Colonial First State | SUCCESSION+

Why advice businesses are leaving $1 million on the table

The Hidden Value Report

CFS 10x

A note from Colonial First State

Through CFS 10x, we are committed to supporting you with strategies to navigate the complexities of running a successful business and opportunities for growth. This report uncovers the value gap in Australian advice businesses – the difference between the current value of your business and its potential worth.

The research we undertook in partnership with Succession Plus showed that on average, 85% of advice businesses say they are prepared for an unplanned sale. Yet, with an average value gap of $1.1 million across these same businesses, there is a substantial opportunity across the industry to improve business value. In a market where established practices are looking to exit, ambitious firms are eager to expand, and significant capital is coming from non-traditional sources to fuel this growth, there has never been a better time to understand and maximise the value of your business.

By identifying this gap, we aim to empower you with the knowledge to enhance your business's attractiveness and profitability. The research and findings outlined in this report offer practical strategies to improve the key non-financial metrics that are pivotal in reducing risk and increasing valuation, ultimately leading to a business that is prepared to capitalise on exit, merger or acquisition opportunities now or in the future.

Bryce Quirk
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1 Executive summary

Australian financial advisers understand that their business is an asset, and they are keen to maximise its value when it comes time to sell. This involves not only strategic planning and market awareness but also recognising the value gap.

The value gap is the difference between the current value of the business and its potential value. By identifying and addressing this gap, advisers can take steps to enhance their business's attractiveness and profitability.

This might include improving management systems, increasing efficiency, and ensuring robust documentation and succession plans. Ultimately, closing the value gap can lead to a more favourable sale that truly reflects the worth of a practice principal's hard work and dedication.

The CFS 10x Hidden Value Report report investigates the current state of advice businesses in Australia and identifies opportunities for value acceleration. CFS partnered with Succession Plus to understand how business owners could increase their valuation to create more opportunities to borrow, invest and grow their business.

This research explores whether business owners are prepared for a planned or unplanned exit, which has a material impact on the sale price. Exit-ready businesses have clearly articulated succession management plans and low key-person dependence. If a sale or partnership opportunity arises, or the business owner is impacted by a negative life event that forces an unplanned exit, these businesses are well positioned to receive a fair value for their business and sell on their own terms.

On average, 85% of advice businesses say they are prepared for an unplanned sale. However, with an average value gap of $1.1 million, there is a substantial opportunity across the industry to improve business value.

