Personal Financial Planning in Australia: an Industry Analysis

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Abstract

This paper analyses the Personal Financial Planning industry in Australia. It draws on existing literature by the industry's participants and academics. The paper provides insights into the dominant issues and trends in Personal Financial Planning services in Australia. It utilises the Porter Five Forces model to analyse the current structure and the dynamics of the industry and suggests possible future directions for the industry based on this analysis.

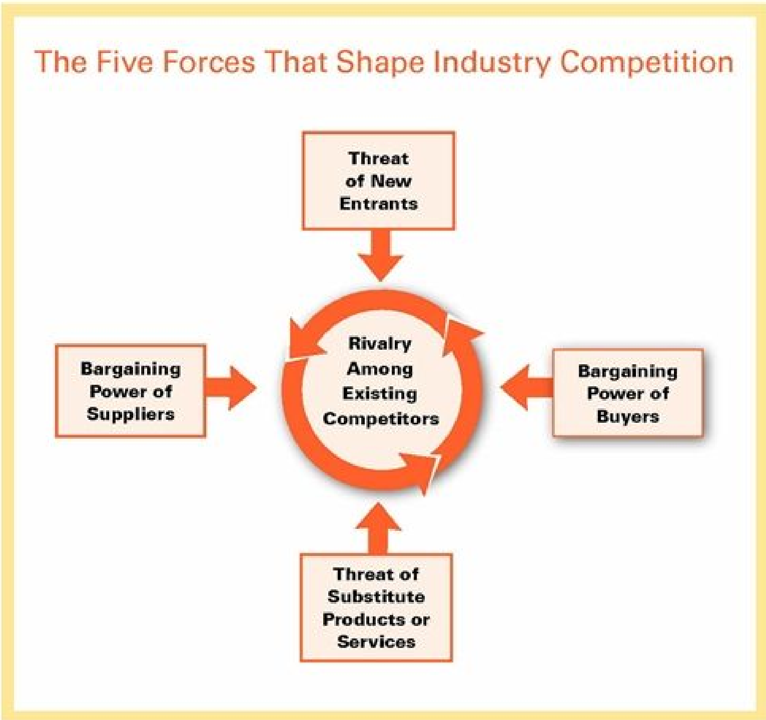
Introduction

Personal financial planning as a distinct discipline started in Australia in the 1970s. Until then, the main sources of financial advice were bank managers, accountants and life insurance salespeople who usually had vested interests in promoting certain products and services (Toten 2006). The demand for advisers grew in the following decades with the development of new investment products and the increasing complexity of Australia's tax and social security system, which created consumer demand for advisory services separate from product sales (FPA 1996). This has led to the emergence of a new breed of financial planners with broader areas of expertise compared to more traditional advisers (McNeil & Soutar 1991). While it is a relatively small industry, with an estimated 15,000 advisers Australia wide, the PFP industry has been one of the fastest growing industries over the past two decades and growth projections for the industry continues to be strong (Toten 2006).

The PFP industry in Australia now has more than A$1 trillion in funds under managements (Tucker 2008). The increased complexity of the financial system and the wide range of choices available to consumers mean that a large number of Australians now rely on financial planners to make decisions that suit their financial and personal goals. The importance of financial advice has led to increasing attention from the regulators and the PFP industry is now one of the most highly regulated industries in Australia. Given the PFP industry's growth and its importance, it seems desirable to examine the current state of the industry and the forces that are likely to be shaping it in the future.

Framework for Analysis

The present paper utilises Porter's Five Forces model as the analytical framework. First explained fully in his book (Porter 1980), this model analyses five competitive forces that determine the attractiveness of an industry's structure and therefore its dynamics. These forces are (1) threat of substitute products or services, (2) threat of new entrants, (3) rivalry among existing competitors, (4) bargaining power of suppliers and (5) bargaining power of buyers. This model allows analysing an industry's structure by taking an outside-in thinking approach when looking at an industry. It is a widely accepted model that continues to exert enormous influence on the field of business strategy in both academe and practice (Brandenburger 2002). The model is graphically represented below (Porter 2008).



Often, a sixth force or factor, government regulation is added to the model. This sixth force will play a significant role in the analysis of the PFP industry in Australia.

Threat of Substitute Products or Services

Financial planners face a great deal of competition from other professionals, including accountants, stockbrokers, private bank as well as insurance brokers. Retirement fund managers (i.e. superannuation funds) have also started lobbying for the opportunity to provide limited advice to their members. In addition, there are a number of online services that offer financial products to consumers at a lower cost. Some potential clients may also seek advice from a less reliable source such as the media or family and friends.

Accountants

Accountants were in a position to dominate the financial planning industry in 1986, when the National Council of the Australian Society of Accountants gave approval to their members to accept commissions for financial planning advice (McNeil & Soutar 1991). The prediction that accountants would dominate the PFP industry has not eventuated to date. Research indicates that 46% of those who had obtained financial advice in the past had asked a financial planner while only 17.5% had asked an accountant. The same research shows that from 1997 to 2004, the use of financial planners as primary advisers increased by 19% while the use of accountants dropped by 10.5% (FPA 2004).

The fact that accountants have not been able to successfully compete with financial planners so far does not imply that the threat of competition can be ignored moving forward. Since the introduction of the Financial Services Reform Act (FSRA) of 2001, accountants are precluded from providing advice on financial products. However, the FSRA provides for an exemption for accountants to give limited advice on the use of Self Managed Superannuation Funds (SMSFs) without a licence. Some are currently calling for the definition of advice to be changed by way of broadening the scope of what constitutes general advice to allow accountants to provide investment advice in relation to SMSFs (Kohler 2008). The Financial Planning Association (FPA) opposes this move and has even called for removal of the exemption that the Act gives to accountants (FPA 2008b). The recently announced review of the governance of the SMSF sector is likely to resolve some of these issues, but it is unclear at this stage in whose favour.

