash reserves then has this expectation been incorporated into your business and pricing plan?

Results – Risk management

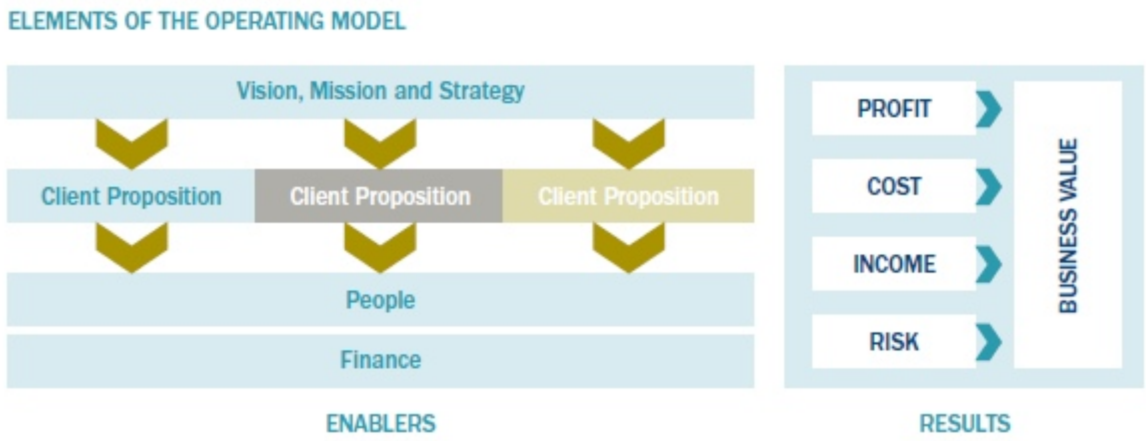
This means implementing robust systems and processes to manage quality assurance and minimise dependency on key individuals. This may also be influenced by things like sufficient capital adequacy etc.

Results emerge from "Enablers"

Enablers are the components of the business engine which lead to the results achieved.
These are the working parts of the business and the way they are designed and operate is often referred to as the Operating Model of the business.

These are the aspects of running a business that one would expect to see described in a pragmatic business plan, with sufficient levels of detail to indicate the medium and longer term strategies to be adopted along with the short term objectives to be achieved.

It is important to assemble a Target Operating Model for your business. This will build a clear blueprint showing all interested parties the kind of market to which the business intends to offer its expertise and value and most importantly how it intends to do this.



Building Your Target Operating Model

Characteristics of high-performance organisations

When a business achieves highly effective performance it can be described as firing on all cylinders. The following statements describe what highly effective performance looks like in relation to the business model components.

VISION, MISSION AND STRATEGY	Visionary leadership drives the business towards a well-articulated vision that has been translated into clear strategies for success. These are documented, monitored, reviewed and updated on a regular basis. The business plan is supported by comprehensive KPIs to measure its delivery.
CLIENT PROPOSITION	A clear view of target markets and well-defined propositions have been constructed to meet the client needs. The organisation's capabilities are actively monitored and reviewed to ensure that the proposition can be delivered.
MARKETING	A comprehensive marketing strategy has been aligned to the brand proposition, ensuring a balanced mix and steady flow of new business revenue streams.
FINANCIAL	Above average profitability, cash flow and balance sheet strength. There is a structured approach to financial management, budgetary control and investment appraisal. Owners actively manage the business mix to achieve desired margins and the remuneration strategy is aligned to business objectives.
INTERNAL BUSINESS PROCESSES	A robust approach to quality management and continuous improvement is evident, making extensive use of technology. Management information is comprehensive and business processes are clearly defined, documented and compliant with regulatory standards. This is embedded in business practices.
PEOPLE, LEARNING AND GROWTH	People are managed, developed and encouraged to achieve their full potential, feeling involved and empowered. Managers communicate with, reward and recognise staff to motivate them and build commitment to the organisation.

Enablers – Vision

What is a business 'vision'?

A business 'vision' is the picture of what you want your business to be at some point in the future e.g. what it looks like, how it feels to work there, which types of customers you work with and the results being achieved etc. When you create a vision for your business, you are articulating your dreams and hopes for your business.

Creating, documenting and communicating your view of how things need to look, feel and operate provide a reference point for you and your team. It enhances the likelihood of fostering a unified sense of direction and provides a framework for all of your planning and decision making for the business

Why is it important to have a 'vision' for your business?

Every business owner is aware that to have a successful business means to strive for good results. However, for many, the daily demands of running a business means that it is very easy to get embroiled in the 'here and now' and consequently lose sight of longer term aspirations.

As a consequence, many businesses fail to achieve their full potential, perhaps even stagnating with little or no growth being achieved. Even if significant growth isn't important, we all know that change is constant and a business owners' failure to track marketplace movements and customers changing demands and preferences means putting the business at risk of being overtaken by the competition.

What do you see as the ideal picture of your business? Who are your target clients? How many outlets will you have and where will they be based? How much revenue are you looking to generate, through how many advisers and support staff and with what level of net profit in mind? How will you make sure your vision becomes a reality and not remain just a 'pipedream'? Without these fundamentals in place, you may assemble an engine comprising components from different manufacturers that misfire or break down as soon as driving conditions become challenging.

