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Team or Ensemble Approach Structure Options

The basic team or ensemble or *symphony* approach to a financial services practice takes on a look that is more akin to an Investment Management firm than the typical independent advisory firm. What is interesting is that the wire house branches have had teams within their branches for a number of years. Visit the website for almost any Merrill Lynch office and you will find this or that Group.

It is curious to me that when advisors who used to be with wires break away, they do not always take the model that worked so well for them in the branch and apply it to their own business. Instead, (presumably due to financial constraints), they start as solo advisors with perhaps an assistant and then add advisors in a relatively organic manner, with very little thought given to structure. The thought is that more advisors mean more revenue, which is true; to a point. At a recent gathering of advisors, I passed around 3" x 5" cards and asked the advisors to look ahead 24 months, (as we age, we start to think in 2 year tranches rather than 5), and write down how many additional advisors they would like to have in their office and what they would like to see in average revenue from each. By the way, most of these advisor/owners produced between $500k and $1million in revenue each year. I was amazed at how many came back and said the average they would like to see was about $150k. Assuming they took 40% of the revenue produced, after the BDs cut, this means they are bringing on an advisor whose *sole charge* is to produce and give them an office and all the associated costs of have an employee, for perhaps a $50k-$54K additional to the **top line** revenue of the firm. And what happens when that advisor has a bad year?

There are no doubt positive arguments for the idea I just outlined. After all $50k with pay for a good assistant in most cities which can help with capacity issues. I submit however that a $150k producer is *not* a full time advisor. This is not to say, an advisor at this level has no value. It simply means that an advisor who has guidance and structure will do much better if there is a plan to follow. An advisor at this level may help the owner with the status quo, but in truth it does nothing to add value, unless the individual is adding value in other ways. In addition, this structure of just adding advisors in a silo structure is not efficient and again, does not add value. While there is some co-operation among

advisors, for the most part it is one man or one woman against the markets and the tax code. Think of your own office. There is sharing of clients, but each person is running their own book. This means that you really do not know how all the clients of Clark Investment Services are being treated or serviced. I suggest this even puts you, and the advisors running individual practices, at a certain amount of compliance risk, albeit minimal.

Ensemble or Symphony Approach

Since there is at least one book out there calling this approach an **Ensemble**, we will use this name, but you could call it simply a team approach or my favorite, the ***Symphony*** approach. You have a leader or leaders, and everyone else contributes to the smooth running of the firm. I am not a music expert, but you can use this and start small, (think of the 4 main guys who started my all-time favorite, the **Eagles**), and you get much larger until you get to the **New York Philharmonic;** but you keep the basic structure and add to it. Without key players, the firm or musical group falls apart, but the *parts are interchangeable*. Everyone is important for the group of firm to work; some are just more important than others. (You cannot play football with 9 players, but you can't win with a suspect quarterback; ala the *Dallas Cowboys*.) As with the two groups mentioned, the players change all the time.

In today's market, about 25% of financial advisory firms operate as ensembles. It just so happens they are the most valuable and profitable 25%, (according to Moss Adams). The decision to pursue the ensemble and especially succession planning is difficult for any advisor who has played in his own sandbox and heretofore not had to share his toys, but you have already demonstrated a willingness to share; sometime, as we have discussed, at your own detriment.

By definition, *an ensemble practice is a team of financial advisory professionals that relies on the team rather than on an individual to manage and service clients relationships,* (from The Ensemble Practice , by Philip Palaveev).

Ensembles involve multiple professionals at various levels, playing specialized roles and bringing different skills and knowledge. Lower cost, less experienced advisors bring energy and enthusiasm to the table to combine with older more experienced and knowledgeable advisors who bring wisdom and relationships. In doing this, you create *leverage*. This use of leverage has helped ensembles to grow faster, attract larger client

relationships, and achieve higher levels of profitability and ultimately higher levels of value.

Addressing the Capacity Issue

Assumptions, (national averages)

- It takes about 20 hours to service a typical client relationship
- The average advisor has about 1600 hours to service clients, (or about 30 hours a week in a 52 week year; 32 hours a week in a 50 week year)
- Theoretically, this means you can service 80 clients. 80 x 20 =1600*

(*So how do advisors service 200,300 clients? Easy, they are not servicing them very well.)