While the FSRA has helped the planners by applying limitations on the type of advice that accountants can provide, the recently proposed changes to the Tax Agents Services Bill could see financial planners being prohibited from giving tax advice that is incidental to another service. Previously, the Australian Taxation Office (ATO) confirmed that a financial service provider can provide tax advice about a financial transaction, arrangement or plan as long as the person is not acting as a taxpayer's representative (ATO 2005). However, the proposed changes would require financial planners to become registered tax agents. This could preclude financial planners from giving advice in relation to salary packaging, tax deductibility of superannuation contributions, tax implications from selling an investment product or tax implications of receiving superannuation death benefits without undergoing additional training and registration. Ultimately, if the proposed changes are legislated, this could mean that financial planners will have to refer clients to accountants for every tax related matter. Given that incidental tax advice is present with virtually every comprehensive advice, the implications for financial planners of passing the Bill as proposed would be very significant.

Stockbrokers

The more traditional stockbroking services do not appear to pose a significant threat to financial planners. Research suggests that only 3% of those who have obtained financial advice in the past or may obtain it in the future, are likely to obtain it from a stockbroker (FPA 2004). However, it appears that the stockbroking firms are changing their direction, which could have an effect on the financial planning landscape. A number of stockbroking firms are recognising the need to replace their revenue, which is mainly transaction driven, with a more reliable income source. As a result, some stockbroking firms are starting to grow their financial planning business (Egan 2008a).

Private Banks

Banks are able to leverage on their image of trust and use the existing clientele as the target market for their private banking services (McNeil & Soutar 1991). Traditionally, the private banks targeted their services to the wealthy individuals, offering them mortgage and transactional services with additional customer care. The evidence suggests that banks are broadening the range of their services (Lindhe

2008) and have now entered the wealth-management market that has been traditionally serviced by financial planners (Kavanagh 2004). This highly resourced force has to be recognised by the PFP industry as a very strong competitor.

Insurance Brokers

Insurance brokers can generally compete with financial planners only in the area of risk insurance. Research shows that insurance accounts for 11% of the total income of financial planing practices (FPA 2005a). The importance of insurance business should not be underestimated. With most Australians currently being underinsured, this area offers one of the best growth potentials.

With the amount of revenue that they receive from commissions dropping rapidly, insurance brokers are now relying more on the income generated from their risk consulting business (MacDermott 1999). Given the importance of the revenue that insurance brokers generate from their advisory services, financial planners can expect strong competition from the brokers in the area of professional advice and not just in product sales.

Superannuation Funds

Another competitor is currently emerging that can potentially attract clients before they even have a chance to approach a financial planner for advice. Industry superannuation funds are starting to provide advice to their members in order to retain the members' funds. Some superannuation funds are calling for relaxation of the legislation to allow them to provide advice to members on the investment options (Kohler 2008). The Australian Institute of Superannuation Trustees (AIST) goes further, suggesting that superannuation funds should be able to give advice about products and services including issues like level of insurance as well as investment choice (Shore 2008). While there may be a perception that superannuation funds will be biased towards their own products, nevertheless this new competitor can potentially have a significant effect on the future of the PFP industry, given the size of the savings that Australians have in superannuation.

Online Providers

The internet has become a significant and growing source of product information. While research indicates that consumers are unlikely to use the internet to obtain financial advice (FPA 2004), there are a number of internet services that have a potential to detract some of the business from financial planners by offering cheaper and more convenient internet-based products.

Investors have had an opportunity to invest in managed investments as well as pension products online for more than a decade. Such services are offered by third party providers who assist in investing customers' funds through a master trust or a wrap service that are already available on the market. This competition would be significant as 65% of financial planners place new business in either a master trust or a wrap service (FPA 2005a).

While it is more common to see an online intermediary selling a third party product, there have been attempts to market own products this way to the prospective customers. For instance, Virgin has created its own superannuation product, Virgin Super, which is being offered online. With 36% of the financial planners' income generated from superannuation (FPA 2005a), such emerging competition can have a significant impact on the PFP industry's revenue.

Insurance providers have also been taking advantage of the opportunities of marketing their products over the internet (Tyson-Chan 2007). The products have been designed to offer risk cover online without the assistance of a financial adviser. Stevens (2004) points out that financial planers are not very advanced in online service delivery, which represents opportunity lost to other providers.

Media

The media has a potential to be the source of advice for some potential clients, especially for those who do not see the value of obtaining professional advice or simply can not afford it. Newspapers contain special investment sections, editorial comments, answers to reader questions as well as investment product advertising. While investor information is not widespread on television, talk-back radio sessions on financial topics are quite common. While the role of the media as a source of advice was considered important in earlier research (McNeil & Soutar 1991), more recent research does not support this view (FPA 2004). This could be an indication that investors these days are more educated and prefer professional personal advice.

Family and Friends

Research indicates that 14.5% of those who have not obtained financial advice in the past and 9% of those who have, would ask for advice from their family or friends (FPA 2004). This is a good sign for financial planners as it indicates that those who have experienced professional advice see the value in it and are likely to use professional services in the future when seeking financial advice. A survey conducted in 1997 – 2000 showed that the most popular source of financial advice was family and friends (41%) followed by financial planners (FPA 2004). This indicates a great improvement for financial planners, who have now managed to gain the top spot as the preferred source of financial advice. The research indicates that those who are just starting out are more likely to consult family and friends about financial matters, while older respondents prefer consulting a financial planner.

Threat of New Entrants

New entrants in any industry bring new capacity and a desire to gain market share, putting pressure on prices and costs and ultimately on the profit potential of the industry. The threat of new entrants depends on the barriers to entry or the advantages that incumbents have relative to new entrants. Porter (2008) identifies seven major barriers that relate to new industry entrants: supply-side economies of scale, demand-side benefits of scale, customer switching costs, capital requirements, incumbency advantages, unequal access to distribution channels and restrictive government policy. The relevance and importance of each of these barriers need to be analysed and applied to the PFP industry in order to establish how the threat of new entrants is likely to shape the future of the industry.

