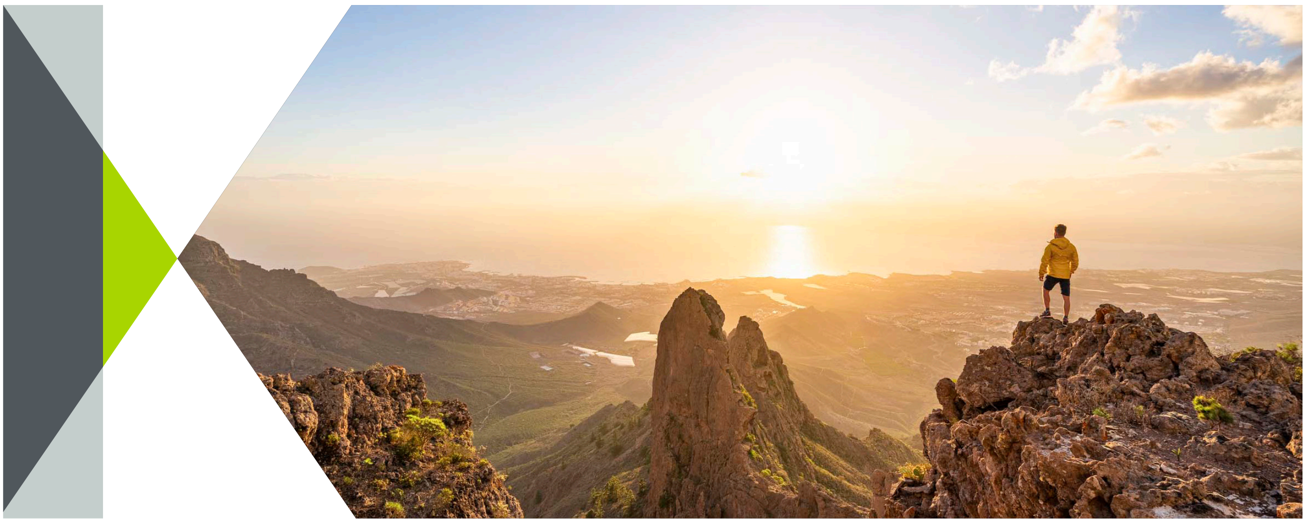

EXECUTIVE INSIGHTS

Re-thinking Target Operating Model in Financial Advice: The Next Frontier in Value Creation

Key Takeaways

1. The UK wealth management industry faces pressure to reduce costs. Rising interest rates, regulations and consolidation are driving the need for cost reduction in the sector.
2. Non-advisor costs are a prime target for savings. These costs can account for 50% of revenue, presenting a significant opportunity for improvement.
3. Large advice firms aren't fully utilising scale efficiency. Smaller firms get by on fewer support staff per advisor, which suggests that larger firms haven't fully optimised their structure. True cost efficiency requires commercial and management sophistication. Firms often fail to implement necessary changes due to cultural resistance and complacency, including a focus on M&A.
4. Target operating model design is crucial. Successful models segment clients, build for future growth and automate tasks wherever possible. Optimised operating models benefit both firms and clients. Improved efficiency can generate increased servicing capacity and organic growth potential.

In a previous article, L.E.K. Consulting argued that the combined pressures of higher interest rates, regulation and consolidation are bound to drive profound change in the UK wealth management sector. Here, Matt Lonsdale, Wealth Management Expert and Bronswe Cheung, L.E.K. Partner, explore how this dynamic will likely motivate wealth managers and financial advisors to reexamine their operating models and cost base structures in order to

thrive in the changing regulatory and economic environment.

In our experience, the non-advisor cost base of wealth managers can typically account for up to 50% of their revenue (see Figure 1), which should make it a prime focus for chief financial officers (CFOs) and chief operating officers (COOs). To illustrate, a quick 'back of envelope' calculation based on data from a Professional Adviser survey points to as much as £10bn of potential savings in the industry.

Figure 1
Illustrative P&L of a large advice firm in the UK

Note: P&L=profit and loss; SG&A=selling, general and administrative
Source: L.E.K. research and analysis

Some effort has been made to improve the cost-to-income ratio, but our experience collaborating with national advice firms indicates that the work remains incomplete. Whilst a range of commercial and operating metrics (e.g. client-to-planner ratio) should be actively monitored and managed, this article focuses on the relationships among financial planners and support staff — and on the valuable opportunities presented by a more efficient operating model.

Planner-to-staff ratio: A measure of efficiency

From our conversations with financial advice firms, the ratio of fee earners (i.e. financial advisors/planners) to middle-office staff (i.e. paraplanners and administrators) ranges from 1:2 to 1:1.5. This means the fee generated by the planner needs to cover the cost of up to two other full-time employees.

With scale efficiency being a major motivation for consolidation, one might expect this ratio to be higher in smaller advice firms, where a single financial planner might have to cover the cost of more support staff. But our market survey reveals this is not the case: smaller firms actually employ fewer paraplanners and administrative staff per planner than their larger national counterparts do (see Figure 2).

Figure 2
Number of paraplanners/admin per planner

Source: L.E.K. research and analysis

Some evidence does support the generous explanation that better specialisation frees up time for planners to service clients, and indeed planners in national advice firms on average handle 1.5x to 2x more assets under management (and therefore fee income) per person than smaller firms do. However, we argue that more is at play here — namely, that the industry has yet to fully harness the power of scale and efficiency and that much more can be done to improve the cost-to-income ratio for advice firms and their investors.

An opportunity for change

Many financial planners are shareholders of their business and thus should have a keen interest in its commercial success. Financial prudence and longevity are at the core of the advice profession, and thus the same philosophy naturally should extend to the running of an advisor's own business.

