

# Future Distribution

Interregnum & Opportunity

White Paper - April 2009

In-ter-reg-num

[in-ter-reg-nuhm]

-noun, plural -nums, -na

*'any pause or interruption in continuity'*





## Background

As worldwide financial instability continues, life in the adviser sector is also understandably showing increased signs of strain, with many companies choosing to consolidate or being forced to admit defeat and leave the industry.

The combination of growing capital, economic and market pressures seen throughout the past couple of years will inevitably continue for some time to come. But despite all this – and the additional regulatory and demographic changes - the failure or lethargy of many financial providers and distributors to adapt their strategic business models for the 'new world' needs urgent attention.

Rather than seeing this period of volatility as an insurmountable barrier however, the more astute businesses should recognise this interregnum – or 'period of discontinuity' – as a period of opportunity.

Archetypally 'interregnum' was the period of time between the reign of one monarch and the next and is often associated with the period after the English Civil War, when England, Scotland and Wales were left without a ruling Monarch. But put more simply, an interregnum can be thought of as a "gap" which emphasises the relationship between 'what comes before' and 'what comes after' in a sequence.

Based on this theory, it is easy to see a whole new mindset and strategy which could practicably be adopted to empower the future of distribution. Instead of viewing the current economic and financial instability as chaotic and fatal, recognising that it is actually more of a 'gap' or transitional phase to a new beginning, could signal a far more positive outlook.

Rather than sticking to the trenches and surrendering in the face of all the apparent adversity and upheaval, the winners on this battle field will be those focused on appropriate transformation of their chosen allies, troops and weapons. And in some areas, with more than a little irony, we should also be prepared to accept that the restoration within financial services may well include a re-emergence of the pure sales type distribution practices more reminiscent of (but hugely more controlled than) those seen several decades ago.

## Interregnum - Analysis and Preparation

Whilst with any period of change there will inevitably be winners and losers, those firms which are sufficiently prepared for the transformation of their business models and committed to putting the necessary steps in place, should claim victory. The key drivers for this change will inevitably include economic and social demographic factors, but in the majority it is the preparative strategy and intelligence gathering which will determine the true survivors in this battle.

Sadly, whilst significant data already exists within many financial services organisations, the identification and analysis of this very powerful weaponry is often overlooked. A good starting point should involve a return to the basic economic principles of supply and demand; identifying what the consumer needs, in what format and at what price. Once this has been determined, the supply of the required product and service then comes down to the pure commercial economics of what can be achieved cost-efficiently with a profitable outcome using the most appropriate distribution model or models.

## Intelligence Gathering

For both adviser distributors and providers, whether these be traditional life and pension specialists, banks or online retailers, intelligence gathering begins with understanding what it is the client really wants.

This not only covers client needs and the types of products that are necessary but also, vitally, the method of distribution which is most appropriate, both from a cost and service basis. It may be that some clients are more comfortable with a face to face advice process and prepared to pay a fee for this, whilst others are happy going online and doing some of their own research before purchasing entirely unassisted (execution only) or with the help of a call centre or telephone based support (guided sales or sales advice). This is likely to be a factor both of a client's understanding of financial services, but also of the complexity of their circumstances.

Some clients may also be keen to have greater access and control over their investment portfolios and therefore a wrap proposition which provides direct client access may be a good solution. But for those clients only requiring basic insurances, investments and protection another solution may be necessary: an interactive, consumer facing website with a secure extranet area may be the answer.

Quite obviously, making the right decision for the distributor in considering these options lies with robust interrogation of the broader client base - or in some cases, for new entrants, the desired client prospect profile. By thorough and scientific segmentation and analysis of the client database, it will be necessary to ascertain the

relevant profitability of different client segments, based on past, present and possible future earnings potential.

Further work should also be done to support a segmented marketing strategy for the future. By identifying how the different categories of clients originally entered the business, possibly through referral, direct marketing or via online resources, future lead generation can be targeted appropriately and costs of acquisition managed more closely.

This attention to segmentation should be a holistic process; encompassing all areas of the business and resulting in the collection of comprehensive, aggregated management information (MI). Only in doing this thoroughly can the distributor then make objective decisions as to the best future strategic business model to adopt.