Supply-side Economies of Scale

Supply-side economies of scale arise when larger established firms are able to lower their costs per unit of output by either spreading fixed costs over more units or obtaining better terms from suppliers. This could mean that new entrants will face a cost disadvantage unless they can match the scale of incumbents (Porter 2008). In the case of the PFP industry, it may be possible for larger firms to deliver services at a lower cost by fixing their overhead costs and employing a more efficient technology. However, most of the financial products are highly commoditised and equally available at a very similar cost to all the competitors. Kautt (2008a) points out that in financial planning, economies of scale are usually derived from developing efficient delivery systems and superior services rather than through product selection.

Demand-side Benefits of Scale

This barrier relates to brand identification and customer loyalty to existing products or services. Demand-side benefits of scale discourage entry by limiting the willingness of customers to buy from a newcomer and by reducing the price the newcomer can command while it is still trying to build up a base of customers (Porter 2008). In financial planning, some clients may work only with larger firms because of their better professional backup and well recognised brand. Any new entrant would need to work much harder and for less money to compete for the market share, and may not attract the same calibre of customers at the start.

Customer Switching Costs

Switching costs are fixed costs that buyers face when they change suppliers. The larger the switching costs, the harder it will be for a new entrant to gain customers (Porter 2008). In financial planing, clients can switch their advisers at virtually no cost. However, Kautt (2008a) argues that the emotional cost of switching advisers is quite high when the current firm is doing a competent job. He believes that this emotional cost is a high barrier for competitors trying to grab existing client base.

Capital Requirements

The need to invest large financial resources in order to compete creates a barrier to entry (Porter 2008). In a field such as financial planning, capital requirements are minimal and potential entrants plentiful. However, for a firm to attract sufficient revenue, a number of skilled and experienced professionals is required which takes a great deal of capital (Kautt 2008a).

Incumbency Advantages

Incumbents may have cost or quality advantages not available to potential rivals. These advantages may be due to propriety technology, experience, favourable geographic locations or established brand identities (Porter 2008). In financial planning, well established firms are able to use advertising and marketing to promote brand identities. They can offer substantial cumulative experience that newcomers may not be able to and are also likely to attract the best professionals (Kautt 2008a). These advantages could create a substantial barrier to new entrants in the markets where the brand name is well know and respected.

Unequal Access to Distribution Channels

To compete successfully, a new entrant must be able to distribute its products and services. In the current largely commoditised financial products market, access to distribution channels presents no barriers for new entrants in the PFP industry.

Restrictive Government Policy

Government policy can limit the amount of new industry participants by way of, for instance, licensing or compliance requirements. The PFP industry has a relatively stringent regulatory regime as well as certain education requirements for financial planners to obtain a licence. The introduction of FSRA in 2001 has, to a degree, increased the barriers to entry into the industry. Under FSRA, entities who provide certain services in relation to financial products have to comply with various disclosure and consumer protection requirements when dealing with retail clients. Larger practices may have an advantage in meeting the compliance obligations in a more cost effective manner.

Expected Retaliation

Apart from the seven barriers to entry, the way the incumbents are expected to react to new entrants can also influence the decision on whether to enter an industry. A more vigorous response from incumbents is expected when industry growth is so slow that newcomers can gain volume only by taking it away from incumbents (Porter 2008). Kautt (2008a) points out that financial planning firms do not seem to respond with a vigorous defence. The seemingly rapid growth of the industry means that the newcomers do not necessarily need to lure the existing customers away from other financial planning firms and can build a successful business through a strong demand for financial services from those who have never had a planner before.

Rivalry Among Existing Competitors

Australia has an estimated 15,000 financial planners (Phillips 2008). While the evidence shows the emerging competition from the other financial service providers and potential new entrants given the low barriers to entry, financial planners must not ignore the already present competitive pressures among the current industry participants. Rivalry among existing competitors can take various forms, with high rivalry putting pressure on the profitability of an industry. Porter (2008) identifies two factors that define competition: the intensity with which companies compete and the basis on which they compete.

Intensity of Competition

Based on a survey, the PFP industry consists of businesses of varying sizes, ownership structure and profitability (FPA 2005a) with no clear market leader. As discussed earlier, the intensity of competition in the PFP industry appears to be low. With the industry experiencing high growth, financial planners do not seem to be focussing their efforts on poaching business from their colleagues. Instead, the focus of competition is on acquiring those clients that are new to the industry.

Basis of Competition

While knowing the intensity of competition is important, the basis of competition also needs to be known to assess the strength of rivalry in an industry. Whether rivals compete on the same dimension is an important factor in assessing the rivalry. The rivalry is especially destructive to profitability if it gravitates solely to price because price competition transfers profits directly from an industry to its customers (Porter 2008). In his analysis, Kautt (2008a) points out that financial planning firms do not seem to drop prices or add services without raising prices as a defensive strategy and prefer competing on basis other than price. This is not surprising, given the fact that research indicates that 40% of clients do not know how they are paying for advice (FPA 2004).

The above analysis indicates that the best way for a practice to compete in the PFP industry would be on a basis other than price. However, Porter (2008) indicates that where rivals compete on the same attributes, the competition can still be quite strong, even without price competition. To avoid this, a financial planning practice needs to compete on dimensions other than those used by the majority of the industry participants. There appears to be a few major dimensions on which financial planners can successfully differentiate themselves from rivals, as discussed in the following paragraphs.

Developing Niche Clients

The opinion of the PFP industry's consultants is that financial planners need to focus on a select market of clients with similar needs, otherwise known as a niche. This enables financial planners to design an effective solution to the specific issues of a niche group, and become know to the niche as an expert who understands their specific issues (Asquith-Hunt 2008). Such an approach would enable a financial planning firm to compete on a different dimension to the rest of the industry, building strong barriers around the chosen niche.

