SUCCESSION PLANNING – MAXIMIZING THE VALUE OF YOUR PRACTICE – BUILDING A BILLION DOLLAR PRACTICE

By David B. Loeper, CIMA®, CIMC®

financeware.com
Powering the future of financial advice®

www.financeware.com

600 East Main Street, Suite 1240, Richmond, VA 23219 p 804.644.4711 f 804.644.4759 www.wealthcarecapital.com

ABSTRACT – As more financial advisors approach their own desired retirement age, there remains an industry wide problem in creating enough value at succession to fairly compensate retiring advisors for their career long effort to build a successful financial advising practice. Feeble formal retirement programs from wire houses lead many advisors to strike their own private deals with other advisors that never truly free them from practice obligations. Alternatively, advisors leave to form their own independent firms in hopes to monetize the practice in a sale that never really pans out with the economics they had anticipated. While stories about practices selling for two to three times revenues are hyped, the reality of the terms of many of these deals (with earn-outs over several years and claw backs for attrition) often have the net result for the selling advisor falling far short of what is promoted.

This paper attempts to identify the root causes and the cures for this industry wide illness based on an underlying premise that more value can be created if an advisor's practice is run more like a business than, well…a practice. This requires rethinking every aspect of the financial advising business from the client experience to the assignment of tasks and from the skills of staff hired to the compensation and incentive structure for all employees in the organization.

It is important to note that some of the ideas offered here are just a theory (at least currently) and have not yet been proven. Most of the elements of what is assembled here have singularly demonstrated in real practices the presumed benefits in my model. Regardless, it is our intent to put these ideas to the test in practical application.

Would You Retire Now If You Could Sell Your Practice For Three Times Revenue?

There are a number of issues that advisors need to consider when planning their succession. First and foremost (hopefully) is the concern for the future well-being of their clients. Many of the clients have truly become friends of the retiring advisor, and the depth of relationships an advisor has with their long-term clients instills a moral obligation to ensure that they will be treated fairly after the advisor retires. Presuming that the acquiring firm practices impeccable ethics and integrity in their business, the next hurdle is a financial one. We fully recognize the impeccable ethics and integrity of the acquiring firm is a very risky presumption.

The retiring advisor is selling his practice and needs to use the proceeds to provide a supplement to his retirement income. If he gets a full three times revenue upfront at the time of sale (without earn-outs and claw backs) and invests the proceeds in the capital markets, he might hope to produce a 5% withdrawal rate to avoid running out of money. Converting this to income, this would mean a practice generating $1 million a year in advisor revenues would sell for $3 million which when converted to an income stream would represent a lifetime income of $150,000 a year.

Let's presume for a moment that a lifetime income of $150,000 a year represents a fair price for the advisor selling his practice. Let's also presume that a practice that generates $1 million in advisor revenues netted an advisor current income of $500,000. This would equate to a 50% payout at a wire house. For an independent advisor, the math would be a bit different because in the wire house, most of the investment product and location costs are funded by the lower payout. For example, say the advisor's business uses a separate account manager platform that charges 2.0%. In the wire house, 50 basis points goes to the wrap account manager, creating production gross of 1.5%. At a 50% payout, that leaves the wire house advisor with income of 75 basis points. An independent advisor charging the same 2% would have additional custody and platform expenses, above and beyond the 50 basis point manager fee that could easily total 30-50 basis points. This leaves the independent with gross production of around 1.1%, from which he must pay for his office, technology, and support staff that could easily total 25-35 basis points, netting him similar pay on an apples-to-apples basis. (See *Appendix #1*)

One might ask why another advisor would not merely be willing to pay the retiring advisor $150,000 a year as a lifetime annuity when acquiring the practice yields around $500,000 in net income. After all, after paying the retiring advisor $150,000, the acquiring advisor would still net $350,000. The reason deals like this do not generally happen is because of the structure of advisory practices. There will inevitably be some client attrition. If after 5 years there is 25% attrition, the wire house advisor's production on the acquired book is only $750,000, and at a 50% payout, he's getting $375,000, less his promise to pay the retiring advisor $150,000, netting only $225,000. This is less than half the income he would have earned if he built the original practice on his own.

For the independent, the risk of attrition works the same way with the fixed office costs. Gross revenues would decline to $575,000 but there would still be about 100 clients left to service and the total staff and office expenses would unlikely materially decline. After paying the selling advisor $150,000, and the relatively fixed location costs running $166,000-$266,000, the acquiring advisor is at risk of his income from this acquired book being only $159,000 to $259,000.

