

Strategic Recommendations for The Garrett Planning Network, Inc.



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Introduction

The financial planning industry is highly fragmented. Hoovers, the online business database, estimates that there are over a thousand financial planning companies, while the Financial Planning Association claims 28,000 individual member planners in 30 countries.¹ Financial planning firms range in size from large investment banks to small sole proprietors. The industry is highly competitive, new products are easily imitated, and barriers to entry are low. Further, financial advice is a credence good, meaning the seller has expertise that only the seller knows; the buyer cannot objectively evaluate it. These forces combine to make strategy in this industry a challenge.

There is a new organization on the horizon, however, that is changing the face of the industry. Garrett Planning Network (GPN) was formed in 2000 by Sheryl Garrett and has 115 members. Members pay annual dues, much like franchisees, and receive benefits in return. GPN members charge hourly fees, they do not sell company products, and they are not engaged in asset management. In short, they sell personalized financial plans to “do-it-yourselfer” clients.

The strategic question that this paper address is: What should be Garrett Planning Network’s strategy for long term success? As an analogy, GPN is a cross between a budding AOL and a Krispy Kreme doughnut shop. They are similar to AOL in that their objective is to build a network. The more members that join their network, the larger the network effects and the more valuable it becomes. On the other hand, they are also similar to the highly successful franchise Krispy Kreme in that they sell only one specialized product, but they are competing against firms that sell a wide variety of products. Unlike HEB or Albertsons, Krispy Kreme sells only doughnuts. Unlike Schwab or Merrill Lynch, GPN sells only financial plans. We believe that GPN can be the next Krispy Kreme – America’s newest favorite source for objective, personalized financial plans.

¹ FPA 2001 Annual Report

Garrett Planning Network

Sheryl Garrett has been involved in the financial planning profession since 1987, having received her Certified Financial Planner designation in 1990. After working as a staff planner from 1987 to 1995 for local financial planning firms, then eventually as Vice President at Stepp & Garrett, Inc., a firm that specialized in high net worth clients, Garrett founded Garrett Financial Planning in 1998. Convinced that serving only affluent customers was too narrow of a focus, Garrett's true passion was in offering financial planning services to people at all income levels.

Garrett opened a small office in Shawnee, Kansas in 1998, which was designed more like a dentist's office than a financial advisor's office. Fees were by the hour and the door was open to anyone who needed advice. Clients simply made an appointment, filled out some introductory forms, visited with a financial planner for an hour or two, then paid as they left. There were no requirements in account size or investable assets and Garrett steered clear of asset management altogether.

Based on this model, Garrett attracted so much business (she currently has over 600 clients), she eventually added another CFP and a paraplanner to her staff. Even after rate increases from \$120 an hour to \$150 to \$180 today, Garrett had more business than she knew what to do with. In response, she opted to develop the Garrett Financial Planning Network. Says Garrett, "I used to get calls from all over the country from people who wanted to work with me but, for a \$500 engagement, it just wouldn't make sense for me to get registered in the state of Mississippi. I didn't have any place to refer them to."² From this demand, the GPN model was born. Garrett comments, "My network has given me a place to send people and in the 14 months since we launched a geographic locator on our Web site, we've had 16,000 hits."³

Financial planners who join the GPN must meet a certain criteria. First, they must have received their CFP designation (or be working towards it). Second, they must work on a fee-only basis. Third, they may not require account minimums or long term contracts. Fourth, they must submit their ADV

² Nancy Ophelia, "The state of financial planning: A grassroots perspective." FPA Journal, December 2002.

³ Ibid.

form, which reveals any prior convictions for investment related felonies or misdemeanors, lawsuits, or arbitration proceedings, through GPN (all ADV forms are submitted to the SEC and/or their state securities board). Finally, members pay a first year's fee of \$5,000 and an annual fee of \$1200 thereafter.

In exchange for meeting these requirements, the GPN members receive a number of benefits. First, they receive a startup kit, which includes forms, documents, videos and instructions for setting up an office that functions in the same way as Garrett's. Second, they get listed in the "find a planner" database on the network's website, from which they receive referrals. Third, they have access to an electronic message board with other members. They also receive time tracking and billing software, marketing materials and support, and access to educational courses through GPN.

GPN now numbers 115 members that range in background from divorce planning to college education planning. Their fees average about \$150 an hour and most service a unique, but very large and neglected niche in the US population: the middle income market. GPN advisers say their clients usually are not looking for someone to manage their money. On the contrary, they want to handle their own finances. Mark Barrish, a CFP and GPN member based in New Jersey says, "The individuals I see are middle or upper middle class. Their primary investment is in a 401k plan, although they often also bring in brokerage statements. They're really interested in an evaluation of their investment strategy – a second opinion."⁴ He focuses on teaching investment techniques that his clients can implement themselves.

