More RISK equals higher VALUE – that's a fact of life

An insurance offer can enhance the value of a financial planning business, but only if the offer is built with a great client experience as its goal. Simon Hoyle reports.

Risk clients remain the most valuable sort of clients to have on your books when it comes to determining practice valuation. But incorporating a risk offer into a customer value proposition isn't something that should be rushed.

An analysis by Radar Results of practices and client registers sold since May this year shows that on average, revenue sourced from risk clients aged under 50 attracted a multiple of between 3.0 and 3.8 times.

This contrasts with the multiple applied to revenues sourced from accounting fees, which Radar says has been as low as 0.65 times in the past six months or so.

Earlier this year a Macquarie Practice Consulting financial planning practice benchmarking survey revealed that risk business contributes about 28 per cent of the average practice's revenue. Macquarie says general financial planning services account for about 62 per cent. By comparison, mortgage broking and share broking contribute 2 per cent and 3 per cent, respectively.

Even so, there remains considerable scope for increased involvement by firms in providing risk services.

"This year's benchmarking results for both financial planners and mortgage brokers indicate [that] while both groups intend to offer new services, they have actually taken very few steps in this direction," Macquarie says.

> “Prices paid for good-quality risk businesses in Australia haven't really changed in three years

Practice benefits

Practice management consultants say extending an offer to include risk business provides a number of significant benefits.

It can diversify the practice's revenue and make it less susceptible to exogenous shocks – risk-based practices generally fared better than investment-based practices through the global financial crisis (GFC), for example.

It extends the range of services that clients will pay for, thereby increasing practice revenue.

And when a buyer assesses the worth of a potential acquisition, they will generally assign a greater multiple to the revenue generated from risk business than from almost any other major source of revenue. (See table below.)

In a recent analysis of practice valuations, Radar says that "demand for risk businesses is as high as ever, particularly since FoFA [*Future of Financial Advice* reform] has basically left this sector alone".

"Prices paid for good-quality risk businesses in Australia haven't really changed in three years," it says.

"They rose substantially during the end of the GFC in 2008 and have clearly held their position as the most sought-after financial-services business.

"Before you formulate your selling price, aspects such as the client's age, type of policy, renewal-commission percentage and servicing levels need to be taken into account. A higher multiple is paid for quality clients who have a professional occupation and who pay high premiums due to the

Revenue source	Multiple of recurring revenue
Investment clients (aged 65yrs+)	2.3 to 2.7
Accumulator investment clients	2.7 to 3.0
Risk clients (average age < 50 years)	3.0 to 3.8
Corporate super clients	1.0 to 1.5
C and D clients (investment and risk)	1.5 to 2.3
General insurance	1.5 to 2.0
Mortgage clients	1.5 to 2.0
Accounting fees	0.65 to 1.4

Source: Radar Results, based on practices and client registers sold since May 2012.

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higher sums insured."

Bob Neill, a director of Seaview Consulting, says that a well-structured risk offer "undoubtedly" enhances the valuation of a financial planning business. But he says firms need to tread carefully to ensure the addition of a risk offer does not undermine their other services and hence destroy practice value.

The first decision

He says risk services may be offered in-house, or outsourced, but either way, the risk business should be left to specialists.

"The first decision you've got to make is whether you as a person or that collection of people who are delivering financial planning advice are also going to deliver risk advice, or whether it's more appropriate to say no, it's a specialised skill set so therefore we actually need a specialist to deliver the [risk] advice," he says.

Neill says a practice risks undermining the perceived quality of its financial planning services if it provides a half-baked risk offer.

"The client picks up very quickly the differentiation in the quality of the advice they get," he says.

"If you're going to do it, you've got to do it properly; it probably is a different skill set, it requires specialist skills if you're going to do it at the same level and capability you do your specialist business.

> If they're taking four or five services, they're more likely to forgive you messing one thing up

"If it's seriously going to be part of your business, then it will generally be bolted on to a business where you've got core skills in other areas – whether it's super, self-managed super, investment or financial planning – and if you do a half-baked offer it devalues your offer across the board."

Neill says integration of a risk offer must be tight, so it's a seamless experience for the client.

"You don't want, for example, client information being captured by the investment adviser, and then the super advice guy and then the risk guy," he says.

"You want an integrated process by which you capture client data, so they do not feel like they're being handed from one person to another, without any cohesion."

Neill says an insurance offer can be used as a risk mitigation strategy for a planning business, but the offer still must be properly structured and integrated.

A valid view

He says it's valid to take the view that risk is not part of the range of services a practice will provide.

"But I think the risk of not doing it... is you open yourself up to the risk of two things.

"One, you open yourself up to competing against businesses that do have this integrated approach and therefore their capacity to provide a range of services to clients. And you open yourself up to the risk around the scale and effectiveness of those businesses and therefore their margins and pricing and all of those things."

Neill says if you only offer one service, you'd better not mess that service up.

"If they're taking four or five services, they're more likely to forgive you messing one thing up because they've got the rest of the things that are going pretty well," he says.

And to move the whole range of services is a lot more challenging." ■

THE FACTS OF LIFE

- The median default death cover provides less than 40 per cent of the subsistence death cover needs and less than 30 per cent of the income replacement death cover needs.
- Only 5 per cent to 10 per cent of contributing superannuation fund members have arranged additional death or total and permanent disability (TPD) cover in excess of automatic cover.
- Median default TPD cover provides less than 25 per cent of the income replacement TPD cover needs.
- The median increase in default death and TPD cover between 2009 and 2012 has been more than 60 per cent for industry funds, around 10 per cent for master trusts and 5 per cent for public sector funds.
- Median prices for death cover have reduced by 4.7 per cent over the past two years.
- At age 40, the average cost for $100,000 of default death and TPD insurance is $119 a year or $2.29 a week – a decrease of 5 per cent since last year.
- The average weekly premium across all segments for default death and TPD cover is $4.11.

Source: Rice Warner *Wholesale Insurance Market Report* 2012

Our Spring 2012 model.

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