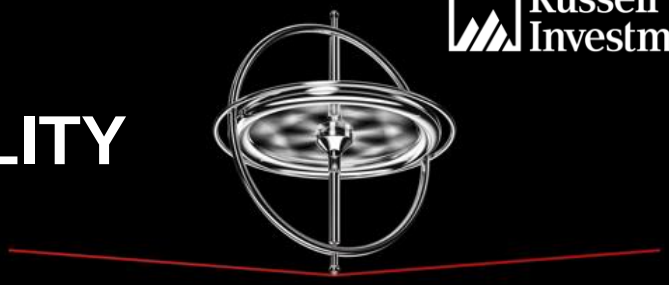
SUSTAINABILITY



Sustainability pillar #2: Understanding your enterprise risk

In the first pillar we discussed the importance of managing the number of clients in your business. Now, in the second pillar of sustainability we focus on: **understanding your enterprise risk.**

Enterprise Risk a broad and diverse topic. From our experience in working with Advisers in Australia and globally, a key area of Enterprise Risk for an advice business is the level of 'Product Inventory'. This simply means understanding the number of Funds, platforms, insurance solutions you may have used, inherited or have acquired over time across your full set of clients, and your associated obligations.

What's the problem with attempting to manage a lot of product solutions?

1. **Compromised efficiency**.
   A significant variable in the quest for adviser scale is product inventory control. More funds require more time and resources to manage. This is especially true when you consider the amount of time required to effectively manage a product solution. Think about the amount of time and resources required for:

   A. **Objective research**: Independent research by the adviser focused on multiple variables, including selection, pricing, and performance.

   B. **Subjective research**: Quarterly meetings and updates to gain insight into the decision-making of the most recent quarter.

   C. **Client education**: The adviser must translate both the objective and subjective research into relevant information for client communications.

Increased liability

Many advisers are familiar with the 80/20 "rule" that describes the **relationship between Revenues and clients** in a typical adviser's book: often 80% of revenue is driven by 20% of clients. We have observed that in many cases the 80/20 "rule" also applies to the relationship between AUM and number of product solutions: 80% of a book's assets are concentrated within just 20% of the product solutions; and only 20% of assets are invested across 80% of the solutions. Sometimes there are solutions that are only used in a single client account with a very small amount of AUM.

This raises the question, if it requires so much dedicated time to manage so many product solutions, and there is little AUM/Revenue tied to that solution, then what incentive does the adviser have to dedicate the appropriate resources? Either the adviser is inefficiently spending their time by focusing on a solution with little client AUM representation in the book, or the adviser is exposing the business to a possible liability by neglecting to spend the proper time for oversight.

The impact

The hypothetical adviser following and researching product solutions would have to dedicate almost the same number of hours per year to effectively manage product inventory as they would the average number of work hours in a year. In theory, attempting to stay abreast of the number of products leaves little time for other business activities and potentially opens the adviser up to litigation if they can't dedicate the time required. Advisers who **make the conscious decision to narrow their product lineup** see a number of key benefits, including, but not limited to, increased scale of the ongoing research necessary to effectively manage the client portfolios, as well as a decrease in the business risk because of an effective reduction in the variability.

The solution

Review your product inventory to **determine whether you have an 80/20 dynamic** in your book. Are you maintaining any product solutions that are used by only a very small portion of your book? Is there opportunity to consolidate your smaller positions into more focused weightings that will then carry the AUM to justify the time spent on keeping them? Even better, the more concentrated inventory will allow for greater efficiency and scale in the portfolio management side of the business, thereby creating capacity for Centres of Influence relationships, prospecting, and deeper client relationships. Finally, consider the enterprise valuation benefits of consolidating your product inventory: a book with fewer solutions typically translates to a higher valuation.

The bottom line

Successfully managing the product inventory in your business is an important step toward building a sustainable practice. By conducting a product inventory audit, you're taking a crucial step to focus your time and resources while limiting your liability within our changing financial environment.