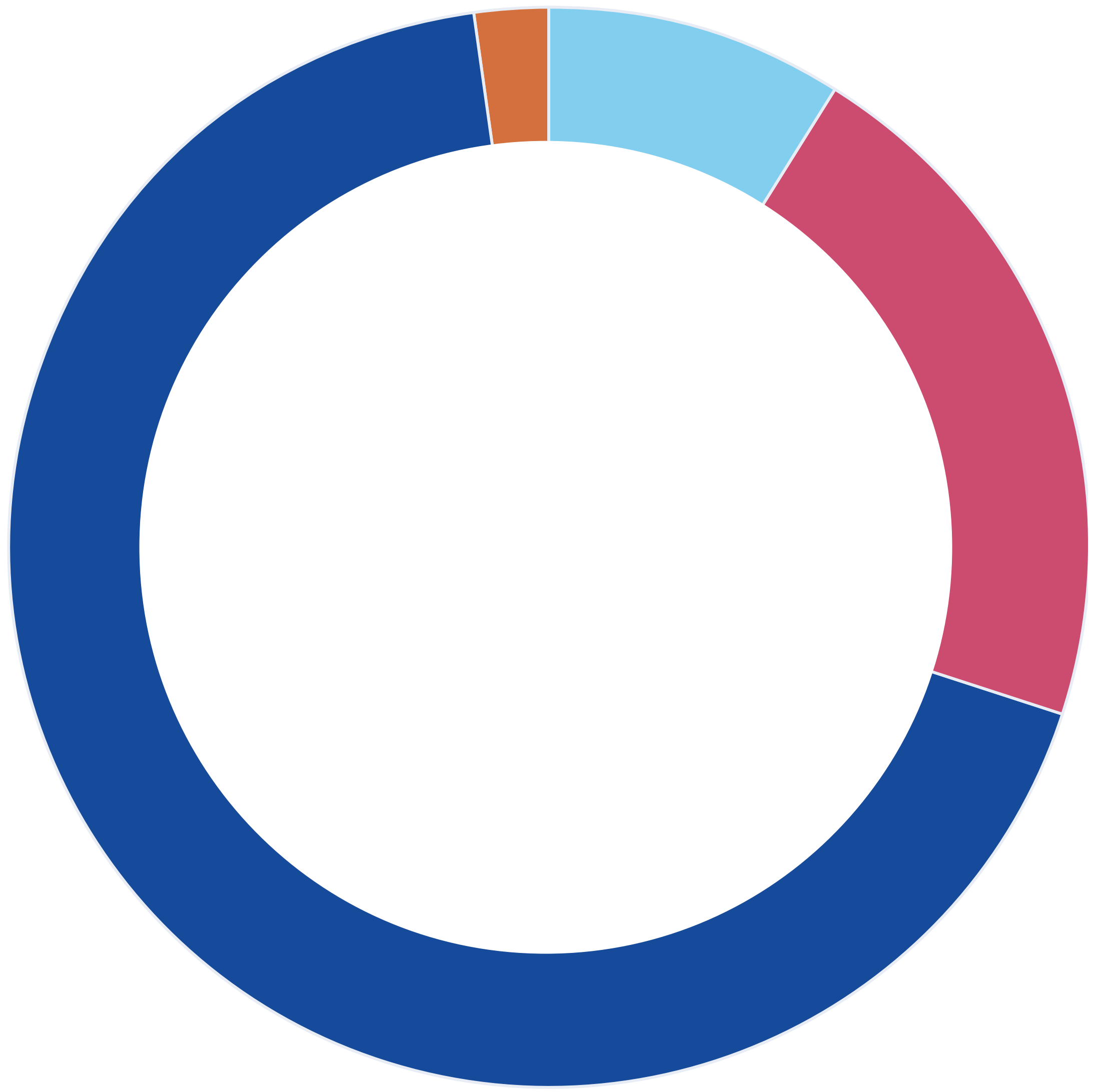
The research found common characteristics among businesses with a low value gap, including a high level of systemisation and documentation, robust policies and procedures, up-to-date succession and exit plans, and strong employee retention models. Focusing on these non-financial metrics is key to reducing risk and increasing valuation.