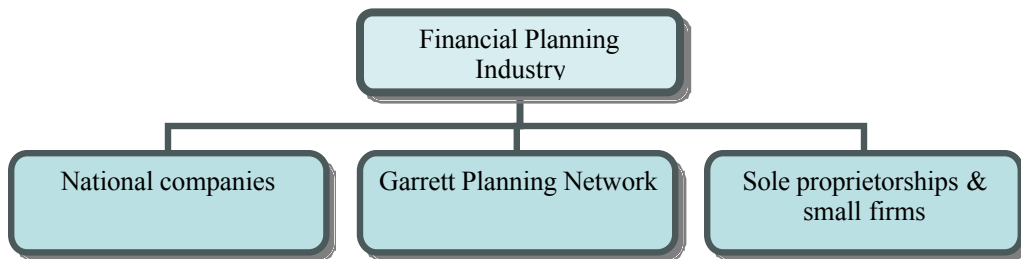
Though this model is revolutionary within the staunchly conservative financial planning industry where 80% of planners work for commissions, there are some weaknesses to this approach.⁵ Initially, planners who franchise under GPN must face small business problems and issues, including high start up costs and a lack of benefits typically provided by a large company (including office space, computer support, phone lines). There is also the challenge of acquiring new clients, especially problematic because the GPN brand is not very well known yet. Though they may be listed in the GPN database, this does not guarantee clients are knocking on their doors. Finally, while a large company may support a

⁴ Lynn Brenner, "Advice a la carte," Bloomberg Personal Finance, January 2003.

⁵ Bob Veres, "Inside Information," Volume 13, Number 2, February 2003.

new planner in earning the expensive and time-consuming Certified Financial Planner (CFP) designation, a GPN member would be entirely on his/her own.

Industry



The financial planning industry can be categorized into three basic segments, representing the choices that new financial planners face when starting their careers. National companies include the large Wall Street investment banks (Schwab), regional banks (Wachovia), tax companies (H&R Block), and mutual fund companies (Vanguard). These companies have the advantage of name brand recognition, a large sales force, and a national reach. National companies' financial planners are typically compensated through commissions and are encouraged to sell company products.

Sole proprietorships and small firms are those financial planners who “hang a shingle” outside their office and approach financial planning through their personal connections. While riskier and more demanding at the outset, owners of these firms often attain high net worth because, as owner-operators, they are in business for themselves. These firms include a mix of commission compensation, fee-based (some fees plus some commissions), and fee-only. They may include a staff of up to fifteen or simply be a “one-person” show. Typically, these small companies do not sell their own products, but rather have alliances with the national companies, whose products they recommend to their clients.

GPN is the most recent addition to the industry and differs primarily because it is a franchise business that is strictly fee-only. GPN members are owner-operators, in the sense that they are in business for themselves. However, they also receive the benefit of national recognition through a network of planners and initial start-up support.

Most financial planning firms have traditionally targeted affluent clients, ignoring other segments of the market. Nonetheless, there has been an increase in the number of semi-affluent households (defined as households with assets between \$1 million and \$10 million). These households now control between \$6-\$8 trillion in assets that can generate \$50 billion annually in recurring fees.⁶ Not surprisingly, more attention is being given to this sector. This proliferation of wealth has not been matched by a similar growth in customers' capability to manage that wealth. Therefore, semi-affluent households are beginning to seek the expertise of financial advisors.

Customers are demanding more from their financial advisors than they ever have before, largely because customers are better informed today than ever before. The proliferation of information through magazines such as *Worth*, *Kiplingers*, *Money*, *SmartMoney*; TV broadcasts such as CNBC, and CNN; and Internet online tools at Morningstar, Motley Fool and Financial Engines, have fueled consumer education. In addition, technology is commoditizing many services that were once only available through the services of financial professionals. Trades that once cost hundreds of dollars can be made online today for only a few dollars. Further, there are many tools on the internet that provide free but basic financial planning. All these trends have combined to squeeze the profits out of the industry, while, at the same time, forcing planners to add more value through their services to warrant the fees they charge.

Porter's Industry Analysis

Product

The product is the financial planning network a new CFP chooses to join. Choices include a national firm, a sole proprietorship/small firm, or a franchise.

Substitutes

Substitutes to the financial planning network are not perfect and most can only replace a part of what the network provides its members. They include: 1) Professional organizations such as the Financial

⁶ Hurley, Fuller, Kanner, Stroh, Jiede, Dowl, and Kobos. "The Future of the Financial Advisory Business and the Delivery of Advice to the Semi-Affluent Investor." *Undiscovered Managers*. September 1999.

Planning Association and the National Association of Personal Financial Advisors, 2) Books and magazines that help advisors stay educated about the financial planning industry, 3) Internet chat rooms, and 4) Other tools and software available to financial planners.