### **Building the Army & Weaponry - the distribution debate**

Having done the segmentation exercise and identified the most and least profitable client categories, the important task of determining the most appropriate and cost-efficient distribution channels now needs to take place. At this stage it is necessary to commit extensive time and research into the various options, but also to recognise that a ruthless approach may also be necessary – with some client segments possibly having to be ‘farmed-out’ or dropped altogether.

For those client groups which do not appear to offer any profitable longer term revenue, it will also be necessary to consider the disposal options; selling, pushing or perhaps leaving this group to natural attrition - if the costs of this are not prohibitive given shorter-term servicing needs. Clearly this has to be handled within the framework of TCF.

Once client category targets are agreed, based on the desired profile of those which give optimum opportunity for profitable outcomes, the next step should include a review of the available resource, technology and systems within the business.

Some distributors will already have an online presence, with external (customer facing) and possibly internal (adviser facing) extranet facilities. Whilst the majority of smaller adviser firms only have brochure-ware websites, others will already have interactive functionality with integrated quotations, calculators and basic planning tools. Many larger organisations have highly sophisticated web-based services in situ and will already be in a position to launch or further develop online retail channels.

At a core level, distributors will also need to review their choice of back office services, portal and point of sale capabilities as well as the broader integration



functionality which each of these can provide. As well as affecting the business's potential valuation, the basic systems and IT infrastructure within a business will be fundamental to understanding the costs and investment needed to launch or develop new methods of distribution. Strong CRM systems are also critical for anyone looking to adopt multi-distribution strategies. Without 'one view' of clients it is impossible to ensure consistency of compliance, brand and client development – ensuring your business continues treating customers fairly.

A business having complete straight-through-processing capability already established, for example, should be well positioned to use this technology as the backbone of a new web-based distribution channel. In contrast, the company with little ability to re-use data or with little or no mobile working capability may find the costs of web-based sales far too prohibitive.

Similarly with compliance systems, it will be necessary to review what is currently in place and ascertain its potential scalability to adapt and support multi and new future distribution models. Moving into guided or online sales, for example, will inevitably require new regulatory understanding and procedures – which may in turn create additional cost and resource needs.

Once the research and audit of clients, marketing resource and systems is complete, this information will enable the distributor to move forward and find the most optimum future business model to suit.



## Bring In The Cavalry - the distribution dilemma

Within the confines of the impending RDR legislation, the future distribution options for consideration by most financial services businesses will include:

- Face to face distribution (independent advice, sales advice, guided sales or execution only)
- Internet/Web based distribution (sales advice, guided sales or execution only)
- Call-centre distribution (sales advice, guided sales or execution only)
- Composite model – involving some or all of the above

In order to determine which of the above makes most sense, the factors to be taken into consideration will include:

- Existing and target customer base
- Existing and target service proposition
- Cost reduction possibilities
- Improved compliance and regulatory systems and controls
- Profit margins
- Competitive position
- Client 'stickiness', retention and servicing options
- New business opportunities

For most distributors the final decision as to which option to take will come down to the clear 'multi-faceted' or 'focused/polarised' option. In essence, the question to be asked being: do you opt for trying to be 'multi-channel' or decide to stick with a 'pure play' model?

If a multi-faceted distribution option is chosen, it must also be recognised that the competition may well include pure-play operators who only specialise in that particular area. Launching a consumer facing online business model, for example, may put the adviser in direct competition with Tesco, Asda and all the other major brand-led retailers. Competing with these will require firms to identify their differentiators, alongside the need for investment into the complexities of search engine optimisation, online advertising and all the skills required to build traffic levels for the site.

Before embarking on any launch into new and especially multiple new distribution channels, it will therefore be worthwhile analysing the potential effects on the existing core business. Will a resource drain or even a stretching of senior management time and focus cause too much detrimental effect, for example.

As a starting ground to gaining greater clarity on the distribution channel dilemma, a thorough understanding of the current and future regulatory climate is vital. Only through proper assessment of the limitations and changes needed to accommodate the new regime will a proper understanding be reached of the potential impacts this could have for the business - as well as for the broader competitive marketplace.