These risks are why advisor practice acquisitions do not support a guaranteed lifetime income to a $1 million selling advisor of $150,000 a year, and why there are earn-outs and claw back provisions in acquisition agreements.

Our acquisition model is designed to be able to support such a succession pay out.

Advisor Teams As A Means Of Succession Planning

The popularity of Advisor Teams in recent years is partially promoted as a means of succession planning. Their origin, many years ago now, was motivated mostly by advisors finagling higher payouts because firms wouldn't pay for growing support staff for the advisor's practice, and they ended up hiring registered staff that they would pay a portion of their production based on an agreed upon split. This triggered smart advisors figuring out how to get the payout of a million dollar producer even though they only produced $500,000. The firm's attempt to control costs ended up costing them a lot more than the $30,000 salary for the support staff the advisor wanted.

Here is how it worked before the formal team approach most firms currently have came into being. Advisor "A" who produces $500,000 in revenue would team up with Advisor "B" and "C" that each produce $250,000 in revenue. At $250,000, "B" and "C" were at the low end of the payout schedule. Advisor "A" was in the mid area of the payout schedule. But, if they did nothing other than combine their books under Advisor "A" and privately agree that if the partnership splits up, everyone's clients goes back to the original advisor, they could probably net up to a 10% higher payout, splitting up a cool $100,000 by exploiting a firm's policies. Originally, firms HATED partnerships because all it did was raise payouts.

In structures such as the one described above, there were no efficiencies gained other than the increased payout for the advisors. The advisors all continued to do the same thing they always had, just under the auspices of being part of Advisor A's practice to pocket the extra payout. They were not really teams in any real sense of the term.

You may wonder why, over the last decade or so, firms have gone from hating these team practices with increased payouts to not only endorsing them, but having firms actually promote and encourage them. The reason they love them now is because by formalizing the rules amongst the team being formed, they are making it difficult for any of the team members to leave to go to another firm. The training for forming teams focuses on separating tasks based on skills. For example, one advisor is the rainmaker who focuses on hunting down new clients, another is the service specialist who handles most of the ongoing meetings, another is the investment guru, planner, or business manager. By the firm's endorsement of such structures, the cost of payouts do increase, however, the attrition decreases offsetting the payout increase. Depending on the term of recruiting incentive bonuses, upfront deals for switching firms can range from 100% of trailing twelve month production to as much as 200%. It is far cheaper for a firm therefore to let a team of advisors earn an extra 10% payout if it prevents the team from leaving. Replacing the lost revenues on a 7-year 100% upfront deal is a far higher cost than the team earning an extra 10% every year. The attrition of teams is much lower when clients are exposed to multiple members of the team and each team member becomes dependent on the others. Leaving to go to another firm is a big (and risky) decision for an advisor, and getting all of the members of the team to agree on a move is difficult at best.

These newer team structures, where different advisors specialize in performing discreet tasks for the more efficient overall operation of the practice, represent a toehold in maximizing the real value that can be obtained by redesigning the operation of an advisory practice. Some efficiencies are undoubtedly gained in such practices, but the root of the issue is that all of the compensation costs are still combined as a percentage of revenues as individual advisors. Also, while the skills of the people performing certain tasks are allocated based on who is the best fit for the task that needs to be accomplished, the skill sets of some of the team members will clearly not be optimal. This is because generally partners are brought in from the basis of already being advisors who in general have already been filtered based on the primary skills needed to be an advisor. This sets everyone's expectation to be compensated a significant percentage of revenue, while a person more proficient at certain skills may not only be paid on a fixed salary, but also might actually have better skills for the task at hand.

Succession planning in a team approach works well for the non-retiring members of the team. But, the risk of attrition (albeit somewhat lower) and the expected compensation levels of new team members get in the way of retiring advisors being able to capitalize on their career efforts, which could otherwise be realized if practices were truly run like a business, instead of a practice.

The common sense results of the traits of some of the best teams are the favorable upticks in client retention and efficiencies from team practices, such as:

- A consistent and clearly communicated and implemented investment process

- Multiple client "touch points" delivered by more than one of the team members [For example, rainmaker brings the prospect in, co-presents the recommendation with the service specialist, glad hands regularly at client events, attends occasional service meetings (particularly those that require new recommendations), stays in occasional touch to generate referrals, listed as author on some client communications, etc.]

