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Strong demand for financial planning businesses

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BUSINESS is brisk at the offices of Rob Knights & Co. The business broker for financial planners, lawyers and accountants has been experiencing strong demand from financial planning businesses wanting to buy up other firms or, more particularly, their clients as the economic and share-market downturn places increasing pressure on business models.

Principal Michelle Knights says the income of businesses focused on wealth creation has slowed dramatically and buying another firm's customer book is a relatively quick way to boost the bottom line in these troubled times.

"We are certainly seeing a greater number of parties that are interested in acquisitions," Knights says.

As well as taking out other planners, planning firms are trying to broaden their income base by buying accounting businesses and moving into life insurance and, somewhat ironically, income protection insurance. At the moment the process is still being driven by those looking for businesses to buy, Knights says. "It's still very much a vendor's market."

Small planning firms are not yet knocking on her door offering themselves for sale. That's partly because firms know they will not get the same revenue multiples for their business that were achievable two years ago and will hold off as long as they can, Knights says. However, she thinks they could be on their way.

"Potentially, there are going to be more forced sales at the lower end if (investment) markets continue to get worse," she says.

Financial planners did very well in the boom years. According to figures from IBISWorld, total revenue for the industry surged from $3.15 billion in 2003-04 to $5.44 billion just three years later.

But the industry is under attack. Its revenues are under severe pressure from the economic downturn, with most business revenue models tied in some way to the level of diminishing client assets.

In the boom times it meant planners and advisers did very well when their clients' investments were rising, but now the model is driving some businesses to the wall.

Scandals continue to hack away at the reputation of advisers good and bad. After the property investment scandals of Westpoint, Fincorp and others came the margin lending fiasco at Storm Financial, all of which have destroyed the retirement savings of thousands of Australians.

An industry that claims it is already drowning under paperwork and loathes the idea of more regulation is facing a two-pronged assault from regulators, with an investigation by the Australian Securities and Investments Commission into Storm and a federal parliamentary inquiry into recent financial collapses that will focus on the role played by advisers.

A further toughening of regulation seems inevitable. Some say the regulatory burden is helping to drive industry consolidation faster by pushing many smaller businesses out.

At a more personal level, advisers are also facing down the acute distress and increased scrutiny of their clients, many of whom have seen their retirement savings cut by one-third or one-half in the global downturn. While some research suggests most clients, for the moment, are not blaming their advisers and are prepared to stick with them, having to deal with angry and distraught people is taking its toll, according to a report from market researcher Wealth Insights.

Almost half the advisers in the study suffered a physical ailment they attributed solely to the increased stresses they were under. “I’ve got shingles due to stress. You don’t want to have to wake up in the morning and tell someone they have lost half their money,” one adviser told the researchers.

Jo-Anne Bloch, chief executive of the Financial Planning Association, the peak representative body for planners and advisers with almost 12,000 members, acknowledges the pressure. “The industry is being challenged, there’s no doubt about that,” Bloch says. “Clients have lost a lot of money in their super returns.”

The FPA says there was an increase in complaints about its members in the December quarter. It expelled eight members during that period for professional misconduct and 44 investigations are under way.

The FPA is attempting to soften the regulatory response by toughening its own professional standards and disciplinary processes, which it says are already tougher than those of ASIC.

Bloch says the association is considering the introduction of a whistleblower scheme to encourage people to come forward and dob in dodgy advisers. It also plans to introduce higher level training and professional development standards for planners from July.

The FPA did raise concerns about Storm’s share-market prospectus but Bloch says it is difficult for the association to act unless it receives a specific complaint of wrongdoing.

“It’s very difficult to stomp into organisations on the basis of hearsay and gossip,” she says.

The fees charged by advisers are also under downward pressure, according to industry insiders, a trend driven directly by the financial crisis.

“I think clients are gradually wising up,” Wren Investment Advisers’ Andrew Quinn says. “People are becoming a lot more fee conscious.”

Peter Johnston, executive director of the Association of Independently Owned Financial Planners, believes the financial crisis marks the beginning of the end of advisers being remunerated by commissions from product providers. “Commissions will be abolished, rebates will be abolished,” he says. “I think these conflicted payments have got to stop.”

About half the advisers already charge their clients a service fee rather than relying solely on commissions.

Critics say commissions leave planners hopelessly conflicted between the best interests of their clients and the incentive to sell products for which they receive the highest commission.

An increasing number of planners reportedly are charging an up-front fee, but that is at least partly because the commission model doesn’t pay as well in a bear market.

“I think the market is using its feet on remuneration already,” Bloch says. “More financial planners are offering both models of charging.”

Sue Dahn, executive director of Pitcher Partners Investment Services, says commissions are on the decline but “it won’t happen quickly”.

Even though Pitcher Partners does not accept commissions, Dahn says some people will continue to prefer to pay for financial advice this way because they do not want to pay anything up-front.

This may be a false economy, however, with a recent report by Rice Warner Actuaries commissioned by the Industry Super Network concluding that clients end up paying more for commission-based advice through higher advice and product costs.

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