Committing to Ongoing Learning

Stackpool et al (2002) suggest that financial planners should make education a priority. Professional development and training of key staff have been identified as one of the industry's weaknesses. A recent paper also shows a gap between client expectation and skills of financial planners (Jackling & Sullivan 2007). While staying educated about constantly changing regulations is important, what is more important is ongoing education about the chosen target market (Stackpool et al 2002) which should include general business and customer-facing skills (Unsworth 2007). Bailey (2008) also points out the importance of educational support network of peers in enhancing the quality of service and depth of advice. In this respect forming an alliance or strategic relationship with like-minded advisory practices appears to be important in staying on top of competition. While there is a need for financial planners to commit to ongoing learning just to meet client expectation, structured training can also assist in increasing the expertise of a financial planing practice, helping in positioning the firm as a group of experts in a particular area. This enables the practice to compete at a level of expertise that may not be attainable by their less skilled rivals.

Using Technology

A recent report shows that over a third of practices do not have any web presence and too many sites are just “brochure ware” that describe the adviser’s capabilities and contact details but give customers little reason to come back (Stevens 2004). The fact that financial planers are not very advanced in online service delivery provides a great opportunity for a financial planning business to use technology in order to bring the competition to the dimension where there are fewer rivals. Technology can provide advantage in capturing new clients, which has been identified as the main competition arena for financial planners.

Technology can also help with the client retention, which is another focus area of financial planners. Stevens (2004) argues that giving clients access to market information, trading solutions and breaking news through the website enhances existing clients’ loyalty, as the clients would not have a need to go to potential competitors for these services.

Having a capacity to enable clients to do as much of the preliminary work online before meeting the adviser face to face can lower the costs and increase the business capacity as well. Not only does this free practices from routine data entry but also allows planners to earn more for the time actually spent with clients (Ungar & Sakashi 2001).

Bargaining Power of Suppliers

In some industries, vendors may control the supply chain and in this way determine the pricing structure, product differentiation and ultimately the profitability of the industry (Porter 2008). The PFP industry depends on a number of suppliers, including fund managers and platform providers, dealer groups, software providers and providers of professional education. The industry also heavily relies on its labour supply that has become significantly important.

Fund Managers and Platform Providers

Fund managers and platform providers (e.g. master trusts) depend heavily on financial planners to distribute their products to the end users. In addition, there are many suppliers of these products and the switching costs are usually low. Given a heavily commoditised market, fund managers and platform providers compete vigorously for their share of the market. With 65% of financial planners' new business being invested through a platform (FPA 2005a), fund managers are keen to be placed on the menus of those platforms. They also offer preferential pricing to get on the financial planners' preferred list of products, as well as provide other assistance to financial planners including training and sponsorship of events.

The birth of platforms was spurred by advisers looking for ways to reduce and simplify the administrative requirements of running a business and managing a client's portfolio (O'Farrell 2008). To stay in the competition, platform providers continue to offer new functionality and products, gradually moving towards partnering with financial planners in providing holistic advice by offering a one-stop-shop approach (Mace 2008).

Dealer Groups

In the context of FSRA, dealer groups are usually the holders of Australian Financial Service Licenses and financial planners are their authorised representatives. Dealer groups can be seen as one of the industry's participants rather than its vendor. However, from the point of view of an individual financial planning practice, they are suppliers of services. Financial planners look to their dealer group to provide technical services, compliance and practice management support (Fielding 2006). Working with a premium dealership appears to be a top concern for almost 70% of advisers (Stackpool et.al 2002).

Dealer groups need to compete among themselves for potential practices to join their respective network. However, they are in a slightly different position from fund managers and platform providers. While there is a large number of suppliers of these services offering very similar products, recent research shows that 84% of planners are loyal to their dealer primarily because of good support provided (Fielding 2006). However, it is also likely that one of the reasons behind staying with the current dealer group could be the high switching costs associated with changing systems, disruption to clients' services as well as additional pressure on staff.

Many dealer groups are moving towards creating a strong relationship with their advisers, offering a large range of services to entwine practice and dealer together (Phillips 2008). While it could have a positive result for financial planners, it will also build stronger barriers to exit the dealership. Any proposition from a competing dealer group would need to have significant value to the practice to make it consider switching dealerships. In a situation when switching costs are high, financial planners would find it difficult to play dealer groups off against one another to get a better deal.

Software Providers

Software providers are another supplier of services to the PFP industry. This supplier group is quite different as two main players are currently dominating the market space – IRESS and Macquarie (Lim 2008). With the barriers to entry being quite high, it is unlikely to see any significant players entering the industry in the near future. Some see this duopoly as a positive aspect and believe that this gives the necessary capacity to provide advisers with high quality products. However, others think that a lack of competition in the financial planning software space could negatively affect financial services businesses by reducing choice (Lim 2008).

In a situation where two main players are able to invest heavily in product development, they can create products that are significantly different from those that their competitors can offer. Effectively, this could lead to a situation where there are no competitive substitute products remaining in the market thereby increasing the power of the major software providers. In this situation they would be able to charge higher prices or limit the quality of services which would be unfavourable for financial planners.

Providers of Professional Education

Providers of professional education play a vital role in insuring financial planners possess the necessary knowledge and skill to successfully perform their roles. In Australia, financial planning education has grown steadily. While in 1995 only two universities offered financial planning courses, this number has grown to twelve (Cowen at al 2006). However, completing a university degree has not been the typical education pathway for many financial planners. This may change though, given the new requirement set by the FPA to be degree qualified in order to receive the Certified Financial Planner designation.

The educational arena in the field of PFP had been previously dominated by the FPA, Tribeca Learning and Financial Services Institute of Australasia (Finsia). With the FPA discontinuing its diploma program and Tribeca as well as Finsia’s education arm being acquired by Kaplan Professional, there is now seemingly a monopoly in the vocational education programs for financial planners.

While PFP education has grown steadily, the PFP industry itself has experienced a rapid growth. This created a situation where there are currently not enough educational programs in financial planning.