- Marketing the visibility of each of the members of the team in client communications

- A consistent and uniformly applied value proposition

- Service standards that are *measured and delivered* as promised

All of these are traits on which my proposed model intends to capitalize. But, fundamental restructuring turns the benefits of these traits from a moderate improvement to a full optimization to enable richer rewards for retiring advisors while delivering better services at a lower cost to clients.

The Right Task, The Right Skill, The Right Compensation

Advisors must wear many hats in running a practice, and there are few who are exceptional at every task that must be executed. Look at the practice management surveys that show how advisors allocated their time. A 2006 Moss Adams LLC survey showed that advisors spend only 41% of their time servicing and prospecting for clients. My model questions whether even these two primary advisor tasks are best served by just one person.

Think about the skills needed to acquire new clients. You must aggressively expand your network. You need a thick skin to cope with rejection. You need excellent persuasion skills so that you can convince people to do what they otherwise might not do. You need to be a confident, polished presenter. Are these the skills that lead to client satisfaction in ongoing servicing? Put yourself in the shoes of a client and think about what you want from your ongoing relationship. Are these traits really what you would seek in an ongoing relationship? Wouldn't you prefer a sensitive, caring, objective listener to work with you on your life goals and dreams?

Think about the traits I outlined above. They describe the personalities of two entirely different people, and every practice needs them both. The problem with the industry is that instead of optimizing these realities and paying an appropriate amount for the relative value of the respective task, all advisors are paid based on revenues and are expected to perform both of these conflicting tasks well. I suspect that a large contributing factor to the ultimate size of a practice and its efficiency is how well both of these tasks are executed.

You have seen evidence of my premises in your own experience. We all know an advisor who constantly struggles to hit production minimums, who frets over his clients' satisfaction, who has terrible call reluctance, and who deep down would prefer to trade an appointment with a new prospect for two or three meetings with current clients if it were not for the fact that he needs more business.

We also all know of sharp, aggressive networkers who hunt down new business at every opportunity. They will spend hours to assemble a powerful presentation to secure a big new prospect yet dread the inconvenience of an existing client calling to schedule an unplanned review meeting or coping with an administrative or operational issue.

No one wants to hear that he is not very good at a job skill. But, we should objectively welcome self-criticism if we are going to build a real business. Perhaps the most striking contrast between these two advisor personalities is how they would respond to hearing they are lacking in some skills. If you approached the adviser with low production who looks for excuses to avoid prospecting and said to him, "Dave, you don't seem to have the best prospecting skills and that is impacting your business's growth," how do you think he would respond? C'mon, you know someone like this. His nature and basic traits would not have him argue with you on this. His objectivity, which makes him effective and empathetic in client servicing, would show through, and he would probably respond with something like, "I know, I really need to make more calls and ask for more referrals." He would actually convey that he feels guilty.

On the flip side, the aggressive, confident networker is likely to respond quite differently when you pose the notion that perhaps his client service could be improved. His confidence and lack of objectivity are far more likely to have him respond with something like, "Bull! My clients get excellent service!" or "If you had anywhere near the number of clients I have, you'd have a hard time servicing them too!" It is unlikely you would hear an objective and guilt-accepting acknowledgement like, "I know, the thrill of getting a new client is what really motivates me and the service of my existing clients suffers because of it."

Generally, in our industry the advisor is responsible for both of these tasks, which consume on average 41% of the advisor's time. Growth suffers with one, service suffers with the other and efficiency suffers with them both.

What are the other tasks advisors spend their time performing? The list is endless: investment research, financial planning, staff management, operations, trading, continuing education, compliance, fee billing and bill paying, etc. No one person can excel at all of these skills, yet that is how our industry is structured. Some advisors recognize this and if they grow their practice to a large enough scale, they hire staff hopefully with complementary skills to their own in order to capitalize on freeing their time to do what they do best (and what is the most valuable thing for them to do). Other tasks, at which the advisor lacks the skill, enjoyment, or both, are fully delegated to salaried staff who are more skilled and actually enjoy their role. You have probably seen some practices like this where there is one "advisor" surrounded by a team of 5 to 10 salaried staff (with an incentive bonus of course normally based on production). Though practices structured like this are very rare for a number of reasons.