## Hail The Revolution - regulatory change

At the time of writing, it looks likely that by December 31st 2012, the FSA deadline for the RDR's implementation, there will be two distinct distribution options within financial services.

1. Independent financial advisers (IFAs) will need to offer unbiased, unrestricted (whole of market) advice and remuneration must be agreed by advisers with their clients – but importantly with no influence from product providers
2. In contrast, the 'sales advice' channel will cater for those offering restricted advice and will include Appointed Representatives (tied agents), for example bancassurance sales staff, with the further options of 'guided sales' and 'execution only' models – most relevant to online distributors

All intermediaries offering investment advice will be required to reach QCA level four standard, with the relevant qualifications this demands and there is a possibility that even higher qualifications may be required for advisers choosing to become designated specialists in specific areas.

Although mortgage-related insurances, general insurance and protection products are not currently covered by the new RDR proposals, many industry commentators would suggest, perhaps wisely, that it would be foolish to believe that longer term, these channels will escape unscathed. Already some reports seem to suggest that the FSA is considering a two-tier system being introduced with different rules for IFAs dealing with mortgages and insurance to those of the traditional mortgage and insurance brokers.

Alongside the increased costs associated with internal regulatory practices, the new proposed FSA fees and capital adequacy requirements could mean significant cost hikes for many firms. Not surprisingly, some industry consultants believe this could lead to substantial consolidation and attrition, with possibly as few as 10,000 adviser firms being left by 2012. Given this additional pressure, business valuations will also become critical and firms will need to ensure this is front of mind when making any strategic changes to services offered and distribution channels employed.

Ironically, given the FSA's initial intentions to improve the financial services market for the benefit of 'ordinary investors', this regulatory change, with such heavy costs involved, could hinder rather than help the mass market. Unless distributors can seize the opportunity to provide cost-efficient new distribution channels to suit different pockets and needs, the potential for the already big 'Advice Gap' to grow even further is a real one.

According to FSA data from September 2008, the overall number of financial adviser firms in the UK increased by only 3.7% over the past 12 months, bringing the total

intermediary population to 15,503 directly authorised firms and 27,100 ARs. But despite the apparent resilience of these figures, almost a fifth of these financial adviser firms were loss-making and a further 24% have reported profits of less than 5% of turnover. And, more importantly given the impending changes to capital adequacy, the Regulator also admitted that a 'significant number' of firms were poorly capitalised, with about 40% having regulatory capital of less than £50,000.

This pressure on supply is perplexing in an economy where the population is so massively under-served. Barclays Financial Planning research, for example, recently identified that nearly half (47%) of UK adults do not hold any protection policies against the prospect of loss of income, health issues or death <sup>1</sup>.

## Restoration - A Look Back In Time?

For many veterans of the industry, it is all too easy to recall the very different financial services sector of the 1980s, when it could be argued the focus was very much on pure selling - with commission-led businesses making an inefficient, but profitable existence without too much struggle. And whilst the legacy of the 80s has led to headlines of mis-selling scandals and some unorthodox business practices, the sales regime, as it largely was, fuelled an active and lively 'adviser' sector.

The irony of this then is that under the new and impending RDR regime, the introduction or re-introduction of pure sales activity, whether this is execution-only, web-based or guided sales, is just around the corner – albeit in a new and transformed status.

Selling in response to simple client needs is already something which many adviser distributors have returned to or in reality expanded on in recent times. The old breed of discount brokers, returning front-end commission to clients as cash-backs in return for smaller annuity or trail commission payments, has now transformed itself into the new breed of web-based advisers. Lifesearch (Baigrie Davies) and Hargreaves Lansdown, represent two very good examples of successful adviser firms with well-established, discreet sales based channels running alongside their more traditional advice-based businesses.

Whether it be with ISAs, unit trusts or other 'simple' and general insurance products, the opportunities for web-based sales and servicing to look after less affluent clients continue to be of growing importance. Streamlining sales in this manner gives clients greater choice and advisers' greater freedom to operate distinct distribution channels with increased cost-efficiency.

Whilst some online distributors operate as sales channels of existing advisory businesses, others have set-up operations specifically for this purpose and avoided advice-based sales altogether.