In addition, as Jackling & Sullivan (2007) point out, there is a deficiency in people skills in the preparation of financial planners, in particular listening and questioning skills. While it is clear that there is a strong demand for professional education for financial planners, it appears that providers of professional education have not been able to cope with the demand and also have not been able to tailor the courses to meet specific skills requirements of financial planners. The lack of communication skills has been successfully identified by the industry's consultants that offer training to financial planners in this area at a considerable cost. For instance, Strategic Consulting and Training a few years ago charged $22,500 per year for their training and coaching services (Wilkinson 2005).

The FPA is currently trying to address the shortage of the available courses and skills, understanding their implication to the growing PFP industry. The FPA has recently formed the Future Financial Planners Council which has as one of its objectives encouraging tertiary education institutions to expand their offering of quality financial planning programs including practical skills (Bloch 2008). While this initiative is commendable, Cowen et al (2006) suggest that one of the possible reasons for the shortage of tertiary financial planning education courses is the lack of academic experts in this area of education. If this suggestion is in fact correct, it is difficult to see how the tertiary education programs can be expanded.

Labour Supply

Although some of the other supplier groups cause a level of concern for the PFP industry's future, the real point of worry for financial planning businesses is the shortage of qualified staff. A recent report indicates that the top three issues facing financial planning practices, in order, are sourcing new team members, retaining members and structuring remuneration packages (Mulcare 2008). Many financial planning practices need to compete among themselves to attract and retain talented people. In a situation where there is a shortage of staff, there is also an upward pressure on the labour cost, with the recent HAYS survey showing continued growth in salaries in the PFP industry (HAYS 2008). This inevitably affects the profitability of the industry.

This situation is unlikely to ease as the FPA estimates that demand for financial planners is set to increase by 55% within 5 years (FPA 2008a). While there are strategies for individual financial planning practices to attract qualified staff from their competitors through higher salaries, flexible working arrangements, mentoring programs or ownership options, this does not solve the issue for the overall PFP community. The real issue remaining is how to attract more people into the industry rather than reshuffle the existing pool of the industry's participants.

As stated earlier, the FPA has started tackling the issue by establishing the Future Financial Planners Council, with another objective of the Council being the targeting of students and graduates to raise awareness of the opportunities within the PFP industry so that financial planning becomes a career of choice for students engaged in business related studies (Bloch 2008). Despite the FPA's initiative, it is unlikely to solve the issue completely without the help of the financial planners themselves. It is suggested that financial planners can help address the issue by establishing mentoring and job training programs in association with universities, as well as developing their staff internally. Another suggestion is to attract specialists from other professions that have suitable skills, including teachers and lecturers as well as professionals from the banking and structured investments sector who may be looking for a less hectic employment environment (Paech 2008a).

An often overlooked solution to the shortage of staff in the PFP industry is outsourcing some of the business functions to technology. However, Mehrotra (2008) points out that while this solution is an obvious one, most practices seem to prefer hiring more staff to cope mainly because they are afraid of losing control and they do not know what technological solutions are available in the market.

Bargaining Power of Buyers

Powerful customers can exercise their force by demanding better quality and more services at a lower price. By playing industry participants against each other, they can push the prices down, affecting the industry's overall profitability. Financial planners also need to find ways of mitigating the customers' power or even using this power to their own advantage. As an initial step, it is important to analyse the conditions that would contribute to clients having substantial leverage.

Undifferentiated Products

Porter (2008) indicates that customers have negotiating leverage when the industry's products are standardized or undifferentiated. In this situation, buyers can shop around for a better price and play one vendor against another. Today financial planners need to compete not only against each other and the other substitute services, but also against the very low cost products and services available via the internet. Because most of the financial planning products are largely commoditised, financial planners can not compete based on products alone. For financial planners, the only ways of differentiation in the eyes of prospective customers are the types and level of service that they can offer. Kautt (2008b) points out that the more advanced the service or the more specialized the advice, the less bargaining power a potential client has.

Low or Non-existent Switching Costs

Another condition when buyers have significant bargaining power is when switching costs between products are low or non-existent. As mentioned earlier in this paper, customers can switch financial planners at a very low cost. In this case, the planners that offer undifferentiated services are in a greater danger of losing their clients to a cheaper competitor. However, given the high emotional costs of switching planners, clients are less likely to leave those financial planners that are doing a good job or have better quality services.

Price Sensitivity

When potential clients can perform the services themselves, they have a significant bargaining power. In this respect, more sophisticated services have a lesser chance of being replicated by clients. In addition, price sensitive clients are also likely to do things themselves. Therefore, it is important to distinguish those potential groups of clients who are and who are not price sensitive, as this ultimately determines their bargaining power.

Porter (2008) highlights the fact that when the cost of a service is high compared to a buyer group's income, this group is likely to be price sensitive and bargain hard. Smaller clients may therefore be more price sensitive, as the professional fees charged by a planner may be relatively high compared to their overall resources. On the other hand, individuals with substantial assets may be more concerned with losing their capital rather than with the fees that they are being charged. According to Kautt (2008b), average wage earners having little excess cash flow are under pressure to watch their costs and therefore are unlikely to use a professional adviser. Highly profitable, usually wealthy individuals, are generally less price sensitive.

Another aspect of price sensitivity to keep in mind is that when a product or service can save other costs or improve performance, buyers are usually more interested in quality than in price (Porter 2008). Therefore, when advisers are able to demonstrate the value of their services, clients are less likely to be concerned with the fees they are paying.

Changing Customers' Power

The bargaining power of customers is not static and changes over time. Some experts suggest that most clients do not presently understand the full extent of their influence and bargaining power, but this situation is expected to change moving forward (Fox 2008). This change is not only attributed to the growing consumer awareness of the power they have over the design and delivery of the advice and service offer, but also to the demographic challenge that the industry is facing. The emergence of Generation Y as the next generation of clients brings additional challenges. This generation is expected to do their own online research, demand faster services and will not accept advice on financial matters blindly. They will not be interested in paying for services whose value they can not see (Hawke 2006).