First, having enough scale in the practice to support all the fixed costs of the staff's salaries and the reality that the money to pay for them is coming directly out of the advisor's pocket are huge hurdles. Secondly, not only must the advisor have the skill to bring in clients, but he must also have management skills because he is truly running a business. Bills have to be paid. Contracts for various services, leases and such must be negotiated. Staff must be recruited and interviewed. Compensation and benefit packages must be designed and communicated to staff. And of course, disputes amongst staff must be resolved. All of these managerial tasks are reasons teams of advisors are assembled. A junior advisor joining a team brings some production to the table to offset his cost. The junior advisor might not be the greatest Wealthcare planner, or service specialist, or investment manager that the practice could have hired; and his compensation might be somewhat higher than the salary you would have to pay for someone ideally suited to the role. But, who cares? Settling for a weaker skill set and paying more for it isn't really a problem if the advisor is bringing in production to fully offset his cost and maybe will even increase payouts. This is the theory behind creating advisor teams. As you will see later, this ends up being pennywise and dollar dumb for the primary advisor.

It Is Hard To Let Go

Advisor teams do correct some of the imbalance in needed skills if all of the members are sufficiently objective about what they bring to the table. The biggest barrier in really putting the right skill set on the right task in an advisor team is that an advisor's book is his greatest asset. Thus, a truly efficient practice design would have all of the advisors in the team focusing their time on their respective skill sets (prospecting, Wealthcare planning, investment management) and turn over their coveted client relationships to someone who is better at the servicing task. When your value is your book, this is very hard to do. This cloud hangs over some of the best teams.

Likewise, the service specialist team member often is *over compensated* for his relative value to the team *because* he is the one that develops a recurring relationship with the clients of the team. (As we will see later, many other team members are also over compensated for their relative contribution.)

The team as a whole views his role as critical (as it is) yet fear that if they relinquish the client relationships to him, there is a risk he might leave and take those relationships with him, despite contracts that say otherwise. It allows him to negotiate a higher percentage of revenues than what you could otherwise hire a salaried worker who might have even stronger servicing skills and traits. But, with all team members joining the creation of the team on the same level playing field as advisors (albeit with different production levels), the service specialist's starting negotiation point is at least what he was already making as an advisor and based on a percentage of practice revenues. *The result for such a team is that the rainmaker of the practice is undercompensated for his unique skills.*

The Optimal Traits for Various Roles

Take a step back and objectively consider what the ideal skills and traits would be for some of the various roles needed to have a truly efficient and effective practice.

Role	Ideal Skills and Traits?
Prospecting/Rainmaker	Articulate, aggressive, thick skinned, persuasive, social, polished in presentations, desire to win, confident (maybe over confident)
Servicing	Empathetic, sensitive, caring, listening, objective, desire to please, accepts and acknowledges guilt
Wealthcare Planning	Analytically creative, attention to detail, intuitive math skills, objective, empathetic
Investment Selection	Excellent mathematical and statistical skills, skeptical, objective
Portfolio Management	Attention to detail, problem solving, disciplined

Perhaps you disagree with the traits I have selected for the various roles; there is no science behind them. To me these are just common sense dominant traits for the roles as I envision them in an optimal practice. Even if you disagree with some of the traits, you will likely at least concur with the rationale for why I selected some of them for the various roles. In a truly optimal practice, there are two other requirements for *every* role. They are ethics and integrity. There is no room to fudge on that.

If you are building a team with these roles, and you are filling most or all of these positions with existing financial advisors, think about how unlikely it is that you are going to get the skills you are seeking. Read through the list of traits and tick off all of those that are dominant criteria to be hired as a financial advisor. Other than the role of rainmaker, most of the other roles have skills and traits that are not dominant criteria for being hired as an advisor, and in fact some of them would actually disqualify you from being hired as one. So, in reality, if your goal is to optimally assemble a team in which each member is placed in the role best suited to his or her skills, but you are selecting these team members from a pool of advisors that has already been filtered out for not having the traits you need, you will ultimately have a team that is weak at the very skills you need for each role.

Where Do The Tasks Get Done?

If all of these tasks are conducted on site, you have other efficiency issues that emerge. Staff need to be crossed trained to cover for roles of others when they are on vacation or leave the practice. Supervision and management is complicated in every aspect merely by the number of people in the branch. Think technology, office politics, facilities, compensation negotiation, registrations, compliance, even payroll…these all expand (sometimes exponentially) with each additional team member. Such management issues are going to distract at least one team member from their primary role.