If you take a salary of $250k, then your service time is worth $156.25 per hour ($250k divided by 1600 hours)

Suppose you delegate just 10 of those hours to another advisor. This is itself doubles the capacity of the team.

Now you can service 160 clients and the associate absorbs the 1600 hours needed. From a profitability standpoint, if each client bring $500k, (@ 1%), or $5000, then 80 clients x $5000 = $400,000.

Using the above numbers, if you compensate yourself $250k, per year, you consume 62.5 %.

Suppose you pay an advisor $80k to service those accounts. The revenue is doubled. 160 clients x $5000 = $800,000

Comp is $250k for you + $80k for the advisor = $330k or 41.25% of total revenue.

The practice doubled in size: From 37.5% (100% less cost of 62.5%) to 58.75% (100% less cost of 41.25%)

Leverage. No doubt, I am not telling you anything, but the concepts are important because

- we can plug in the real numbers of your practice to judge growth

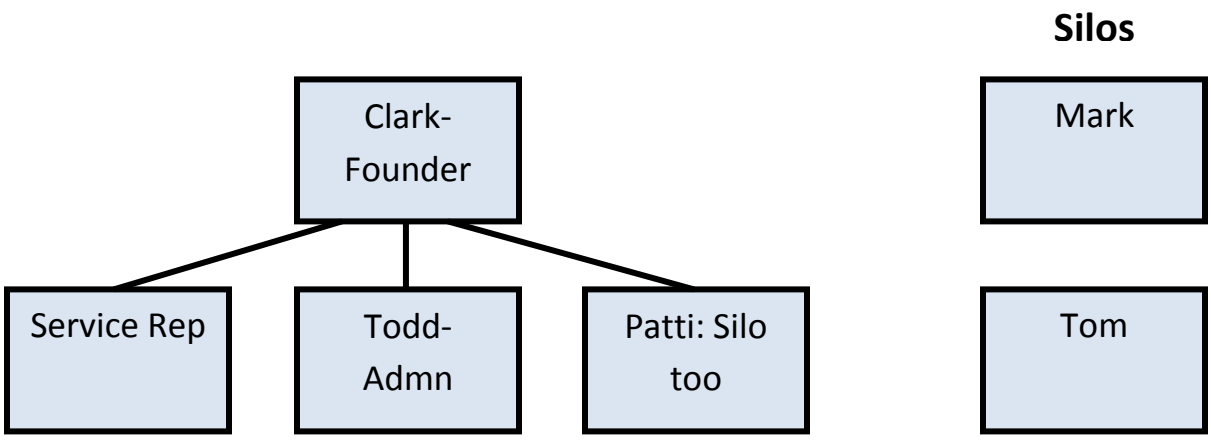
- we can use the concept to demonstrate to other advisors how they benefit financially while contributing to firm strength
- perhaps ***most important***, we can demonstrate to a potential successor, how leverage will grow the firm's value and their investment in it.

By the way, this simply will not work with as well with individual silos within a firm, because you always create turf wars over whose client it is and requests for more comp on the clients.

Creating the Structure

The lead advisor plus service advisor is an excellent potential succession vehicle. Of course we have to find the right service advisor who wants to become the lead advisor. The other way is to bring in another, somewhat younger lead advisor. What I will be proposing is two structures. Either one works and in truth, we could switch from one to the other as time and circumstance dictate.

We will start with what you have: (We assigned names to players, Clark is owner, Todd is Admn, the rest are advisors