About the research

SUCCESSION+

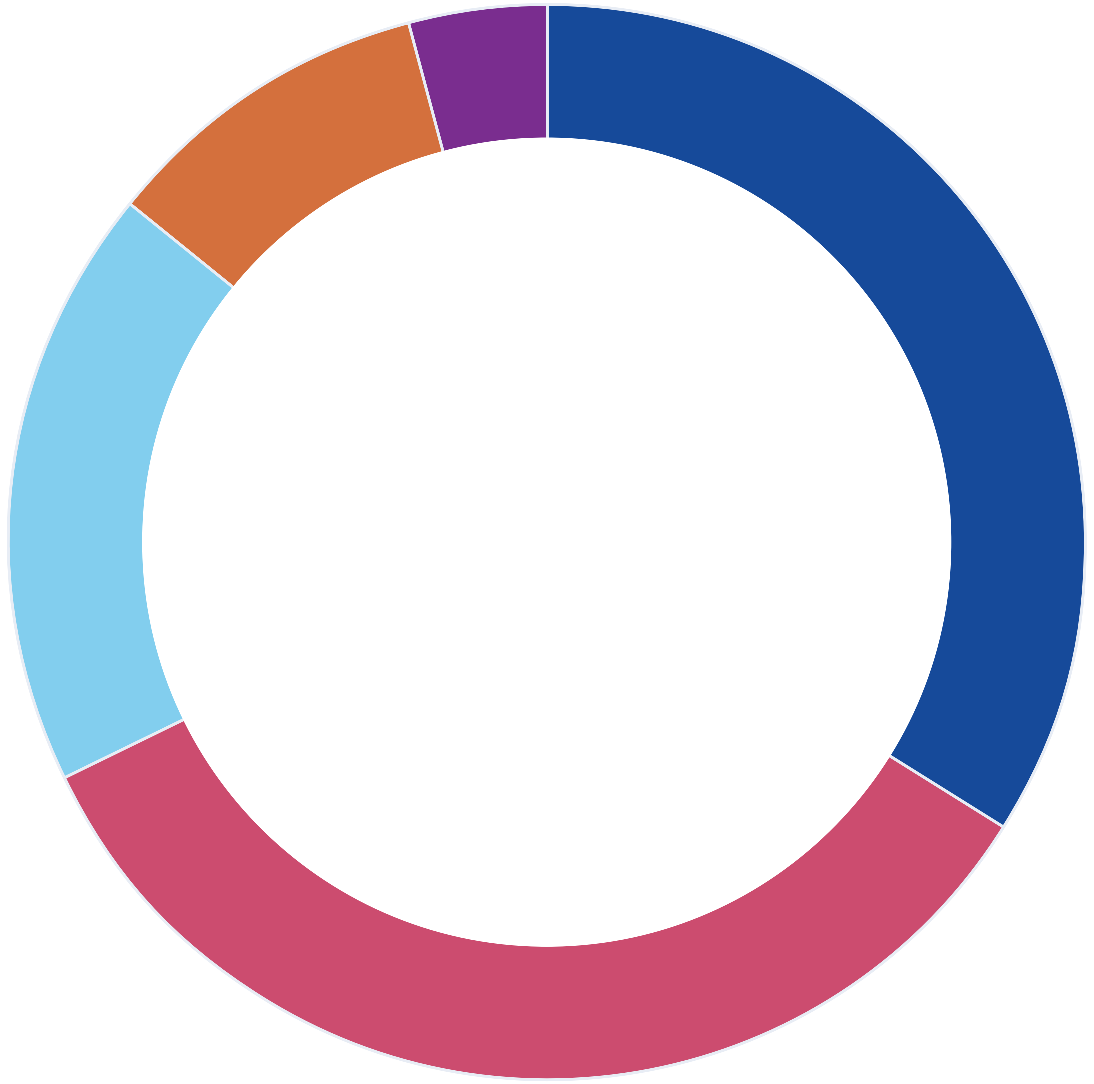
Succession Plus is a specialist strategic advisory firm that works with business owners to help them identify, protect, maximise and unlock value in their business at any stage through to sale or succession.

Between August and November 2024, Succession Plus conducted a survey that was completed by 116 advice businesses of various sizes. More than two thirds of the respondents categorised their business as financial services and 11% were multi-discipline businesses that also offered accounting, insurance or superannuation services.



Industry category

- **9%** Accounting
- **21%** Business and Professional Services
- **68%** Financial Services
- **2%** Insurance and Superannuation



Number of employees

- **34%** 1–5
- **34%** 6–10
- **18%** 11–20
- **10%** 21–50
- **4%** More than 50

2 Business valuation

While most businesses had strong revenue and business growth, one in four generate less than 20% profit.

- The average Australian advice practice generates $2.71 million in revenue, with an average revenue per employee of $286,932.
- The highest performers had an average revenue of more than $500,000 per employee.
- More than three in four businesses reported a predicted annual growth rate of at least 10%, with the average sitting at 15%.

However, an accurate representation of business value must include management systems, cash flow predictability, working capital requirements, employees, processes and suppliers.

A closer look at profit (rather than revenue and growth) reveals inefficiencies. While the average annual profit per advice business is $848,781, including the business owner's earnings, there is a substantial variance in the profit percentage (net profit after tax as a percentage of total revenue). The lowest was -4% and the highest was 81%. One in four businesses have a profit percentage of less than 20%. The average profit percentage across all respondents was 35%, which is slightly above the industry benchmark profit percentage of 32%.