Taking Advantage of Customers' Power

While clients' bargaining power can pose a significant threat to financial planning practices, advisers should focus on utilising this power to their advantage. One of the options is using clients' power to generate new business through referrals. Research indicates that 48% of new referrals come from existing clients (FPA 2005b). A recent survey also indicates that 85% of existing clients are willing to refer (Bertino 2008). This makes existing clients the most powerful referral source for financial planners. However, it appears that financial planners do not use this significant referral source to their advantage because either they do not ask their clients for referrals, clients do not know how or who to refer, or simply because clients do not know that the adviser needs their help in obtaining new referrals (Bertino 2008). Importantly, the quality of service plays an important role in whether or not clients are going to refer. A recent research indicates that only 12% of those clients that have not been contacted by their financial planner in the past 12 months are willing to refer (INGA 2007). Low level of contact with existing key clients is generally accepted as one of the weaknesses of the PFP industry.

There is another emerging way of utilising clients as a resource. According to Chaplin (2008), many American advisers are now seeking formal input from clients on how to improve their practices by forming client advisory boards that discuss issues like client satisfaction, business strategies and fees. It appears that Australian financial planners are yet to pick up on this trend. As 100% of those American advisers who had formed client advisory boards are happy with the outcome (Chaplin 2008), this trend has a good chance of picking up in Australia.

Regulatory Issues

While government is sometimes viewed as a six force of competition, Porter (2008) suggests looking at government as a contributing factor and not as a force. Given the significance of government regulation in the PFP industry, it is necessary to look at this important factor separately.

Development of Current Regulatory Framework

The removal of government restrictions in the banking sector in the 1980s, followed by a vast array of new regulations with an investor protection focus, paved the foundation for what has eventually become the regulatory environment of the PFP industry of today. The accumulation of regulation over the years has produced many overlaps and inconsistencies in regulation with the government later on realising that multiple systems are no longer workable or justifiable on cost grounds (FPA 1996). This has eventually led to a single regulatory framework for financial planners, incorporated in the FSRA which commenced implementation on 11 March 2002.

The FSRA imposed a single licensing regime for financial sales, advice and dealings in relation to financial products as well as a consistent and comparable system of financial product disclosure. While the FSRA eliminated many regulatory overlaps, its implementation has led to significant compliance costs for the PFP industry and its customers. Further compliance obligations were introduced in December 2007 with the implementation of the new Anti-Money Laundering/Counter-Terrorist Financing rules. The new legislation imposes certain customer identification and record-keeping obligations for financial planners and suspicious matters reporting obligations.

High compliance costs have resulted in disclosure documentation which is costly to produce and complex and difficult for consumers to understand (FPA 2008c). These issues have led to some refinements of the regulations with the view of reducing the compliance burden. More recently, government has established the Financial Services Working Group with the objective of solving the issues associated with financial services advice and disclosure.

Upcoming Reviews and Enquiries

The financial planning industry has experienced continuous reviews and enquiries, starting with the Wallis Inquiry in 1997. This trend is not about to stop with Tucker (2008) identifying the following items being on the government agenda: review of the governance of the SMSF sector, establishment of the Government Superannuation Advisory Group and release of the Green Paper on Financial Services and Credit Reform. Add to this the May 2008 restructure of the Australian Securities and Investment Commission (ASIC), including the creation of a dedicated financial advice team which will look at the issues that affect the ability of individuals to access advice (Paech 2008b) and it becomes clear that the microscope remains firmly focussed on the operation of the financial services industry (Tucker 2008).

Considering the number of enquiries into the industry, the question arises why the PFP industry is constantly under intense review. Tucker (2008) identifies a number of possible factors that have contributed to this, including the amount of funds that the industry is managing, the unfavourable results of the regulator's shadow shopping exercises, constant media attention, high profile corporate failures as well as claims of sales misrepresentation. While the above contributing factors are very valid, the main reason behind the constant scrutiny comes from the fact that the PFP industry has failed to self-regulate and this role has been filled by the regulators. At the heart of this failure lie the issues of conflicts of interest and commission driven industry practices. Reducing conflicts of interest and the cost of advice seems to be dominating the current government's agenda, especially in relation to the question of adviser remuneration.

Adviser Remuneration Debate

The debate over a pricing model for financial advice is among the most discussed issues in the press by industry participants and government officials. The main point of argument appears to be between commission-based and fee-for-service structures of remuneration. A fee-for-service model is a system of pricing services where customers pay an agreed for the service they receive. On the other hand, under the commission-based structure, financial planners receive commissions from the providers of products that they recommend.

The main argument against commission-based advice comes from the opinion that this type of remuneration has a potential to affect the integrity of advice given to clients by creating a conflict of interest due to a bias towards recommending investments with higher commissions. Some industry participants go as far as proposing a total ban of commissions in the provision of financial advice, but this does not appear to have overwhelming support. While many agree that the commission system is not the best way for the industry to operate in the long term because of its potential to distort the advice (Tate 2007), there are a number of issues associated with moving away from the commission-based remuneration structure.

Firstly, there are many products having embedded commissions that are impossible or very difficult to eliminate or rebate. This is especially relevant to life insurance products, where not only are some insurance companies unable to rebate commissions, but the premium reduction that some insurers offer stand at around 20% to 30% of the first year's premium, which does not offset the forfeited commission (Yeow 2008). Arguably, in this situation it is better to accept the commission, which in some cases exceed the first year's entire premium and rebate it to the client and then charge a flat advice fee. Whelan (2008) points out that in addition to the administrative issues, in some instances this may crate a bias towards those products that allow automatic rebate of commissions, which may not be the best product for the client. Given the associated complexities, O'Toole (2008) argues that banning all commissions completely would be unreasonable without a significant restructuring of many products.