Complements

Complements include policies that cause consumers to seek out the advice of a professional planner. Examples include complex tax and accounting laws, changes in retirement plans, uncertainties involving Social Security, and major financial decisions that consumers must plan for such as buying a home, estate planning, or saving for college. Complements also include industry organizations that promote financial planning in general.

Suppliers

Suppliers are financial software companies, educational sources, IT suppliers, and even network members themselves. At best they have modest power. IT suppliers are a commodity. Network members that provide ideas to one another are too fragmented to be able to influence financial planning networks. Financial software companies and other educational sources have the most power over financial planning networks because they are such an important part of the network's value proposition. However, even they are fairly easily imitated and thus cannot demand high prices from the network.

Customers

Customers have little power. A new CFP has three options. They can either join a large organization (Vanguard, Merrill Lynch), join a franchise such as GPN, or they can start a sole proprietorship. They are fragmented and cannot demand a better arrangement.

Barriers to Entry

Barriers to entry are low. There is little capital required to start a financial planning network. Resources and educational materials are easy to plan. Chat rooms where members can exchange ideas already exist. The network's ability to draw referrals is only as strong as the brand name associated with the network. Another reputable institution can easily draw the traffic needed to result in many referrals to network members, as well.

Rivalry

Rivalry is high because CFPs have many choices in how they want to start their financial planning careers. They can join one of many large firms such as Vanguard, Schwab, Merrill Lynch, JP Morgan, they can form their own sole proprietorship, or they can join a franchise network. Regardless, all of these firms are directly affected by trends in the industry, including shrinking margins. As a result, financial planning networks must offer better services to persuade CFPs to join.

GPN Strategy

There are several strategic areas that GPN must address in order to expand its reach and enhance its brand within the financial planning industry. These include managing and growing the GPN network, differentiating from other integrated corporate financial planning companies, nurturing and understanding partnerships and complements that will make GPN more valuable, and identifying areas of cooperation available within the industry.

Network Effects

Much of the value offered to financial planners by GPN lies in its inherent network effects. One of the primary benefits of the network is the exchange of information and experience passed from member to member. For this type of network to be useful, it must be as large as possible. Metcalfe's Law states that the value of a network increases as the square of the number of users.⁷ AOL is a good example of how network effects can create a community of users and lock-in customers.

A successful network for GPN must include members that are diverse in terms of the customers they serve and their experience levels. GPN needs to attract members in all different phases of their career lifecycle, from grizzled financial planning veterans to shiny, new, "I just passed the test" CFP's. Inexperienced members will value the open interchange of financial planning wisdom culled from other experienced planners on the network. They will get more use from the training tools and start-up

⁷ Shapiro and Varian, "Information Rules," Harvard Business School Press, p. 184

materials provided by GPN, and will progress up the learning curve faster because of access to these experienced members. Because of the inherent value to experienced and new members alike, GPN should focus on recruiting people who have been in the business longer. They can effectively segment the market into experienced and inexperienced and develop products that satisfy each.

Geographic exclusivity is another network issue. Like a Krispy Kreme franchise, GPN should limit the number of members that can be active in a given location in order to limit competition between members. This is a tradeoff, as it will slow the growth of membership (and network effects), and some may be turned away once the limit is reached. Doing so, however, may add an air of scarcity to the network, raising the perceived value of the service. Problems remain, however. Who will set the limits? Does the lock-in outweigh the loss of members?

Finally, speed is important in the establishment of a strong network and the resultant network effects. First mover advantage can be the difference between being an AOL or a Prodigy. Often, the first to establish a critical mass of members and develop a community of users is the last one standing.

Differentiation

In order to be successful over the long-term, GPN must differentiate itself from other corporate financial networks. Its main point of differentiation is that members charge fees by the hour and do not collect commissions. This movement, although still small, is gaining momentum in the financial planning industry. Ethics serves as the primary driving force, as there is little opportunity for conflicts of interest in a fee-only arrangement. Fee-only does not eliminate the risk of ethical lapses entirely, but it does reinforce the trust element in financial planning which defines it as a credence good.

There are two potential disadvantages for GPN to rely exclusively on hourly fees. While a fee-only structure may attract customers that were previously uncomfortable with commissions, it could dissuade financial planners that like a commission based structure and desire to profit from it. In addition, if in the future fee-only becomes the norm, GPN will need to prepare for the loss of that as a

point of differentiation. It will then need to rely on the strength of their products and the quality and usefulness of their network community to build barriers to entry.

Besides the well publicized fee-only position taken by GPN, other aspects of the business serve to differentiate it from competitors. First, GPN enables its members to offer personalized, one-on-one service to customers that may be lacking in large corporate firms. Because it is fee-only, all customers are treated as equal, regardless of financial situation. This personal service translates into customer loyalty, where clients return not only for annual “check-ups,” but to inquire about specific purchases throughout the year.