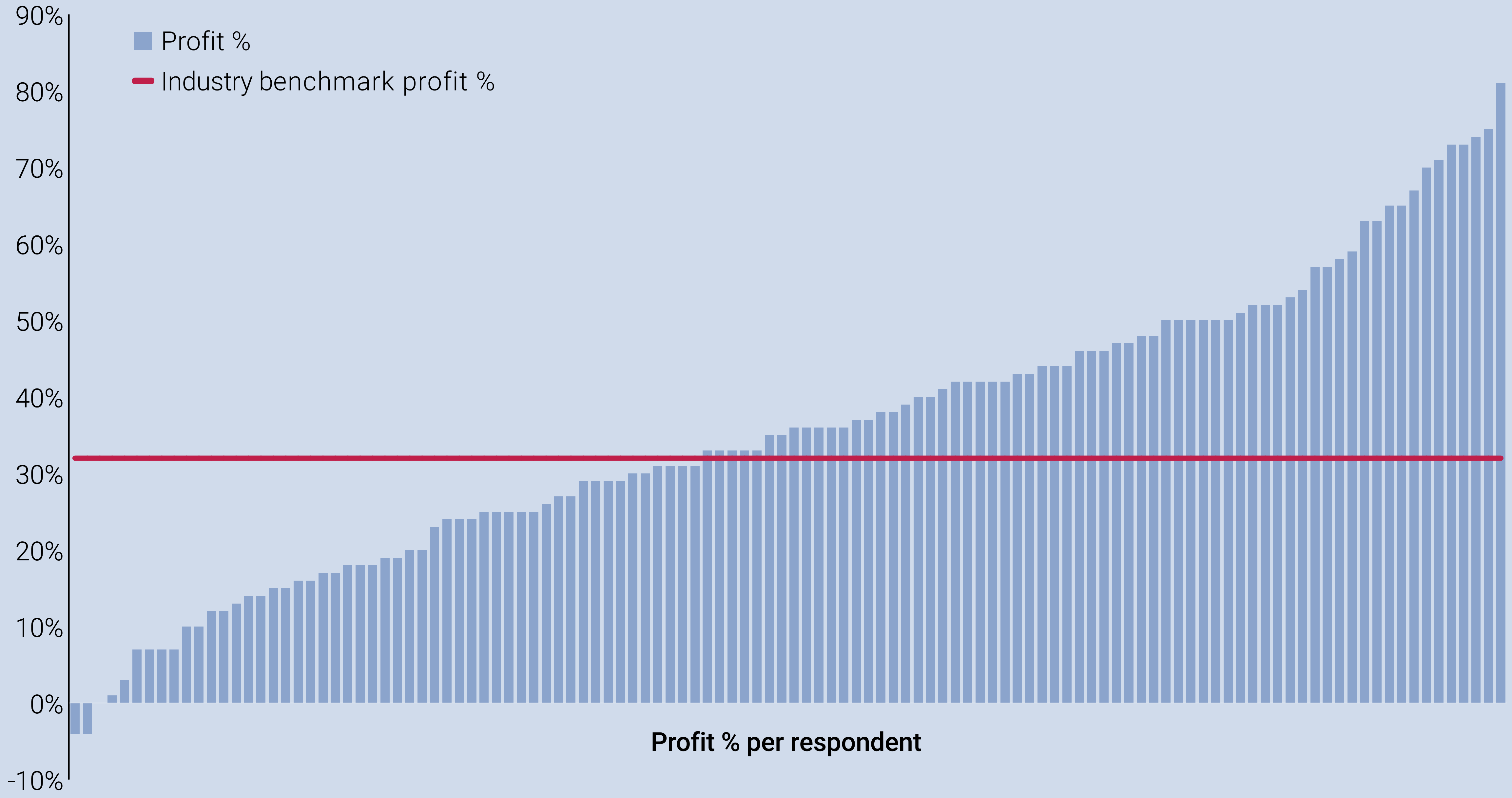
Key findings:

Average revenue per employee was $286,932.

Average profit percentage (NPAT as a percentage of revenue) was 35%, which is slightly higher than the industry benchmark.

Average value gap (difference between potential value and current value) was $1.1 million.

Profit percentage



Value gap = Potential business value – Current business value

The average value gap was $1.1 million per business.

On average, the value gap was lower for businesses with fewer employees and lower business revenue. For example, businesses with less than $1 million in annual revenue had an average value gap of $269,109 while businesses with more than $3 million in revenue had an average value gap of $2.7 million.