Secondly, as Taylor (2008) points out, commission-based financial advice provides tax deductibility advantages to clients while advice given by fee-for-service advisers does not. However, the Minister for Superannuation and Corporate Law has indicated that the Government could consider the tax deductibility of adviser fees, but only as part of a broader reform (Paech 2008b).

Another big argument for keeping the commission structure in place is that some clients cannot afford upfront fees and commissions enable clients to pay for advice over a period of time (Whelan 2008). If advice-related costs can be paid from the recommended products, this would solve the affordability issue for some clients. It is also suggested that pushing a fee-based model on risk insurance advice will result in a greater underinsurance problem (Yeow 2008).

Apart from the above issues, there are other difficulties that businesses may encounter when switching to a fee-for-service model. It can disrupt the business during the switching process, as it is likely to create a need for additional staff training, designing and implementing the fee structure, discussing rebating commissions to clients with the product providers and convincing the existing clients to move to the new fee structure. Some financial planners may also resist the change because their business is profitable under the current commission-based structure. Switching to a fee-for-service model is likely to see the administration costs to go up. Under the fee-for-service structure, there will be a need to calculate and collect the fees, rebate commissions as well as potentially record and monitor the time spent on each task (Whelan 2008). Tate (2007) also points out that the hourly rate system of charging that may be used under a fee-for-service model has a potential to reward incompetence or inefficient work.

Some owners of financial planning firms are concerned about the effects on the sale value of their business, as trail commissions often determine what a potential buyer would be prepared to pay for an existing business (Whelan 2008). However, some argue that the world is changing and prospective buyers of financial planning businesses will be looking beyond revenue streams and question the quality of the revenues (Weaven 2008). In this respect, the buyers will be looking at sustainability of revenue in light of the likely future direction of the industry in terms of regulation as well as community and media attention. Hoyle (2008) highlights the fact that while the values of those businesses that rely on trail commission depend on market movements, businesses that have their revenue independent from the trailing commissions will have more stable income streams. However, it is also possible that if the value of a client's portfolio falls, but the same or higher fee is charged under a fee-for-service model due to the time required to service the client, some clients may actually complain about their fees (Whelan 2008).

Another difficulty in implementing a fee-for-service model is that some financial planners are concerned with the fact that if they charge a professional fee for their advice while their competitors provide free advice and receive commissions, they will be disadvantaged. It would also be easier for the competitors to undercut fees, as under a fee-for-service model it is easy to see and compare the fees that are being charged (Whelan 2008). Under a fee-for-service model, clients control the fee they pay, and can choose to pay more or less. This can create a situation where servicing smaller clients may become less profitable than servicing larger clients, as smaller clients may be more reluctant to pay more while the time required to service them may not be much different from the time that planners spend on advising larger clients.

The argument that consumers are becoming increasingly aware of the fees they are being charged and that this factor will eventually force more advisers to switch to a fee-for-service model is frequently seen in the press. While this argument is valid, the evidence so far does not support this point of view. O'Toole (2008) argues that a commission or fee basis is not a big issue for clients of financial planners. This view is supported by a recent research indicating that consumers have no clear preference for fee structure with 18% preferring commissions, 18% a mixture of fee and commission and 20% having no particular preference (INGA 2007). Another survey indicated that 42% of those respondents who have obtained financial advice did not know how they paid for advice, while at the same time showing an 82% satisfaction rate with the advice they received (FPA 2004). In the eyes of the consumers, the debate appears to be not about commissions versus fee-for-service, but about the provision of quality advice (INGA 2007).

While the industry is divided between the commission and the fee-for-service argument and the clients appear to be indifferent to the issue, the real issue with this argument seems to come from the fact that the industry is not yet ready for the fee-for-service model. The industry is a price taker not a price maker, advisers are not good at selling themselves and the idea of charging fees scares them because they would have to articulate what they do to earn them (Yeow 2008).

Stackpool (2008) argues that the debate whether a fee-for-service model is better than commission-based pricing is only tangent to a more relevant issue of ensuring consistency of ongoing revenue, which is a crucial factor for business success. Given the criticism of the commission-based structure and the shortcoming of the fee-for-service model, he supports the use of retainers as the most effective billing system which uses clear dollar amounts that are independent of the amount of products sold or servicing hours.

Possible Future Directions for the PFP Industry

Based on the previous analysis of the current situation of the PFP industry in Australia, possible future directions are identified in this section.

Substitute Products or Services

Considering the current trends in the area of financial advice, financial planners are presently facing a very challenging environment. The future competition from the alternative financial services providers is expected to increase, and financial planners need to determine the strategy that will allow them to successfully compete with the strongly positioned rivals. Research shows that holistic wealth management - an integrated process for helping clients manage their wealth on a consultative basis, is expected to become the dominant business model in the future (Stackpool et al 2002). Therefore, financial planners need to concentrate on offering a full menu of products and services to their clients. In that respect, forming partnerships rather than competing with the other financial services providers should become increasingly important.

Legatt (2008) suggests that it is difficult to imagine a financial planning practice being really successful without the development of a number of relationships and there is already evidence that the holistic wealth management model is becoming the focus of some businesses. For instance, wealth manager Ord Minnett has taken the first step towards an integrated model by combining their advisers and stockbrokers into a team of client advisers (Egan 2008b). The DKN Group has gone much further with their model, bringing accountants, solicitors, business brokers and financial planners together in one business (Taylor 2007). This trend is something a modern financial planning practice cannot ignore if it is to be successful in the future competitive environment.

New Entrants

As the threat of new entrants increases, so does potential competition, with resulting downward pressure on prices. Based on this, the future success of financial planning practices will depend on creating strong barriers to entry. It seems that growing the size of the practice and establishing brand awareness should position a financial planning practice in an advantageous way against the newcomers. Research indicates that there will be fewer advisers practicing in the future (Stackpool et al 2002), suggesting that there may be amalgamation of financial planning businesses going forward.