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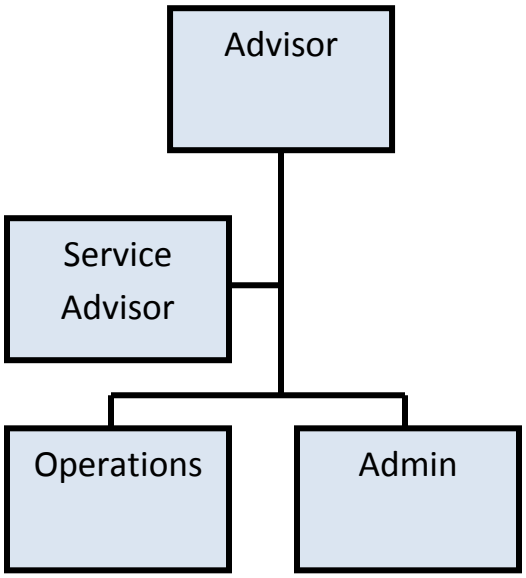
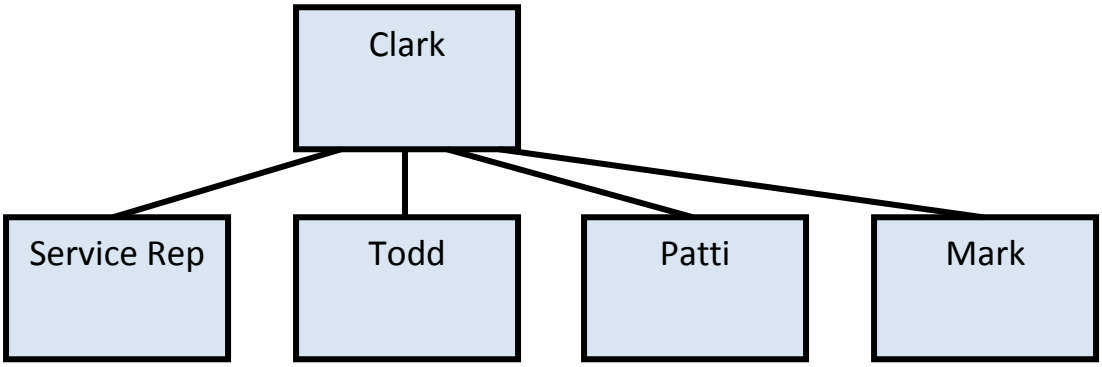
In effect, you have an ensemble with you as the lead advisor, and Todd as the Administrative Assistant . Increasingly, Patti is becoming a Servicing Advisor, with Mark and Tom doing their own thing, for the most part. Compare this with a typical beginning ensemble practice setup.



Pretty close. The difference is that Patti is also running her own book. Based on what she produced last year, (admittedly a transition year), you may have benefitted more, and she may have received more income, had she been almost a fulltime servicing advisor and/or rainmaker. If I were going to design a model with your current staff, adding perhaps one more person I might do something like the following. (I have added Mark as another, possibly Service Advisor.



The role Assignment becomes important.

Clark- Founder

- Seeing “A” clients, (might want to redefine what an “A” client is based on your activities last year.
- Seeing new clients of a certain size once you are sure Kelley, (or someone else), can start clients in your process)
- Work “on” the business
- **Note:** The hardest thing you will have to do is trust others to do it as you would. Try to remember that **no one will.** But if you can get them to do it 75% of the way you would you are doing great. The training program, which will be completed in January, should help.

Patti

- Making rain
- Servicing the clients she has now
- Servicing the clients you assign, (I know this is an immediate need, but the more of these you assign her the less of the other two activities she can perform, unless of course you get her to the point when she can become your Service Advisor, in which case her role will change to some degree.

Mark

- Servicing the clients he has now
- Servicing the clients you assign
- Perhaps clients uncovered by Kelley

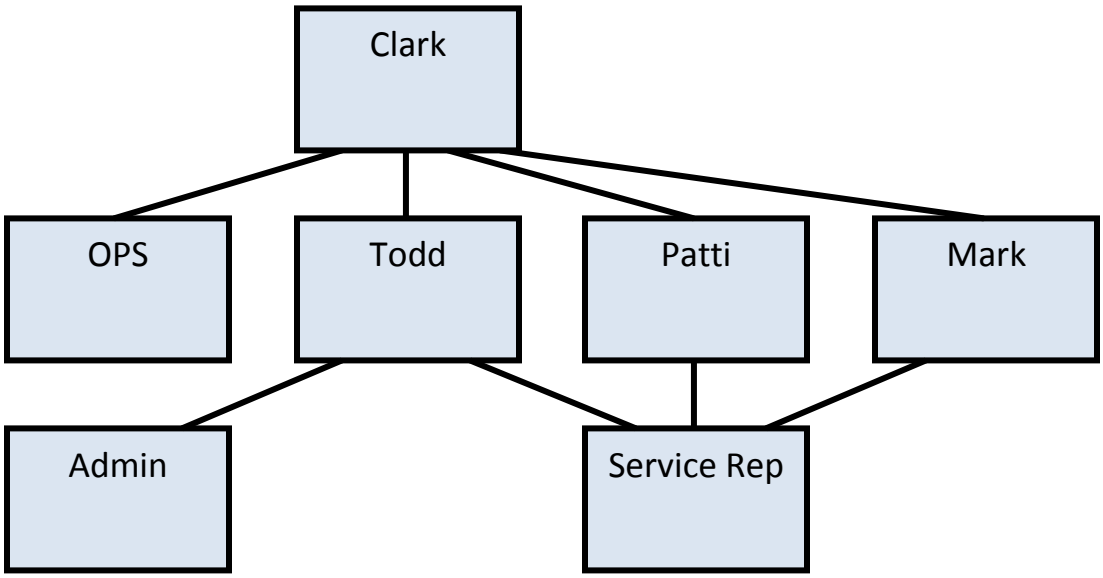
Todd (Sales and Service)