Although opportunities for significant value creation still exist for advice firms and their investors, realising true cost efficiency requires commercial and management sophistication. In defence of large firms, many realise the cost-out opportunities but face a market that continues to be weighed down by its own legacy.

Common complaints from our conversations with CEOs and COOs include the following:

- "Advisors are set in their own ways, and [their approach is] difficult (though admittedly not impossible) to change."
- "Advisors like the paraplanners and admins they have worked with [before], and disturbing this arrangement will ruffle feathers."
- "Cost has been taken out in things like property and [professional indemnity] insurance, so we can stop there without having to rock the boat too much."
- "The focus is on M&A. We will figure out the integration and operating models later."

However, these statements go a long way towards revealing structural issues that most advice firms have yet to tackle:

- Evidence suggests that the assumption 'size = scale = operating leverage' is often misguided and should not be considered inevitable.
- Advice firms too often fail to harness the potential of workflow simplification from vertical integration.
- Using too many platforms and tech systems ultimately drains time and increases the effort required to stay on top of things (e.g. dual keying problems).
- Technology adoption will falter without corresponding operating model changes.
- Enforcing the target operating model throughout the organisation, from top to bottom, requires dedication and follow-through.

Clearly, root-and-branch changes are required in order to transform an organisation's target operating model and ultimately improve cost-to-income ratio. Yet many organisational leaders are products of the industry who may lack the tools to instigate an overhaul of the status quo. This need not be the case. COOs and chief technical officers who adopt the principles of good target operating model design can learn lessons that are essential for value creation in their advice firms.

Unfinished business in value creation

Advice firm leaders could start by recognising the distinction between a genuine, client-facing unique selling proposition and vital, behind-the-scenes functions. Consider Henry Ford, who is credited with popularising the first automobile but whose true innovation was the development of the groundbreaking assembly line, which enabled mass production of a complex but highly reliable product. Financial planning, in many respects, requires similar genius when it comes to operations.

Successful operating models follow several simple design principles:

- **An operating model should reflect the cost of service.** Because a firm's advice services vary for different client segments, an effective operating model design should start with segmentation into at least three operating models within the business:
  - One for telephony/remote clients
  - One for standard face-to-face clients
  - One for higher-value clients who might require more bespoke services
- **Build for the future, not for today.** Make sure the overall operating model is an accurate fit for the purpose of the organisation's ambitions and plans for growth.
- **Keep, reallocate, automate.** Encourage a process where each function keeps any required tasks, reallocates tasks that can be performed in a cheaper role and automates as much as possible, e.g. an expensive planner should not be sourcing insurance quotes that an administrative team can provide (see Figure 3).

Figure 3
What does an advice firm do?

Source: L.E.K. research and analysis

- **Focus on impact.** Start with the front office, as these staff often set the tone for the rest of the organisation.
- **Share services appropriately.** Paraplanner and admin staff should increasingly be thought of as shared resources, with dedicated senior paraplanners and admins recognised as particular centres of excellence rather than as costs assigned to a certain advisor.
- **Streamline tech systems.** Initiate honest conversations about technology and third-party systems. Do advisors really need to use three different cash flow modelling tools?
- **Adopt a flexible cost structure.** Rotate between fixed and variable costs, e.g. thoughtfully insource and outsource tasks according to capacity and demand.
- **Be open to using innovative tech.** Consider what benefits generative artificial intelligence and process automation could provide for the organisation.
- **Track client satisfaction.** Actively monitor efficiency and capacity utilisation vs client satisfaction for evidence of the impact of a better operating model.
- **Align organisational incentives.** Advisors will recognise that they have ‘skin in the game’ when delivery of the new operating model reflects the organisation’s goals.

Operating efficiency: The next focus for boards and investors

With investors beginning to avoid or down-value businesses that are perceived to be poorly integrated, advice firms lacking an appropriate operating design urgently need to take action. The principles of Consumer Duty also have placed the onus increasingly on advisors to justify their ‘cost to serve’ to both their clients and the Financial Conduct Authority. New light is bound to shine on inefficient cost structures, so many firms have begun to include operating model improvement as part of their action plan over the next five years.

In the longer term, firms that are open to changing their operating model and advice process can materially increase their servicing capacity (client-to-planner ratio) within the industry’s pool of c.27k financial advisors. By complementing this transformation with the right initiatives to improve commercial effectiveness, advice firms can meaningfully transform their organic growth profile as well — making the effort to design their target operating model a win-win for them.

How L.E.K. can help

The L.E.K. Financial Services team helps clients develop fact-based, practical, winning strategies for our dynamic sectors. Our work for investors, shareholders and business leaders brings insight and a rare breadth of experience and perspective to drive strategic decision making. For more information, please contact us. You can also subscribe to our LinkedIn newsletter to get the latest insights and views from the team.

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Bronswe Cheung, a Partner in L.E.K. Consulting's London office, is a member of the Financial Services practice, with a focus on European wealth management and specialist consumer and business lending. He has significant experience across the wealth management and lending value chains and has worked on strategy development and implementation, due diligence, M&A and synergy valuation engagements across Europe and Asia. Bronswe, who joined L.E.K. in 2011, holds a BSc in economics from the London School of Economics.

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Matt Lonsdale is a seasoned wealth management professional with over 20 years of experience in financial services. He has held leadership roles at prominent organizations like Iress and BNY Mellon Pershing, demonstrating his expertise in navigating the ever-evolving financial landscape. Driven by a passion for growth, Matt leverages his deep understanding of the multifaceted wealth management industry and his keen commercial acumen to develop and execute strategic plans. His successful track record includes scaling commercial teams, implementing impactful proposition enhancements, and driving operational model changes, all contributing to significant growth in AUM and ARR.

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