Many advisors have learned that some of these roles do not need to be performed on site. For example, if you outsource investment management selection and portfolio management to a turnkey asset management program (TAMP), two of these roles can be eliminated. And, while some advisors fancy themselves as gurus in this regard, there is plenty of evidence from the success of those who have outsourced these functions that they are just as valued by their clients (sometimes more) than advisors who do not outsource these roles. Of course, outsourcing usually comes at a price, and depending on the practice and how scalable the operations are, outsourcing can cost more than doing it internally. It can also be a significant cost savings too. The decision should not be based solely on the cost, though, as there could very well be some strategic reasons to outsource, even if the initial cost is somewhat higher. The bottom line is that it is important to recognize that a practice can be successful without performing the investment selection and ongoing portfolio management on site. Whether or not it makes sense depends on the practice and goals of the advisor.

Planning Can Be Outsourced Too

Wealthcare planning and ongoing monitoring are other roles that can be outsourced, potentially more cost effectively than doing it on site. Various services are available to outsource traditional financial planning too if you are still in that legacy environment. In our case, we have a dedicated planning team hired for their specific skills, that craft each recommendation and go through multiple levels of review. With that effort and set of skills, the quality of the plans dramatically increases. Further, plans are constantly kept up to date so you are always ready for a client review. Finally, while we do allow members of our planning team to take vacations, the team as a whole is always there for you.

So in fact, the only roles that actually *need to be performed on site* are those client-facing roles: prospecting, presenting recommendations and ongoing servicing. If the branch is 100% dedicated to these roles, it is not burdened by the management issues. The people in the servicing role (we call them "Wealthcare Confidants") are registered and trained by us and the local advisor to be purely effective at listening and communicating the premises of Wealthcare to clients. They are exceptionally skilled at the traits we need to consistently deliver Wealthcare service…empathy, listening, objectivity, caring, and a desire to please. They are not involved in prospecting but are trained to introduce the advisor to referrals they obtain in their regular client meetings. They are paid a salary and a bonus based not on production but on client satisfaction and meeting service requirements. Their backgrounds are not those of advisors. They are social workers, psychologists, guidance counselors, etc. One Wealthcare Confidant can deliver exceptional service to more than 300-400 clients because that is the only role he or she serves. Every client in this practice meets for an hour with their Wealthcare Confidant at least four times a year. Like a dentist's practice, the next meeting is scheduled at the time of the last meeting. With service appointments every hour on the hour, one Wealthcare Confidant has capacity for 1,600 annual one hour meetings in a practice with 400 clients, and has another 400 hours a year to make impromptu phone calls and handle other issues. How many clients of yours consistently get four one-hour meetings a year?

Being a Wealthcare Confidant is emotionally a very, very, very rewarding career. And, *this* is what motivates a person who has the right traits to serve in this capacity. While their income is significantly superior to their prior profession, the real reward for them comes not from the money, but from filling each day discussing people's hopes and dreams and showing them how they can reach them, and from the hugs they receive for delivering advice that makes the most of the client's life. All of the Wealthcare Advisors who have joined our firm have experienced this in practice and in every case it has completely changed their perception of the industry.

Capacity To Serve

Few advisors have practices with 400 clients. This means that one Wealthcare Confidant can service $100 million to $400 million in assets (based on an average household size of $250,000 to $1,000,000). To fill this capacity, it is our intent to identify advisors who want to build a $1 billion practice under our model. In the home office we handle everything that does not need to be done in the branch. We handle the investment selection, Wealthcare Planning including ongoing reviews and new advice as needed, tax efficient portfolio management and trading including location management (which can save an investor with $750,000 about $150,000 over 20 years depending on their circumstances), fee billing, bill paying, benefits packages, technology support, accounting, etc. The Wealthcare Confidant handles the ongoing servicing of clients.

The advisor identifies and works with new prospects, attends and speaks at client events (a critical aspect of our business model to keep the advisor in front of clients but also to generate referrals as clients are encouraged to bring guests), participates in some occasional client meetings, manages what little left there is to do in the branch, **AND indentifies and develops practices of retiring advisors we help him acquire for his practice.**

Take an independent advisor with $100 million in assets, charging a 1% advisory fee generating $1 million in revenues with 200 clients. With a dedicated Wealthcare Confidant in place (completely freeing him for his most valuable role) and with client servicing capacity to double the size of the practice, he might earn $700,000 a year. The costs coming out are all of the local office expenses, travel and entertainment, benefits, client events, technology, etc. You might ask where the money comes from to pay us for all of the work our teams with the right skills are doing in the home office for those roles that do not need to be done in the branch. Interestingly, it doesn't come from the advisor's pocket.