- Todd is key. He needs to continue to do your work, but we need to determine if a $12-$15 and hour person a few days a week would make a significant difference is the amount of work he can do.
- If Patti begins to cover some of your clients, you are shifting some of the back up Todd is doing for you, to her. The more of that she does, the less of her other

activities she can do. So again, we determine financially if it makes sense to find part-time help for Todd and ultimately for the firm as a whole. (Remember that under the ensemble, any help we hire, is not for Patti or even you, but for the firm as a whole; with the possible exception of Todd)

- What I would see ultimately is that Todd is Service Manager. He sees to it that all business is processed and serviced. This might be by him, or it might be by someone who he supervises.

Structure Options



Obviously we have a way to go, but you are not as far as you think. **Service Advisors** also produce by bringing in revenue from current clients and new ones they obtain through referral, (we can teach them). As Service Advisors, one of which is Patti), begin to show promise, you can ease yourself out. **Service Reps** do all the paperwork. Generally you split them according to the type of client, so that they will become familiar the paperwork for that type of client, (qualified, non qualified, high net worth, alternatives, managed money, insurance, etc.)

You determine duties and when it is time to hire a new employee by metrics. Going back to the discussion on capacity, you determine how many employee hours are available and keep records to determine how much clients are worth to you and how much time you spend with them, but also how much time your staff spends on their work. It is more than just time management; it is the **cost of time**.

Metrics

I do not know what you measure to determine how to run the firm, but here are some things to consider: (Some we would use to determine the value of your firm; others to help determine if it is time to hire additional staff)

Ratios

- Revenue per Client
- Revenue per total Staff
- Revenue per Advisors, (Professional Staff)
- Clients per total Staff
- Clients per Advisor or Professional Staff

Tactical Measurements

- Time to complete financial plans
- Time to produce quarterly reports
- Error Rate
- Time to open new accounts
- Time to prep for client meetings, (as your clients get bigger and there are more of them, this is critical and a big determining factor as it pertains to two items, additions to staff, and targeting of client asset levels.**

**Most advisors have a choice to make around the time they approach a million in revenue. How many clients do I want? What will the average asset level under management per client be? I think you are pretty close to the point of diminishing return on your time.

The idea is to set baselines from which to measure improvement.

Moving Toward the Ensemble

As you move toward the ensemble there are a few things to keep in mind. If you want growth, you have to think strategically about how you are integrating technology and staff into the client experience.

- Don't just implement *systems*. Implement business processes. Process encompasses people and technology.
- Technology does not drive firms. People and processes do. Technology must be combined with the right people in the right processes.
- More sophisticated technology requires more sophisticated staff. This will affect your cost of hiring and keeping good employees.

The steps are easy to identify, less easy to carry out. However, I am proposing we do most of the work, capitalizing on the processes that you already have in place. You will want to keep the above point in mind, but the action steps are:

1. A determination, (perhaps a re-determination of the clients Clark will handle. What defines an “A” client? Then a rule of thumb for the clients he will handle and the other roles he will play. (Here is a clue; you will have less responsibility for the day to day, and more for the growth strategies. I know you have been looking at this, but an examination of the “prospects” you have might also be in order, vis a vie the capacity information above.
2. Patti’s role defined along with her comp plan. I suggest that all of her business is owned by CIS, and her role is to make rain and serve certain of the “firm’s” clients who Clark does not service.
3. If Mark were to join, or another advisor, we also bring in his business and design an appropriate comp plan.
4. Todd’s role for now stay as is, but as we decide if any of his duties are better handled by another person, we will determine , using financial metrics if it makes sense and to what degree
5. We will recruit another Service Advisor. As mentioned, I’d like that to be Mark, but even if that works out, we need the revenue and the capacity that another one will bring. My suggestion is a 30-35 year old advisor with $30million under management and insurance background, (someone who knows estate planning), and perhaps $300-$350 in revenue right now. This means he/she will be making

about $250k-$300k right now before expenses. We can work the comp plan, along with assigning firm clients to give him/her and track to double income.