Of the 116 businesses benchmarked, 58% had a value gap of more than $500,000. Half of these 67 businesses had less than 10 employees and around 18% had revenue of less than $1 million.

Average value gap by number of employees

$333.2K	$1.5M	$4.7M
0-9 employees	10-29 employees	30+ employees

Average value gap by annual business revenue

$269.1K	$655.8K	$2.7M
Less than $1M	$1-3M	More than $3M

"This value gap represents a huge opportunity for owners to invest time, effort and money to grow the equity value of the business – this should be a primary focus for any owner."

DR CRAIG WEST

Founder and Chairman
Succession Plus

Action:
Rethink traditional valuation methods

Traditional valuation models can be problematic. Using a multiple of revenue (typically 2.5) may not provide an accurate representation of business value. Many financial institutions are now moving away from traditional valuation models in favour of other approaches.

Two valuations models commonly used are:

1. **Recurrent revenue:**
   This approach multiplies the annual revenue by an agreed multiplier. It may be done on a total business revenue basis, or by using the individual revenue from each ongoing client.
2. **Mulltiple of NPAT:**
   This approach multiplies the annual net profit after tax by an agreed multiplier.

Complete a Business Insights Report to assess your key value drivers and value gap. Consider what can be done to close the gap and increase the equity value of your business.

"There's a legacy within the financial advice industry of businesses being valued on a multiple of revenue. But that's not an accurate valuation model anymore and it's not how a bank will value your business if you try to borrow money."

DR CRAIG WEST

Founder and Chairman
Succession Plus

3 Exit readiness

Around one in two businesses are key-person dependent, making it difficult to navigate external factors that may lead to an unplanned exit.

One in three advisers (34%) want to exit the business within the next five years. The same number are planning to stay for more than 10 years.

Unplanned exits are not uncommon as external factors can force a business owner to make an involuntary exit from their business. Succession Plus refers to these external factors as the five Ds: death, disability, divorce, disagreement and disruption.

On average, 85% of businesses say they are prepared for an unplanned sale. Those that are less prepared usually feature a lack of up-to-date shareholders agreements, including buy-sell and funding clauses, inadequate insurance coverage vs the business valuation and a lack of up-to-date wills and estate planning.

Approximately 47% of respondents admitted that the business couldn't operate effectively without the owner, making even short absences for annual leave problematic. A further 23% were unsure what would happen if the owner was absent. This suggests these businesses may have weak organisational resilience and a high degree of key person/owner dependence. In terms of exit readiness, if these businesses were forced to sell unexpectedly, they would likely be offered a much lower sale price than what they believe the business to be worth.

Key findings:

One in three business owners want to exit within the next five years.

Nearly one in two businesses indicated they couldn't operate without the owner.

Around one-quarter of businesses have no contingency in the event of an owner being unable to return to the business.

Desire to exit business

Action:

Prepare for future opportunities

Business owners may encounter an opportunity when they are approached by a potential buyer, investor or partnership opportunity. Exit ready businesses will be appealing to the buyer and avoid a situation where they are undervalued in the due diligence stage. These opportunities can present themselves well before a planned exit from the business.

"We see a lot of advice businesses that are not exit or sale ready. Their scores for both planned and unplanned exits are very low and they admit that they haven't really thought about succession or exit before. Regardless of what stage you're at, you need to build your business with an exit in mind."

DR CRAIG WEST

Founder and Chairman
Succession Plus

4 Business operations

A third of businesses do not have adequate systemisation and documentation. This can negatively impact business value and make it difficult to transition to a new owner.

Key findings:

One in three businesses admitted that they do not have good management systems or well-documented processes.

In most businesses, clients deal with the team, not just the owners.

Only 16% of businesses experience cash flow issues.

Systemisation: "We have good management systems in place"

Strongly agree	9%
Agree	56%
Don't know	23%
Disagree	8%
Strongly disagree	3%

Documentation: "Our business processes are well documented"

Strongly agree	19%
Agree	56%
Don't know	10%
Disagree	14%
Strongly disagree	7%

Systems and processes

Nearly two-thirds of respondents (65%) said they have good management systems. This indicates that most businesses have well-organised operations that are efficient and accessible. The remaining 35% accept their systems are inadequate.