Disintermediation of Products

For most advisors, instead of making themselves valuable to clients, they attempt to inherit their value from the products they offer. This should obviously be problematic, and the product vendors the advisor "partner's with" have a huge stake in perpetuating this misconception. Access to or selection of any product that thousands of other advisors can also offer cannot be the source of the advisor's value…particularly for one earning ongoing fees.

Ironically, I often hear a twisted excuse for active management as a fear that a client will not continue to pay me for a passive portfolio. The implication here is that the client will continue to pay you for selecting products that your investment policy states need to be evaluated (***held***) for a market cycle of 5-7 years, even though they can transfer those selections to a multitude of other advisors or even to Schwab or Fidelity to avoid your ongoing fee. Of course, clients don't usually do this, nor do they do this with us. But the product vendors promote it to irrational levels.

When it comes to true Wealthcare relationships with clients, most clients care little about the products and portfolio selections that are made and are more than willing to change their portfolio implementation, particularly if it can be demonstrated that it will lower costs and save on taxes. In reality, most clients don't really connect much to what is actually used to fulfill the asset allocation model. They trust the advisor for this; that is after all ONE of the things they are paying the advisor to do. The other, in the case of Wealthcare, *is to constantly change the plan* to make the most of the client's life because markets, goals and priorities of a client's life will misbehave and change. This includes changing the main driver of performance—that is the allocation to stocks, bonds and cash—based on the funded status of the plan and the client's priorities. We do not wait five to seven years to evaluate whether new advice is needed. We deliver it all the time. Clients see this and this ***increases the perceived value of the advisor*** relative to other advisors who merely chant to the client, "Stick to your long term plan" or "Your policy said we would evaluate it over a full market cycle" or "Stick with them, the management team is still in place and has a solid track record." To the client, these statements all sound like "Suck it up—I'm not doing anything about it now despite me getting an ongoing fee." It is really quite silly when you think about it.

All of these products used by advisors skim an awful lot of fees out of the client's *and the advisor's* pocket that simply are not needed for a successful practice. How many Wealthcare plans has American Funds done for you lately? How much in taxes was saved by that automatic rebalancing event that generated a ton of tiny trades by your TAMP? How much did owning the muni-bond allocation model in the client's taxable account cost the client in 2008 because the TAMP couldn't customize focusing the Treasury allocation to tax deferred accounts for the whole household?

For an advisor whose product costs are 75 basis points, we can:

- Lower <u>the total cost</u> to the client by 25 basis points (improving the client's lifestyle and/or confidence level in his Wealthcare plan)

- Dramatically lower taxes both strategically and tactically

- Keep the client on their target allocation while dealing with monthly contributions or withdrawals for an average of about 8 trades a year for the entire household (not per account)

- Create all of the Wealthcare plans needed both initially and ongoing with at least quarterly updates and new advice

- Do all of the fee billing and office bill payments

- Support your technology infrastructure

- Perform all required compliance functions

- Handle all of the benefit programs, payroll, accounting, etc.

And, we can actually make a profit doing this. <u>So can the advisor.</u>

Let's go back and examine our $1 million producer that starts a beach head office with a Wealthcare Confidant, with 200 clients who earns $700,000 net of all of his location expenses. He has the service capacity to double the size of his practice. If we fund the acquisition of another practice similar to his of a retiring advisor and merely amortize the acquisition cost to his local profit and loss statement, his income would go from $700,000 to $1,545,000, more than double. In reality of course there are not a lot of million dollar practices for sale, but it makes no difference whether he acquires practices with $200,000 of production over a time or all at once. The Wealthcare Confidant is now at full capacity and we will not let the service standards be compromised…every client will get at least 4 one hour meetings a year.