Creating a meaningful vision is a step towards achieving control of your business, where external factors help to shape your thinking not undermine it. In doing so you will:

- Create a framework for all of your future business decisions.
- Create a benchmark against which to evaluate your current performance and make the changes necessary to achieve your longer term vision.

- Enthuse and motivate employees through the provision of a clear sense of direction with opportunities for them to progress their own career development.
- Provide existing and potential customers with the confidence in your longer term commitment to them.
- Provide a clear message of longer term business intent to all other stakeholders as a reason to continue their association with you.
- Create an attractive proposition i.e. as a business with a future, for all potential employees.

Creating your vision

Begin by describing the best possible business future for your company, using a target of 3-5 years into the future. Your written goals must be realistic and therefore achievable. Unachievable goals can create frustration or lack of 'buy in' from all parties involved and may have an adverse effect on both yours and your team's morale.

When looking at the Personal Goals in the last chapter there may be some aspects of your answers that point the way towards your chosen style and culture of working.

What was it that you wanted people to say about you – family, clients, employees / colleagues, peers etc.?

Establishing your business goals and the vision you have for the type of business you want to operate provides a context against which key decisions can be taken

When describing and recording your vision, use the present tense as if your business has already become what you are describing. Make sure you document what you see as your business vision. If it can't be described in simple, clear terms on paper, how achievable is it likely to feel?

To help you create the vision, ask yourself the following:

- What do you want your business to look like in the future?
- How should the business team, premises and literature look?
- How does your business currently compete and excel in the marketplace?
- What do you currently use to judge your business' effectiveness and what will you use going forward?
- What do your employees see for the company's future and if you don't know, ask them.

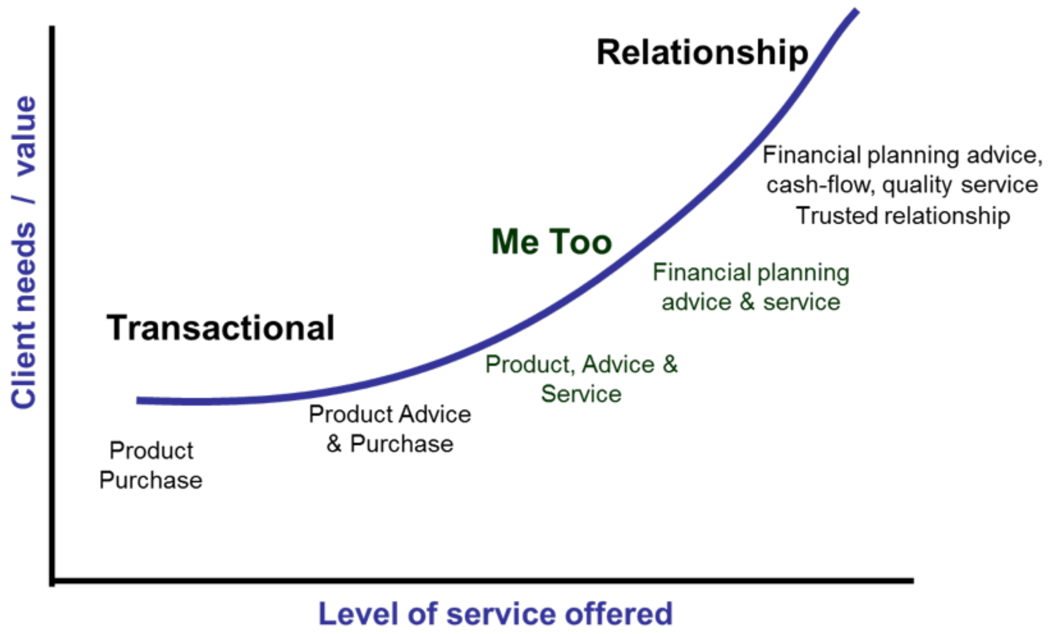
Accept the fact that what you write down may change to some degree over time. However, if your initial draft is realistic as well as reasonably stretching, it shouldn't change out of all recognition.

Using the market place to help define your vision

Most markets comprise demand for goods and services from three broad segments:

- a low cost, transactional segment – no frills supermarket mentality
- a middle range “Me-too” segment – a generic service led environment
- an upmarket segment – requires high quality/luxury service around complex needs

The segments in which a business wants to compete determine the type of proposition required to meet the needs of clients in that segment.



Airlines and restaurants reflect these segments as well as any industry. Each features a low cost, “no frills” service and a high end luxury service for the wealthier consumer. Both also feature services which sit between these extremes.

They all provide the same core purpose to get you from A to B or to satisfy your appetite / stomach. But these businesses understand the needs of their target markets and run operating models designed to deliver consistently and profitably to those needs.

Diners at McDonalds do not expect waitress service with a wide choice of drinks and burgers served on fine crockery. By the same token, nobody expects to queue at the kitchen counter, sit on a bench, eat burgers off a plastic tray and pay less than £5 for their meal in a Michelin-starred restaurant.