6. We seek out acquisitions that are appropriate, both locally and in Chicago.
7. The measuring standard will be to do all of the above while maintaining your percentage of revenue for expenses.
8. Revenue increases come from 3 sources:
    a. Increased capacity, (we need to turn Patti loose as well as your ability to follow up on the leads you are receiving).
    b. Revenue from new advisor(s). We **never** hire to create deficit spending. This means finding advisors who we can pay a generous payout that will be close or above what they are getting, but they need to buy into the "growth" potential.
    c. Acquisitions- revenue comes from buying a book that services the debt, pays for the increased need for servicing the book and then provides positive cash flow.

Ensemble Succession and Buyout

Introduction

Accounting firms often make use of a *buy-in leading to a buyout structure*. In this approach, a buyer purchases a partial stake in a firm seeking a successor. The buyer then completes the transaction when the retiring partner is ready to slow down.

In the internal buyout of an advisory firm for purposes of succession planning, we use a similar approach, but the successor advisor's book is often the "partial stake."

One way to think of it is like an ESOP, in the sense that the corporation buys the founder's stock and then the successor(s), buy the stock. This addresses *ownership*, but not *leadership*. Leadership is decided by the owner, by determining how much stock you will allow certain individuals to buy. This is why it is really more like a buy-sell agreement than an ESOP.

With all this said, what follows is an example of how it could work. I have used an actual smaller firm as the example, with real numbers wherever possible, but obviously with some assumptions and projections.

Let's begin with a look at some metrics (*Remember;* these are just illustrations)

Advisor	Current Revenue	Current Book Value	% of total
Clark, (owner)	$700k	$1.5million	68%
Mark	$250k	$400k	18%
Patti	$100k	$100k	5%
Advisor	$200k	$200k	9%
Total (combined)	$1,150,000	$2,200,000	100%

Other Assumptions:

- Clark will continue to take about $200k in income from the firm as long as he works.
- We will run expenses at 40% of the revenue
- We will use a 10% increase in revenue year over year.

Plan

1. For the next 2 years, Clark continues to work in the firm and collect his normal compensation.
2. In addition, the 3 remaining advisors begin their *downpayment,* but generating payments collectively of $75k per year to Clark. This can come out of increased comp they earn, or personal contributions, or even personal loans. The amount is less important than the fact that employees, especially successors have some 'skin in the game." I am convinced that through a collective ensemble approach to the business, revenue and advisor income will increase substantially. Of course advisors have to buy-in to the process.
3. At the end of the 2-year period, (or when Clark decides to retire), a valuation would be completed.
4. With a 10% growth in revenue per year, the firm will be producing $1,800,000 in revenue by the end of year 2. Using a 2 X revenue valuation multiple the combined firm worth $3.6 million. This would mean that the advisor ownership values have grown to be as follows, (assuming no change in the percentages):
    a. Clark- 68% or $2,448,000
    b. Mark - 18% or $648,000
    c. Patti - 5% or $180,000

   d. Other - 9% or $324,000
5. Assuming the payments above, Clark has been paid $150k and his remaining balance to buy his interest would be $2,298,000.
6. If expenses are held at the 40% level, ($720,000), this leaves about $1,080,000 profit.
7. Beginning in year 3, a payout to Clark of 37% of profit, not to exceed $400,000, it would take approximately 6 years to complete the payout from profit. (If the level was set at 50% of profit, the term drops to about 5 years. I have used a subjective number. The firm members would agree to a level that would allow a quick buyout, without putting the firm financials into jeopardy.)
8. The process above "retires" Clark's stock. Ownership by the successors depends on:
   a. Clark's determination of eligibility to buy the stock
   b. The amount the eligible employees pay the firm to own it.