Defining client profitability

WITH THE RDR ON THE WAY, A KEY ISSUE FOR MANY PLANNERS WILL BE DEFINING CLIENT PROFITABILITY. **ANDREW WHITELEY** OF ASSETFIRST LOOKS AT WHETHER ESTABLISHING CLEARER INVESTMENT STRATEGIES FOR CLIENTS IS ONE WAY FORWARD.

What do you need to do to ensure that you have a profitable, compliant and scalable business come 1 January 2013?

Much has been written about the need for client segmentation over the last 18 months. In fact, many believe that without undertaking this segmentation and adapting your business proposition to offer different levels of service to differing types of clients you are destined to fail in the post-RDR world. The problem with this is that segmentation is very often determined by revenue receipts rather than actual client profitability.

The only way to truly establish the profitability of your client base is to measure both the revenue received and the total time spent by you and your team on generating it. To do this you need to adopt a discipline to record all time spent on every client and itemise all the revenue received from those clients broken down into trail, renewal, initial and one off or repeat fees or retainers

The results of this analysis can be surprising. There are many clients who generate significant amounts of revenue but who suck up inordinate amounts of time costs. By contrast, there are also plenty of undemanding low revenue clients that are actually among the most profitable.

In addition, this will also enable you to see where your team are spending their time and enable you to focus the right people on the right tasks to maximise future client profitability.

In our experience, a range of risk graded portfolios held centrally on a wrap and mapped to a risk analysis tool is an excellent method to ensure all clients are getting consistent advice. The model approach encourages uniformity and the wrap ensures ease of execution and portfolio monitoring, making the proposition extremely scalable.

The right strategy for the RDR can offer protection for Financial Planning businesses

There are two seemingly opposing forces at work when it comes to compliance; simplicity and independence. Despite this, it is possible to have a simple, formulaic proposition which is still demonstrably independent.

Provided that you have systemised as many processes as possible but still left room for "personalisation" of any client solution then this can only improve things from a compliance perspective. For instance, you may choose not to include cash as an asset class within your portfolios as this is a decision that should be made individually for each client.

Most business owners would agree that their post-RDR service proposition must be scalable and include a compliant investment solution which suits the needs of all clients (and all planners). This being the case there are numerous choices available:

Discretionary Fund Managers: - Currently, the most popular trend is to outsource investment management to Discretionary Fund Managers. This is perhaps seen as the most sophisticated option available. The DFM will charge a management fee and most portfolios are built from collective funds which carry additional annual charges.

Total charges can easily exceed three per cent per annum once all fees and dealing costs are added in. Crucially the adviser has no role in the investment management process but will need to account to the client for any share of fees received from the DFM.

Special care should be taken to ensure the adviser understands where the compliance responsibility rests, as this often remains with the adviser, particularly where the DFM service is hosted on a wrap platform and involves no direct contact with the client.

Pick Funds - Many advisers have traditionally picked fund portfolios for their clients in the past but this places large demands on limited resources. Performance is often mediocre and there can be issues where individual advisers select different funds leading to no continuity within the firm. In light of the TCF initiative, the FSA will not view this favourably in the future and unless the adviser firm is willing to employ a specialist investment professional - at significant additional cost - to monitor and research their fund selections this may well prove to be a compliance problem in the post-RDR world.

Fund of Funds – These are packaged solutions where typically one overarching fund manager will select "best of breed" funds with the aim of delivering out-performance through regular monitoring and alterations to the underlying portfolio.

TERs are generally over three per cent with many being considerably higher. Recently there has been a move among some larger adviser firms to produce their own "in house" funds specifically for their clients with the aim of delivering better returns than those available from the retail market. These "Distributor Influenced Funds" have attracted adverse interest from the FSA due to the fact that they are generally more costly than mainstream fund of funds due to lack of scale and they generate additional fees for the adviser firm leading to a potential conflict of interest.

Model Portfolios – Some wrap platforms provide model portfolio options for advisers using their service. These take the form of risk-graded portfolios which are rebalanced regularly (usually quarterly) and the adviser elects to rebalance their clients back to the current weightings on an ad hoc basis.

These portfolios have typically been based on a selection of active funds (similar to Fund of Funds) and the providers tend to be limited to research houses and fund providers. While there is no specific charge for this service, investors will face the

TABLE 1: INVESTMENT OPTIONS: TOTAL EXPENSE RATIOS AND COSTS

Portfolio Management Method	3rd Party Costs	Average underlying Fund TER (net of trail)	Total Costs on £10m total client portfolio	Regulatory Risk
Discretionary Fund Manager	0.3% to 0.75%	1.15% *	£145,000 to £190,000	Low to Medium
Pick Funds	nil	1.15% *	£115,000	High
Fund of Funds	nil	1.94% *	£194,000	Medium
Model Portfolios	nil	1.15% *	£115,000	Low
Insourced Investment Solution	£500 + VAT pm	0.45%	£52,200	Low

Source: Lipper Fitzrovia 2008

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