Only 69% of the respondents said they have well-documented business processes, which means nearly a third of respondents have work to do in this area. Businesses with strong documentation find it easier to onboard and train new employees. It also promotes consistency and efficiency within your business.

Systemisation and documentation contribute to exit readiness and business value. When selling a business, thorough documentation, comprehensive standard operating procedures and an effective workflow management system make it much easier to transition the business to a new owner.

Owner dependence

Two in three respondents (68%) work less than 50 hours per week, suggesting a good work-life balance, and 74% said that their clients deal with the team, not just the owners.

If a business is too dependent on its owners, they are likely to be working long hours and taking responsibility for most of the customer interactions. This is a significant business risk and can have a negative impact on the value of the business.

Cash flow and working capital

Only 16% of respondents said that cash flow is occasionally an issue for them. This suggests that most businesses have strong financial health. This is backed up by the capital working requirements, with 68% of respondents stating they don't need much working capital to operate. Low capital working requirements generally indicate efficient operational management with strong control over the business balance sheet. As with strong systemisation and documentation, this is an appealing factor for potential partners or purchasers.

Action:

Conduct a task audit

Automation and efficiency are key drivers of value, reducing stress and enhancing client outcomes and experiences. This involves implementing the right systems, policies, and procedures to support your team or potential new owner in operating effectively.

Conduct a task audit to ensure the right people are completing the appropriate activities. Document your policies and procedures. Appoint champions responsible for specific areas of your business, such as AI and technology, client engagement, workflows, and cybersecurity. These champions should also provide training and upskilling to the broader team, driving continuous improvement and innovation.

Action:

Reduce owner dependency

Imagine taking the key person out of your business without any access to technology. How long could your business continue to function? Do you have a team you can trust to run your business in your absence?

To truly let go, you need to cultivate levels of responsibility and trust, ultimately building a business where the owner can take a holiday without emails or phone calls. Transitioning control and responsibility of certain parts of the business over time allows you to step away – even temporarily.

Identify, mentor and develop talent within your business. Gradually build up their responsibilities, ensure you have the right development pathways to support them, and implement remuneration or equity models to retain them.

> “If owners are working more than 50 hours a week, we view it as a red flag because it suggests that the business doesn’t have a succession strategy in place and it’s not well documented and systemised. This makes the business higher risk, and higher risk equals lower valuation.”

DR CRAIG WEST

Founder and Chairman
Succession Plus

5 Attracting, retaining and motivating employees

Four in five businesses rated their employees highly, emphasising the importance of offering attractive employee incentives to retain top talent.

Most respondents rate their employees highly. Four in five respondents (81%) gave an answer of 'agree' or strongly agree' in response to the statement 'We could not ask for better employees'.

The average people score in the research was 0.75 (where 0 is poor people management and 1 is good people management).

The people score covers key metrics around attraction, retention, development and reward mechanisms for employees. While 0.75 is not necessarily a bad score, in a tight labour market with increasing costs, businesses need to focus on mechanisms to remain competitive and relevant to employees.

> **The recruitment market is highly competitive, and employee demands and loyalties are changing. Providing a competitive salary is important, but it is no longer sufficient on its own to retain talent.**

Offering a diverse range of incentives, bonuses, income and equity plans can attract and retain the right people and drive employment decisions.

Key findings:

Most businesses rate their employees highly.

One in two businesses have a structured employee training program.

Equity models and share plans

Employee equity models and employee share plan programs can be a powerful tool to grow a business. They align employees' interests with the long-term success of the business, create a sense of ownership and responsibility, and enhance motivation and loyalty. Employees are more likely to contribute to the success of a business if they have a financial stake in it.

Employee equity models can take many different forms. One example is the ladder to equity model, which moves employees through five different stages that begins with the employee earning a salary and ends with the employee advancing to a leadership role within the business.

Employee share plan programs offer a structured and efficient way to distribute ownership and financial benefits to employees. Linking performance with business goals rewards employees for the right behaviour and can be a strong motivator.