<sup>1</sup> Datamonitor UK Mortgage Intermediary Distribution 2008

Alongside big brand names like Tesco and Asda, many smaller broker distributors are now selling significant amounts of savings products, term assurance and loans via their own, often separately branded websites. But whilst the majority of the big brand online retailers operate purely via the web, others have harnessed technology a step further with the use of integrated call-centres and more sophisticated back office solutions. Using this strategy, once the prospect has done a simple online quote or basic research form to short-list options, a seamless process can then connect them with a call-centre - where a trained operative then talks them through the final stages of the sale and, without giving any advice, completes the business there and then. Obviously the associated cost-efficiencies of this type of process are obvious, not to mention the benefits derived from economies of scale.

Not surprisingly, with cost pressures affecting many adviser firms and a growing shortage of pure fee-based revenue, other distributors are likely to follow suit, ditching the more highly regulated and costly life and pensions sector for the more lucrative attractions of the b2c 'advised sale' opportunity.

Added to this is a growing awareness of the opportunities offered by providing services direct to employees via employers' extranets. Radical review of client needs and focus on 'customer journeys' is turning the promised benefits of worksite into a reality.

### **But Pure Advice Also Has Its Place**

Fortunately however, as earlier market analysis has shown, the opportunities for multi-faceted distribution channels are vast and whilst, for some distributors, the costs associated with sticking to a fee-based, face to face, advice model may be too much, the demand still exists.

With many more affluent clients and particularly those approaching retirement, demand for pure high-end professional and independent advice will remain buoyant. The reassurance of face to face advice, particularly for larger investment sums and retirement planning will not just benefit from demographic change but also from the uncertainty created by financial instability in the markets and the broader economy.

Whilst some advisers may not decide to make the investments needed to reach this upper tier, the major players in this market, who have the systems and resource in place to handle this, will inevitably join forces to form major new distribution aggregators.



We are also seeing firms who are strongly committed to face to face advice now looking at offering direct to consumer (b2c) services to help deliver better and more cost effective options. Technologies that allow clients to review their ongoing and changing financial needs online and pass information direct to a face to face adviser are now a reality - enabling dramatic changes to the costs and value of client servicing.

## Research

In support of this White Paper, over 120 adviser firms (all FSA regulated but including both independent and tied) took part in online research carried out by Ist – The Exchange in March 2009 (see Appendix 1).

## Future Distribution Strategy

Just over half (51.4%) of all adviser firms which took part in the research see the focus of their business being 'independent' and aimed at 'high net worth' clients by 2012 – the current deadline for introduction of the new RDR legislation. But significantly a high proportion of those sampled (over 40%) saw their future distribution strategy being a composite one, involving multiple channels. Only 7% believed their future would be solely focused on sales or guided advice and only a couple of firms saw the execution-only or non-advised guided sales route as their future model of choice.

## Expected Future Distribution Focus

Simply looking at the method by which they would be most likely to be providing advice or sales services by 2012, more than 75% of adviser firms saw a 'continued focus on face to face advice' as their preferred option. Although, tying in with the strategic question (above), one in five firms agreed a 'multi-distribution' strategy would be their most likely outcome. Not surprisingly, given the research sample of FSA regulated adviser firms, very few saw call-centre or web-based sales as their predominant future distribution channel.

## Preparation For 2012

Whilst the pace of technology evolution has been very encouraging in the past few years, it is perhaps a little surprising that so many adviser firms already believe they have 'all the necessary systems, technology and resources in place' to support them by 2012. Over 40% of advisers however believe this to be the case. Just under 30% took a more measured view and agreed they would need to conduct a more serious review of costs, clients and profitability before possibly changing their future business model. In line with industry predictions and the recent, rapid growth in acquisitive activity, 16% of the sample admitted they would be most likely to merge, sell or leave the industry by 2012. The remainder, just under 10% of firms, confirmed they already had plans in place for a 'definite change of future focus' for their businesses.



### Changing Business Areas

Reassuringly, over 32% of adviser firms (the largest group) saw 'client segmentation and data quality' as the business area which they envisaged making the most changes to - in order to stay competitive by 2012. The second most popular answer, with 22%, was 'marketing and brand strategy' with the three remaining options all polling between 14 and 16%: 'technology and systems'; 'people, training and resource levels' and 'distribution methods and channels'.