Competitive Rivalry

Despite the current low intensity state of competition in the PFP industry, a research that interviewed 630 randomly selected financial advisers throughout Australia indicates that the majority of financial planners believe that competitive pressures within the PFP industry are increasing (Stackpool et al 2002). Forward looking financial planning practices need to be focusing on different customer segments and developing the skills and attributes that would clearly distinguish them from the rivals in the eyes of the consumers. The dimensions that offer greater opportunity for a financial planner to distinguish itself from the rivals include: focusing on specific needs of niche clients, committing to ongoing learning to enhance the expertise and investing more on website-based technology to capture and retain clients as well as lower costs. These strategies should help a financial planning practice in building significant barriers to competition against its rivals, which should ensure better positioning for the future challenges.

Suppliers

Given their dependency on financial planners to distribute their products and the vigorous competition between the suppliers, fund managers and platform providers are likely to continue to be driven by the ever increasing demands of financial planners and keep on sharing some of their profits with them. Further functionality and new products are likely to be added to their offerings with the costs of these most likely to be met by fund managers and platform providers. While platform providers are moving towards more integrated solutions for financial planners, their products are likely to become more differentiated. This may cause the switching costs to eventually increase thereby reducing some of the leverage that financial planners presently exercise and make them more dependent on the platform providers.

Choosing a dealer group to become affiliated with will become an important decision for financial planners more than ever. With already high loyalty from the planners, dealer groups are working hard to build even stronger exit barriers by increasing the integration of their businesses with those of financial planners.

With the high barriers to entry in the software industry, the monopoly of IRESS and Macquarie will probably continue, unless a resourceful rival decides to enter the market. However, if it does not happen soon enough, financial planners are likely to be stuck with their current provider as software suppliers are also building high exit barriers for financial planners through their one-stop-shop integrated solutions.

Providers of professional education are likely to continue struggling to meet the demands of the PFP industry, given the apparent lack of availability of academic expertise in this field. This means that financial planners would need to continue addressing this deficiency by acquiring the services of the industry's consultants at a considerable cost.

Given the fact that the demand for financial planners and support staff is projected to rise, the issue of staff shortage is expected to continue for some time. While the FPA's Future Financial Planners Council's initiatives should help to solve the problem in the long term, in the short-to-medium term the solutions seem to rest with individual financial planning practices that would need to look closely at their remuneration packages, internal mentoring and training programs as well as forming alliances with providers of professional education. Given the shortage of other alternatives, it is likely that technology will be looked at closely to help in reducing the pressure created by the staff shortage issue in the PFP industry.

Buyers

Given the growing consumer awareness and the subsequent emergence of clients' bargaining power, the pressure will be on financial planners to differentiate their service offering in order to remain profitable. Clients will be increasingly looking for value and quality of advice, challenging those businesses that do not address their specific needs. Financial planners need to design the service offering that would increase the emotional switching costs for their clients as well as offering highly sophisticated services that would be difficult for clients to replicate themselves.

The industry's experts predict that a holistic, client-centred wealth management model that helps clients manage their total wealth on a consultative basis will become the dominant business model (Stackpool et al 2002). In addition, the requirement to address specific clients' needs means that those servicing the "everybody" market will be unable to design an offer that will attract everybody to their business, because advice needs are different for different client groups (Fox 2008). This implies the necessity to focus on specific niche markets comprised of individuals that are not price sensitive, usually defined as high net worth individuals. The offering to these niche groups still needs to demonstrate the value of their services, which can only be achieved after gaining an understanding of what issues a particular niche is facing and designing a tailored offer that would address these issues.

The importance of utilising technology in providing services will increase with the emergence of Generation Y clients. Addressing the intergenerational issues such as the transfer of wealth, will also become very important. In this respect financial planners should look to involving the children of their key clients in the advice process and providing a holistic service to the entire family.

While the bargaining power of clients will rise, financial planners need to develop an efficient client referral system that will facilitate using clients' power to generate new business. Because clients are best positioned to understand their needs and the services that they would like to see, creating client advisory panels should also emerge in the future. However, Chaplin (2008) warns that advisers should carefully select panel members to ensure they all share the same general concept of where the business should be heading.

Regulatory Issues

Years of legislative changes have created a tough regulatory framework for the PFP industry, leading to very high compliance costs. The recent government initiatives indicate that it is concerned with the industry's compliance burden and how it affects the affordability of advice. The government's focus is now on reducing the industry's compliance costs, but as part of a broader reform.

Because of the PFP industry's failure to self-regulate, it is unlikely to avoid further ongoing reviews and enquiries. Given the importance of the industry to Australians' retirement savings, the government will continue restructuring the industry that has arguably missed its chance to do this itself.

Predicting the way the industry will move in terms of its pricing structure is quite difficult. While discussion is sometimes focused on the issue of professionalism of the PFP industry and integrity of advice, it seems to be more about consistency of revenue streams and preserving the value of the business. In the current circumstances, a total ban on commissions is highly unlikely, given the associated issues and the government's stand in relation to these issues. It is likely that the government will eventually equalise the tax treatment of commission-based and fee-for-service pricing models. It is also probable, given the current trend, that in a few years product providers will cease paying commissions and will allow for a more transparent fee structure where the administration, management and advice costs can be clearly segregated. Despite the enhanced transparency, it is likely that product providers will continue to allow flexibility in adviser fees, so that those with cash flow issues can continue to pay for advice using their investments. It seems to be more appropriate to move towards a retainer-type pricing structure, while giving the smaller clients the option of choosing to pay by way of commissions. Any move from one billing system to another needs to be gradual with minimum disruption to the businesses and their staff. Given that consumers do not seem to care about how they pay for advice, businesses have time to transition to a new fee structure without much pressure and effect on the business' valuation and the ongoing revenue. More than anything else, the focus of financial planning practices needs to be on improving the selling skills of their advisers and sharpening the value proposition to their clients.

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