"A huge proportion of the enquiries we get are about employee share plans, because business owners understand the impact key person risk can have on their practice. It's a tight labour market and it's hard to get good planners, so you have to work hard to get them and keep them."

DR CRAIG WEST

Founder and Chairman
Succession Plus

Case study:

How FPB added $2 million in value

In 2021, a financial planning business called FPB engaged Succession Plus to create an Employee Share Ownership plan. The broader goal was to ensure the business value could grow consistently for current and future equity holders. The business was in good shape, with 14 staff in a single office and an EBIT of around $800,000 and NOPAT of around $550,000.

The first step was to create a business insights report, which considered both financial and non-financial measures, providing a scorecard on financial performance and performance against benchmark. The business was valued at $6 million.

However, Succession Plus calculated that there was potential for up to 28% growth in value, based on:

- closing the profit gap
- achieving best in class financials
- business attractiveness

Each of these measures had specific goals and actions detailed in the report. FPB's financials showed they were in an ideal financial position for growth by acquisition.

FPB has since become a regular acquirer of suitable businesses and expanded its range of services through strategic acquisition and strategic partnerships. Staff have embraced the opportunity to participate in the growth of the business through equity, which has significantly improved performance.

In four years, FPB has grown to 40 staff and expanded its footprint with three additional offices. The business is now valued at over $8 million, exceeding the original estimated value gap of 28%.

Ladder to equity model

Stage 1:
Salary
Employee earns an income based on their job role and hours worked.

Stage 2:
Income model
Compensation incorporates performance-based incentives such as bonuses and commissions.

Stage 3:
Profit share
A portion of the business profits are distributed to the employee.

Stage 4:
Equity
Employee is transitioned into an equity ownership position within the business.

Stage 5:
Control
Employee advances to a leadership role, such as CEO or Board member.

Employee training and development

Nearly one in two businesses surveyed (49%) said they have regular, structured employee training programs in place. This suggests a strong focus across the industry on employee development, however the data suggests there is still room for improvement.

Employee training programs promote succession within the business and make the employee feel valued. Along with financial compensation and ownership, they're an important factor to attract, retain and motivate employees.

Action:

Get creative with your employee benefits

To attract and retain top talent you need to offer something different to your competitors. While equity models may be a longer-term opportunity to work towards, develop a unique employee value proposition that includes mentoring and development pathways as a minimum.

Other valued benefits can be introduced to increase employee satisfaction and serve as a point of difference to drive employment decisions:

- Salary packaging
- Additional annual leave or parental leave
- Birthday leave, wellness days or social clubs
- Paying off a HECs debt if the employee meets certain criteria (such as tenure and KPIs)
- Mentoring programs
- Education courses
- Restaurant vouchers
- Dollar matching donations
- Qantas Club memberships

Action summary

1 Rethink traditional valuation methods

2 Prepare for future opportunities

3 Conduct a task audit

4 Reduce owner dependency

5 Get creative with your employee benefits

6 Conclusion

Whether you plan to exit your business in two years or 20, your primary focus should be on value acceleration. This is the key to achieving your personal and financial goals, protecting your legacy, and ensuring a smooth transition when the time comes to exit your business

A successful business exit can only be achieved when the owner, the business, and its financial goals are all in harmony. By addressing the value gap, implementing robust management systems, and ensuring thorough documentation and succession plans, business owners can enhance their business's attractiveness and profitability.

Remember: you need to be exit-ready, with clearly articulated succession management plans and low key-person dependence. By focusing on non-financial metrics such as systemisation, documentation and employee retention models, business owners can reduce risk and significantly boost the value of their business.

Ultimately, closing the value gap can lead to a more favourable sale that truly reflects the worth of a practice principal's hard work and dedication.

Colonial First State

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Contact

Succesion Plus can help you identify, protect, maximise and unlock value in your business at any stage through to sale or succession. Work with a specialist exit adviser to grow the value of your business with proven strategies suited to your business and goals.

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Watch

Learn more about employee retention, reward and remuneration strategies

Watch our CFS 10x webinar with Craig West here.