### Interregnum, Transformation and Restoration - the conclusion

Amidst uncertainty, economic and demographic change and regulatory upheaval, it is clear that the financial services industry must accept it is in a unique transition period – an interregnum or 'gap' exists and with it, opportunity.

Beyond acceptance however, there is an urgent need for providers and distributors to make time for ground-level strategic analysis - to re-group their troops, armies and weapons before transformation and a return to the battleground. But only in investing the necessary time and resources in the intelligence gathering process, will the eventual victors gain the competitive advantage needed to stay ahead.

Whilst focusing on looking forward, recognition and respect for the old established, core principles of sales and demand; basic customer needs as well as the obvious drive for commercial and economic efficiencies are fundamental. Only once this has been acknowledged, can the distributor of today migrate successfully to ensure they remain amongst the distributors of tomorrow.

Whether the multi-channel or pure play distribution model is selected as the desirable outcome, the choice of technology systems, regulatory tier (high end advice through to execution only pure sales) and business partners will be crucial. Choosing to play in a cluttered market space with plentiful big-brand competition or electing to stick to niche markets and fee-based revenue streams could be a make or break decision.

On a positive note, many organisations have already used the new tools available to assist them in the new marketplace and rewards, for some, are already starting to be reaped. Technology and ecommerce has become the crucial enabler in combating rising cost pressures and distribution inefficiencies, but a failure to choose the optimum solutions can be costly.

Over half of the firms sampled in the research already believe that their future lies with face to face advice amongst a high-net worth population. But these firms will not just have to absorb all the extra costs of qualifications, regulation and increased capital adequacy, in a tight market; they will also have to fight for market share in an increasingly competitive space.

And whether it be false hope, denial or in some cases, pure bravado, the 45% of firms who believe they already have all the 'systems, technology and resources' in place to take them through to 2012 may well come to regret this idealism. A 'head in the sand' attitude could easily prove to be the undoing for those who choose to underestimate the challenges that lie ahead.

The good news however is that an encouraging proportion of firms (over 30%) did recognise the important role which reliable data and thorough client segmentation plays. And the gathering of this MI will give those firms powerful armoury to help determine the most lucrative and rewarding future distribution options.

With 20% of distributors already having decided that the multi-distribution channel option is the way forward, solid preparation and investment to support this must be embraced.

Costs must be stripped; clients must be better serviced at all levels, with more choice of methods and channels and distributors must uphold and adhere to a new regulatory regime with courage and conviction. The restoration of a profitable, secure and respected financial services industry depends on it.



*In support of this White Paper, over 120 adviser firms took part in online research carried out by 1st - The Exchange in March 2009. The results are as follows:*

<b>By 2012 what do you foresee the focus of your business distribution strategy being?</b>	
Independent advice to high-net worth clients	<b>51.4%</b>
Sales or guided advice channel only	<b>6.7%</b>
Execution only or non-advised Guided Sales	<b>1.0%</b>
A 'multi-strategy' with some or all of the above	<b>41.0%</b>
<b>By 2012 how do you expect to be distributing products and services?</b>	
Continued focus on face to face advice	<b>75.2%</b>
We will offer call based advice	<b>2.9%</b>
Focus on technology or web-based sales	<b>1.9%</b>
A 'multi-channel' distribution strategy	<b>20.0%</b>
<b>In preparation for 2012, which of the following most closely fits?</b>	
The systems, technology and resources are in place	<b>45.1%</b>
Following review, poss change of future business model	<b>29.4%</b>
Possibly merging, selling or leaving the industry	<b>15.7%</b>
Definite change of focus for our business by 2012	<b>9.8%</b>
<b>Which of the following business areas do you foresee making the most changes to in order to be competitive by 2012?</b>	
Marketing and brand strategy	<b>22.1%</b>
Client segmentation and data quality	<b>32.7%</b>
Technology and systems	<b>14.4%</b>
Distribution methods and channels	<b>15.4%</b>
People, training and resource levels	<b>15.4%</b>