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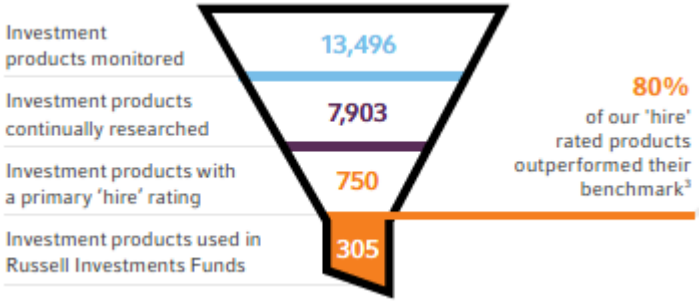

As at December 31, 2017 unless otherwise stated.

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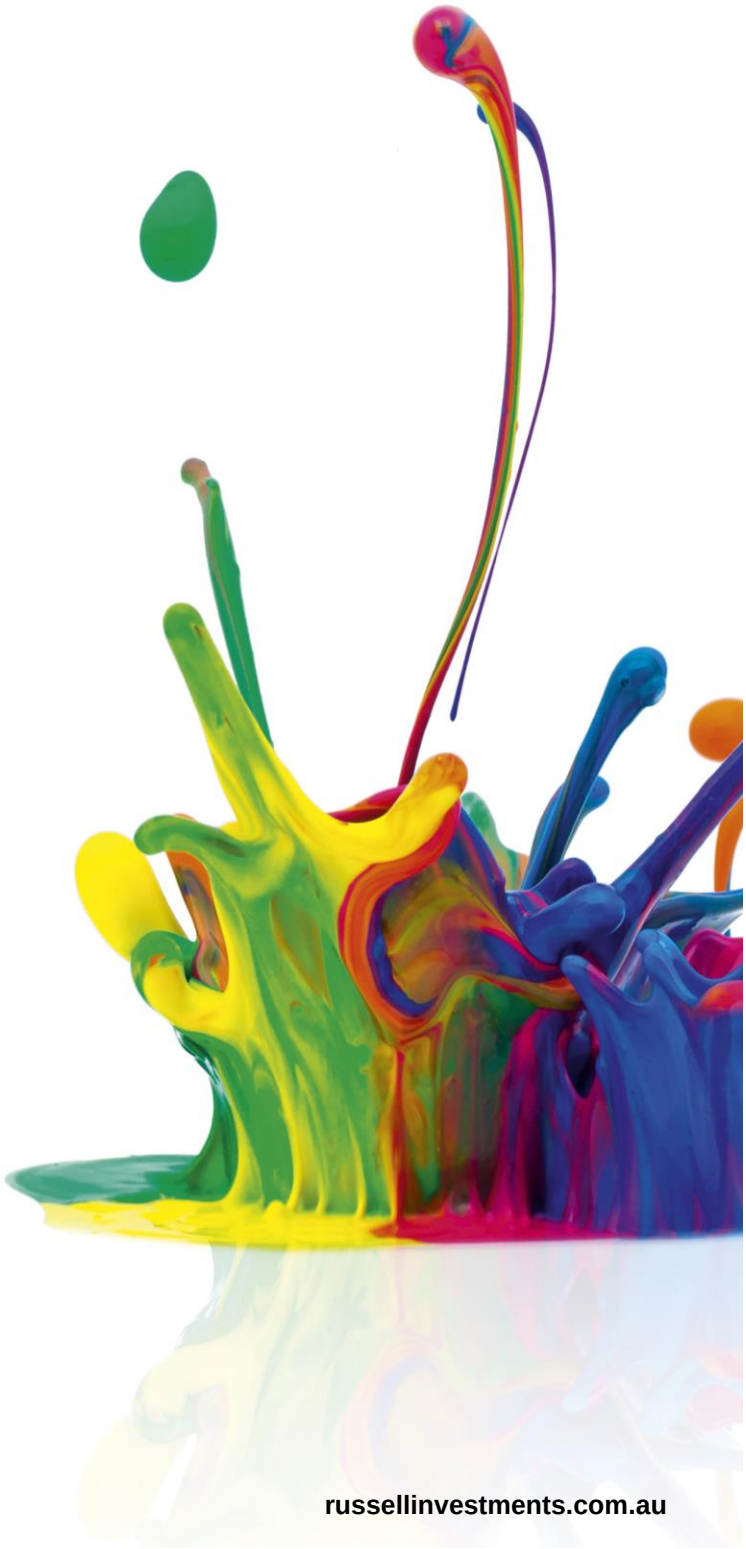

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