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$$Profit = Total\ Revenue - Total\ Cost$$

$$\pi = TR - TC$$

$$\pi = P * q - \frac{TC}{q} * q$$

$$\pi = P * q - ATC * q$$

$$\pi = q * (P - ATC)$$

Recently, we explored the concepts of simplicity and efficiency in managing a financial advisory/planning practice. With those lessons learned – or constantly being learned, as growth is a process – the focus now turns to profitability.

While some financial advisors get into the business purely for the rush of being a "hunter" finding new opportunities, many of the best financial professionals choose the career path because they want to help people. People who help people for a living often do not think about profitability as a primary objective.

However, failure to think about, understand, and manage the profitability of your financial advisory practice is one of the surest ways to jeopardize compliance with the Fiduciary Rule.

Profitability and Fiduciary Responsibility

Think about it. An advisor who is not adequately focused on profitability runs the risk of going out of business and leaving the profession. That outcome wouldn't be good for his or her clients, and certainly would not be in the clients' best interests, assuming the advisor runs an ethical, conscientious, attentive practice.

An advisor who does not properly manage practice profitability can also be tempted to "sell" a client a product for the purpose of covering an operational shortfall in a given month, quarter, or year. Is that approach in the client's best interest? The answer is no.

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Profitability: What's the Recipe…Really?

While the basic components of profitability – revenue and expenses – are obvious, the factors which influence them in a modern advisory practice are not quite as simple to understand. Some of the fundamental components affecting profitability in a financial advisory practice include:

- level of effort
- allocation of time
- management of overhead costs

Level of effort speaks to the intention, focus, and diligence one puts into the development of one's practice. "You get out of it what you put into it," the old saying goes. There is no secret ingredient here. If you want to run a profitable financial planning/advisory practice, you must put in the effort to make it successful. Lack of diligence results in poor decision making and cutting corners, plain and simple. But, you must also ensure you are being diligent about things that positively impact profitability.

Allocating one's time to the most important tasks – perceived or real – and understanding how allocation of time affects profitability are two different processes. One advisor may assume his or her primary task is spending as much time as possible face-to-face with clients. Another may believe time spent doing the tasks of financial and investment planning are the highest priority. Yet another may believe interviewing and assessing investment managers is the best use of the majority of his or her time. Yet, what is the impact on profitability? This is a complicated question, because it involves a proper understanding of one's clients, one's abilities, and one's resources and the best way to balance these in the situation at hand.

Management of overhead costs is a bit more tangible and more easily assessed. But, an advisor's business model often dictates certain limitations for managing expenses. For instance, if you are an independent advisor attached to an independent broker dealer, you may have no choice but to rent your own office space. While you can choose where to domicile your office, the ability to generate economies of scale may be limited. Conversely, if you are a wirehouse advisor, almost all your overhead costs are baked into the cake of your compensation model,

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and you have little control over how those expenses are managed. Sometimes, a change of pace is necessary to acquire better control of your practice's profitability model.

"Life is divided into three terms –
that which was, which is, and which will be.
Let us learn from the past to profit by the present,
and from the present, to live better in the future."
William Wordsworth

Is Fee-Compression Actually the Problem?

For the past decade, there has been a lot of talk in the industry about margin compression. While the Fiduciary Rule may result in some additional compression in the qualified account space, most of the firms and practices which remain competitive addressed fee compression some time ago. If your practice is just getting around to that, you may be in more trouble than you realize given how much further ahead of that curve much of the industry is today.

It's true that the low-interest-rate environment has not helped the issue of fee compression by reducing portfolio growth for many advisors whose clients are aging and relying more and more on fixed-income investments from a risk management perspective. This trend is likely to continue even if interest rates rise, as some large asset managers like Blackrock[1] are calling for tempered growth in global equity markets. So, relying on the "good old days" of market-fueled, top-line revenue growth – even for advisors whose clients are not all Boomers – may not be the answer going forward.

The truth of the matter is, many advisory practices got away with sloppy profitability models for a long time because commissions were robust and the financial markets cooperated largely for nearly three decades. Many advisors were taught to be salespeople first and business owners second. Accounting and its close cousin, profitability, were treated as dirty words because they meant one was "managing" a practice and not "growing" it.

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Times have changed and the financial advisory industry has matured to a place where sound management principles will mean the difference between growing your business and going out of business. If your practice is behind the times, you may be at risk of owning an asset with diminishing value simply by default.

What Can You Do?

If you need help becoming more profitable, the first step is admitting you need help. Sometimes the obvious needs to be stated.

Here are three possible solutions to help you improve profitability in your practice:

1) Hire a bookkeeper, controller, or CFO
   This might seem simple, but many advisors are great at giving advice to clients about their financial condition, yet not-so-great at understanding the financial condition of their own practices. Hire someone who is a professional at keeping you on track financially. This may be as simple as outsourcing your Quickbooks function to a freelance bookkeeper or as complex as conducting an executive search for a seasoned CFO. But, do get on top of your financials and stay there.

2) Retain a business coach or mentor
   Accountability is one of the key ingredients to profitability. Advisors who truly excel and are at the top of the field rarely get there by doing everything on their own. They reach out for assistance and ideas to improve how they do what they do, for whom, and why...and they do so intentionally and consistently. There is no shame in arriving at your destination with the aid of a co-pilot and Air Traffic Control. Don't go it alone and end up on the ash heap of advisors who refused to think bigger by learning a little humility.

3) Change anything that needs to change
   If your firm/broker-dealer doesn't support sound principals for profitability – or worse, directly hinders your ability to be profitable – consider changing your affiliation. If your business partner or protégé is an impediment to profitability, maybe it's time to sit down and have a heart-to-heart. If your staff is getting in the way of keeping the lights on,

perhaps it's time to revisit the efficiency evaluation process. If certain clients are consistently costing you more than you make by helping them, you're not actually helping them and they aren't helping you, either. Maybe it's time to break up and move on. If your technology costs more than it should, doesn't actually help you and your clients like it should, or both, maybe it's time to rethink your platform entirely.

Profitability is not a dirty word. In fact, it is critical to your survival in this industry and a necessary part of managing your practice going forward. The days of hiding behind big commissions or the next bonus programs are over.

Practice profitability. *You and your practice will get better and better as you do.*

References:
1. "The Changing Equation, Building for retirement in a low return world." BlackRock, Inc. October, 2016.

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About Ashton Thomas Private Wealth

Ashton Thomas Private Wealth is a diversified, boutique financial advisory firm headquartered in Scottsdale, Arizona. We're committed to excellence, integrity, and respect in every aspect of our business. We also strive to stay at the forefront of technological innovation and thought leadership within our industry. We encourage our advisors and staff to use independent thought and collaborate collegially.

What we believe sets us apart:

- A family-oriented, warm, professional culture where you and your clients can thrive
- A seamless, cutting-edge technology solution to manage your practice and serve your clients
- Smart, interactive tools for communicating with clients and tracking their progress
- Single-platform access to SMA and institutional fund managers with a choice of custodian
- A DOL-compliant, fully-integrated 401(k) platform with comprehensive fiduciary capabilities
- Over 40 years of combined in-house portfolio strategy experience and guidance

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Hello, Future. Hello, Ashton Thomas.
Come home to Ashton Thomas. We'll be glad to have you!