Second, GPN offers financial planners the support of a network of colleagues without the requirement to invest in a limited number of financial instruments, as is common amongst the national firms. GPN planners can choose the best performing instrument for a given investor, not simply the instruments available in the corporate portfolio (i.e. only Vanguard mutual funds).

Third, for those financial planners that are more entrepreneurial but that desire some name-brand recognition, GPN offers a good alternative to the national corporate financial planning companies. Members are their own bosses, are free to set their own rates, better manage their own income, and choose their clients based on their own criteria.

Finally, as we mentioned above, the network itself can serve as a point of differentiation once the network provides benefits that a large corporate planning department cannot.

Partnerships

GPN can further their network and better differentiate themselves by partnerships. One efficient way of reaching new members would be through alliances with universities, specifically those that have dedicated CFP programs like Northeastern University⁸ and the University of South Carolina⁹. In those universities that do not have dedicated programs, GPN can lobby for programs and advise University

⁸ http://www.ace.neu.edu/programs/typ_cert_cfp.cfm

⁹ <http://www.uscdmc.sc.edu/cfp.asp>

officials about the benefits of such programs. GPN can offer scholarships to senior CFP students to build loyalty early and generate goodwill in the upcoming class. GPN can offer discounted student membership prices that would encourage young college students to learn about the network early in their careers and advise them of the GPN alternative to corporate careers. GPN members could be encouraged to provide CFP seminars to students to give them an introduction to financial planning.

A second way to strengthen GPN's overall product is to partner with industry renowned Bob Veres, who authors an online information service for financial planners. "With *Inside Information*, financial planning journalist Bob Veres has built a must read newsletter that's become the talk of the financial planning community," says Ellen Uzelak in Profiles in Success.¹⁰ Veres' content is highly respected by the most experienced financial planners, so adding his service as a part of the GPN benefits would greatly increase the attractiveness of the network. Veres could be inclined to the partnership by gaining a greater audience through the GPN network.

Cooperation

Cooperation in this industry is possible through financial planning associations. The Financial Planning Association itself is a voice for the entire industry, and collectively "promotes the legislative, regulatory and professional interests of the financial services industry before Congress, the 50 state legislatures, and federal and state regulators."¹¹ While this association provides a venue for cooperation among all industry players, the National Association of Financial Planning Advisors (NAFPA) advocates on behalf of fee-only CFP's. NAFPA offers "a chance to be a part of a collective voice for fee-only planners everywhere."¹² Thus, the fee-only segment cooperates against the commission-based practitioners to evangelize the fee-only message.

Offensive Measures

¹⁰ http://www.researchmag.com/articles/pdf/rh02_10.pdf

¹¹ http://www.fpanet.org/member/govt_relation/index.cfm

¹² <http://www.napfa.com/>

In the interest of attracting customers away from large, corporate commission-based financial planners, GPN can engage in lobbying efforts to promote fee-only and full disclosure of commissions. These large corporate firms use transaction based commission pricing, which encourages “churn and burn,” and can hide the true cost of the portfolio services provided. Full disclosure would reveal exactly how much the commissions cost customers.

Competitive Response

If GPN institutes some of these strategic recommendations and the most talented CFPs begin leaving other networks for GPN, it should prepare for a competitive response from its rivals. Fortunately, only the national firms would have the resources to collectively challenge GPN. Unfortunately, however, they could easily respond to GPN’s expansion in the industry by simply duplicating its services or marketing strategies. For example, they could begin offering fee-only services for financial advising yet still earn commissions on their financial instruments. They might also have an advantage over GPN in persuading CFP schools to partner with them if they have strong brands such as American Express. Further, they could dissuade CFP candidates from joining GPN by emphasizing its relative youth in the industry and its lack of brand name recognition amongst the general public. And finally, their deep financial resources would allow them to make large bets on a wide variety of tools, educational resources, and other services that consumers and CFPs might be interested in, as compared to the smaller, relatively few partnerships GPN will have access to. In response, GPN must invest in the growth of its network and begin to build other barriers to entry through partnerships (with Bob Veres) and lobbying efforts (to promote full disclosure of commissions).

Conclusion

In conclusion, GPN has the potential to become the AOL and Krispy Kreme of the financial planning industry if it expands its network and partners with other well-respected organizations. Only then will GPN be able to leverage its system into a valuable, not easily imitated, resource. Further, as

consumers become more educated about their financial resources and realize the advantage of employing non-biased fee-only financial advisors, demand will fuel growth amongst the specialized planners who comprise the GPN network. With the dual addition of brand recognition and an incentive structure for owner-operators, GPN can easily become the dominant of the three networks from which CFPs can choose.