Ryanair passengers are accustomed to low basic ticket prices and the additional cost incurred for a range of “extras” such as checking-in baggage for the hold.

Emirates Airline on the other hand provide airport lounges, a high ratio of staff to passengers and a top quality flying, sleeping and dining experience.

Financial Services Segments

Segments in our market place are created by a combination of economic status, consumer knowledge and preference and complexity of needs.

The Transactional segment comprises a mix of consumers.
Some lack the means to pay for advice, complexity of needs or capital available for investment to make the provision of an advice led, service based offer a meaningful proposition. Their economic status is the key factor in driving them towards a self-select or limited advice means of purchasing financial products relevant to their circumstances or needs.

At the other extreme, there are consumers with funds available to invest or to purchase financial products. But, they do not value the availability of professional advice in designing and populating their financial planning strategy. Some intelligent, affluent clients feel they can make their own decisions and simply seek a low cost route through which they can implement their decisions. Maybe nobody has ever effectively articulated the benefits on offer from working with an adviser. Either way, they are pre-disposed to operating on an execution-only basis.

Some firms may choose to serve this segment of the market. In this market, profit will only come from a highly streamlined and, ideally, automated process. Margins will be tight and get tighter, so volume has to be high. To succeed as a core proposition, this offer will need to be nourished by lead generation from sizeable client banks / database. Newer entrants to the market place such as the retail supermarkets have the scale necessary to dominate this segment.

Key segments for financial advisers

The Me-Too & Relationship segments cover a wide spectrum of clients who need and would value a service from a financial advisory firm.

There is also a wide spectrum of financial advice businesses operating. These range from a traditional “G.P.” offering through to firms with recognised expertise as pension planning and investment experts. A growing strand of advisory businesses are those incorporating lifestyle cash-flow planning into a comprehensive financial planning process.

Many advice firms try to be all things to all people. Confucius once wrote “He who chases two rabbits catches neither”.

More recently, American comedian Bill Cosby said he “didn’t know the secret of success, but the secret of failure was trying to please everybody”.

Clarity about the true value your business can add to its ideal client types is essential. Whether you are in a pile them high sell it cheap Transactional space or the high value more exclusive, service space strong process management and controls are critical if the twin viruses of variability and inconsistency magnified in the first chapter are to be avoided.

So what is your preferred option?

- Market yourself aggressively day in day out, running 12 appointments a week to sell 250 products a year to at an average of £500 per transaction
- Build and service a mass affluent client base of around 150 clients, running 5 appointments a week with people prepared to pay for a financial planning service at an average of £1,000 per client
- Focus on 50 high net worth clients, running 4 appointments a week providing a comprehensive wealth and financial planning service for a premium rate of £4,000 plus per client

Many firms provide some high quality service to a small number of their top clients 4 or 5, whilst delivering a standard service to a core of 50 or 60 and then carry out ad-hoc work on a transactional basis with 200 or so others.

This tiered model can work if clients know what to expect and there are distinct processing lines to cater for each tier. However, there will always be compromises made not only on service and quality but also on long term business potential. Resource and time diverted away from the “sweet spot” the firm delivers to best effect can never be recovered and can have a detrimental effect on cash-flow – the lifeblood of any business in any market in any industry.

Summing up your vision

The vision of their business described by many advisory practice owners encompasses characteristics such as:

- Knowledge of what clients really value
- A proposition based on long term relationships
- Clients paying fees and delighted with service
- A high proportion of recurring income
- Clients have written service charters
- Every client receives the review we promised
- Manageable client bank per adviser
- A clearly segmented client database
- A fully utilised CRM system
- Culture of continuous personal development
- Clearly defined roles in the business
- Consistent application of company processes
- Everything possible is automated / outsourced
- Strong relationships with other professionals
- Marketing material that reflects our purpose, brand and processes
- Profitable activity
- A business enjoyed by staff and clients alike

Such characteristics are unlikely to arise by chance. To achieve a desired business model requires planning, attention to, and action regarding, several elements of running a business.

Your decisions here will determine how you design the remaining components of your Target Operating Model.

- Client Proposition – who is your target market, what are their needs and wants and hence does the Proposition need to include
- Operations – How do you deliver the proposition?
- Marketing – how will get it to market?
- People – what skills, knowledge, mindset, culture do you need to build
- Finance – how will this all be paid for?

Each of these factors will be considered in the remaining chapters at various points.

Summary

If you have read each of the first three publications you will understand the need for a clearly defined purpose and alignment of your personal goals to your business goals.

You then need to be focused on the client segment and strategy you will pursue as the means for generating profitable revenue and a successful and positive reputation.

Being clear about what you are trying to achieve means you chase only the rabbits you need to catch. This means minimising variability, not being all things to all people, determining what your core target market is, what they need and want and how can you deliver this as a means towards achieving your ultimate goal

The next chapter will focus on understanding your target market, their needs and wants and how this should influence the design of and marketing of your Client Proposition

If you have any comments or questions for me then please feel free to drop me a line to teamtalk@12man.co.uk and I will endeavour to get back to you.