Hiring another Wealthcare Confidant might reduce the advisor's income to be only a bit more than a double. But now, he has capacity to double the size of the practice again through acquisitions that we fund. If over the next three years we can together acquire practices of retiring advisors to bring the office back up to full capacity, the advisor's income would grow from the original $700,000 to over $2,900,000. We think, for the right advisor, we could support him in building a $1 billion practice over ten years, ultimately generating $10 million in fees, with a team of five Wealthcare Confidants, netting him compensation of over $7.5 million. And, if he wants to retire at that point, we could buy the practice from him under the same generous formula we used to acquire the practices for building his business of the economic equivalent of three times revenues…a retirement annuity of $1,500,000 a year. Even if the advisor only gets halfway to our ten-year goal, he would be retiring on a lifetime income that was more than 100% of his income when he started with us.

Contrast This To A Team Of Advisors

Take our example million-dollar producer and contrast what happens to his income if instead of acquiring practices and focusing on having only the roles needed in the office, he recruits a team of three additional advisors who contribute various roles and together add the same additional $1 million of production. Instead of his income growing from $700,000 to more than $1,500,000, he is lucky if the cost of that team would enable his income to grow from $700,000 to $800,000. Instead of two associates he would probably have an office of five people, a lot more management headaches and not a lot to show for it. Services to clients would not be materially better. Costs to clients would probably be higher. This is why growing a practice through a team approach to save on salary actually ends up being pennywise and dollar dumb.

What We Know

Most of the elements of this practice design have individually been proven to work in real world scenarios. We have already demonstrated the effectiveness of centralized planning and portfolio management at scale. We've seen client acceptance of passive portfolios (we had one million-dollar practice that had 350 client households all implemented actively that converted 349 households in two months… the one straggler's brother was the separate account manager). We have seen clients accept teams with different roles and actually prefer to deal with their Wealthcare Confidant on an ongoing basis. We have seen how emotionally rewarding it is to serve as a Wealthcare Confidant. We have seen successful practice acquisitions with payouts to the selling advisor less than what we are proposing with reasonably high client retention rates.

Conceptually, all of these elements should also all work together. Yet, this is the one thing that has yet to be proven. We are determined to test it. There is so much financial leverage in this model that we have a lot of room for errors and time on our side to make some adjustments as needed.

Summary

Business should be a win, win, win. This model delivers exactly that. It is better for the retiring advisor who is selling his practice. It is better for the acquiring advisor trying to grow his practice. It is better for the Wealthcare Confidant who is determined to keep clients happy. It is better for the client in terms of cost, taxes and the quality of the service they receive. That alone should be reason enough to execute on this plan. Finally, it is better for our firm and shareholders and is actually even better for industry…to finally have an example of a proud financial services business that always puts the client's interest first.

There is one loser in this model and that is the product vendors. One must ask why we should care. I certainly don't, nor do clients. The advisors who do care more about the product vendors than their clients do not fit into our firm. We will get around to helping their clients when they retire.

Appendix 1- Contrasting wire house versus independent wrap program income

$1 million wire house advisor at 50% payout

Total assets:	$66,666,666
Number of client households	133
Average Client Size	$500,000
Total fees billed to clients (2%):	$1,333,333
Production Gross (total less 50 bps mgt. fees):	$1,000,000
Payout:	$500,000

Equivalent Independent Advisor:

Total assets:	$66,666,666
Number of client households	133
Average client size:	$500,000
Total fees billed to clients (2%):	$1,333,333
Mgt. Fees (45 bps):	-$300,000
Platform Fee (20 bps):	-$133,333
Custody/Trading (20 bps):	-$133,333
Gross Office Revenue:	$766,667

Less:

Rent, Technology, Support Staff, T&E, Etc.	$266,000 - $166,000
Net Payout	$500,000 - $600,000

A popular industry speaker and writer, DAVID B. LOEPER is the CEO and founder of Financeware, Inc. in Richmond, VA. He is author of the top selling book Stop the 401(k) Rip-off!, three other books released in 2009 by John Wiley & Sons (Stop the Retirement Rip-off, Stop the Investing Rip-off and The Four Pillars of Retirement Plans) and numerous white-papers. He has appeared on CNN, Fox Business, CNBC and Bloomberg TV, served on the Investment Advisory Committee of the $30 billion Virginia Retirement System, and was chairman of the Advisory Council for the Investment Management Consultants Association (IMCA). He regularly writes for Forbes, Dow Jones, Advisor Perspectives and has a monthly column on ethics for Transitions Magazine. Before founding Financeware in 1999, he was Managing Director of Strategic Planning for Wheat First Union. He earned the CIMA® designation (Certified Investment Management Analyst) from Wharton Business School in 1990 in conjunction with IMCA.