MANAGING YOUR PRACTICE: A DIMENSIONAL PODCAST SERIES

Keeping an Eye on the Bottom Line: How Your P&L Statement Can Help Guide Your Business Decisions

Catherine Williams: Hi, everyone, thank you for joining us today. Effectively, managing your business financials is critical to understanding the current health of your business, as well as planning for where you see yourself in the future. We capture income statement data from the hundreds of advisors globally who participate in our study each year. And we see some pretty consistent metrics and approaches to the financials for top quartile firms. They regularly demonstrate strong operating profit. They're managing their debt, including paying off retiring owners or financing an acquisition. And their owners comp is in line with the business. But none of this happens by accident, and often advisors miss some of the signs that their financials may have issues. So how do you manage this and maintain a healthy income statement, a healthy balance sheet in your organization? To help me with this discussion today, and we're probably going to talk about a few additional items, it's my pleasure to welcome and introduce the founder and CEO of The Ensemble Practice, Philip Palaveev. Philip, thanks for joining us today.

Phillip Palaveev: Thank you so much, Catherine, and thank you for the invitation to be part of this discussion and obviously a fascinating discussion with some very, very important questions that essentially every business owner needs to be able to answer.

Catherine Williams: Agreed, let's get into it. I'd love to even just start with the question of why is it important?

Phillip Palaveev: It's kind of the way my brain works is always in terms of analogies and comparing one thing to another, but in many ways, looking at the P&L, we're looking at the financial statements of a business is like looking at the dashboard of a car. Of course, you can drive a car and ignore the dashboard. But if you were to do that, you're risking, first of all, driving and running out of gas and not even realizing you've run out of gas. And the same can happen to a business. A business needs capital. The capital is the gas, and that capital needs to be replenished periodically. Profitability insurance that you have ensures that you have enough capital to continue operating, that you can continue getting the resources that are necessary for the operation of the business. And, of course, all the services you deliver to clients that you can hire and compensate the people that you need, that you can also hire and compensate yourself as a business owner. So you got to keep looking at the dashboard, asking yourself the question, are we running out of gas? Do we have enough capital? Are we replenishing the resource? And that's the function of profitability. Actually, profitability, very importantly to a business owner, is the return on investment.

Phillip Palaveev: It's the compensation for the risk you've taken. And it's also the capital that you need in order to continue doing what you love to do. So profitability is essential and the P&L tells you if you're profitable or not. And very importantly, when we look at the dashboard, much like when we look at a P&L, we should not only be looking at are we running out of gas. There are a lot of lights on the dashboard of a modern car and they are all very important. And the same is true for the P&L. There are a lot of other red lights that we should keep an eye on. Do we have perhaps too many clients, given the number of people that we have? Are we perhaps trying to do too much for the clients that we already have? Are we working with the right clients? Is everyone productive to their optimal capacity? What is our capacity? All of those are very important questions in business that that should be answered by a good look at the P&L.

Catherine Williams: Talk a little bit more about that productivity piece and what about the P&L, what about that income statement could illuminate how you're looking? I mean, certainly there's profitability that it's easy enough to look at relative to operating profit and some of those other metrics. When you think about productivity, what stands out for you as you look at that?

Phillip Palaveev: And I was going to say it's very tempting for business owners to assume that they know exactly what's going on. I mean, you walk into the office every single day. I know I do. And you can observe most of the activities in the office. I know I do. And you kind of walk away in the evening and think, OK, I know what's going on. I can see the emails. I can see the people, I can see the computer screens. I can see the chairs. I can see the conference room. So I have this intuitive understanding of how well the business is functioning. And I have this notion of are we successful? Are we not? Unfortunately, though, is very often sometimes to miss things that are obvious or to overlook things that perhaps should be obvious but are not. And I believe the P&L, together with other financial statements and again, I want to emphasize the P&L is not the only financial statement. The P&L and financial insight can actually help us overcome some of these blind spots that we sometimes have. And I've been a business owner for the last 12 years, actually 13 years now. And I can appreciate that there have been times when I thought the business was doing better than it actually was. There were times when I didn't quite see a problem coming, but it came. And I believe the P&L can be not just the scoreboard of are we doing well, but it can also be an early detection system. When it comes to productivity, there's at least one number particularly that catches my attention, and that's the revenue per staff. If we were to take the entire revenue of the practice, the entire business divided by the total number of people that we have, including yourself as a business owner, assuming, you know, our listeners are mostly business owners, then that number of revenue per staff will give you a very good sense of where is our capacity relative to our own historical performance and relative to other firms in our own industry.

Phillip Palaveev: And again, notice there are two sources of benchmark. One source of benchmark always is how have we done this in the past? Are we doing better than we have in the past? Are we doing worse than we have in the past? The second source of benchmark is what about others? What about all the other firms that are about the same size that we are, that are pursuing the same clients that we are, that are delivering services similar to what we do? Are we performing as well as they are? And both benchmarks can tell us quite a bit. The historical comparison can tell us if our capacity is being depleted or if we have more than we have in the past. The external benchmark will tell us that if we're using people at about the same level of productivity as others are. So your revenue per staff will give you a very good idea of do we have enough people given the levels of revenue that we generate? And then if we see that number going very high, that would suggest that, hey, we are probably very profitable, but are we perhaps running out of capacity? Should we start hiring people. Obviously, if the numbers running low, that will be an indication that we have quite a few people now we need to get the revenue to the same level.

Catherine Williams: I think that's one reason why in our Global Advisors study that revenue per full time employee metric is one that everyone sort of automatically goes to and to your point drives conversation around productivity, profitability as well as capacity. Is that number too high? Is it too low? How does it look alongside your peer group? So I absolutely hear you on that and we've seen that number. I'm curious if you've seen it kind of sit at a certain in a certain space or at a certain level, if you will, for a number of years. We have within our study. Has it been a fairly, as you look at a sort of across the industry or across certain firms of certain sizes, do you see a fairly consistent number?

Phillip Palaveev: Probably a couple of very notable trends, the first one is, generally speaking, large firms tend to have significantly higher levels of productivity than smaller firms. If you look at the statistical averages across the industry, the largest firms in the industry have more than three times the productivity of smaller firms. There's a reason for that. The largest firms tend to have the largest clients. The correlation between the size of the firm and the size of the client relationships is staggeringly consistent. If you actually do correlation analysis, the correlation between the size of the firm and the size of the client is 96 percent. The larger you are, the larger the clients you work with. It is relatively unusual, not impossible, but relatively unusual to find a small practice working with very large client relationships. The larger the clients, the more productive the firm. Generally speaking, of course, some of these things are overgeneralization, but if you're working with $20,000 average client relationships, you're probably at least twice as productive than a firm working with $10,000 client relationships and probably at least three times as productive as a firm working with $5,000 client relationships. So the larger the client relationships are — up to a point, up to a point, I want to make that point clear – the more productive the firm. So a large firm may see productivity numbers such as four to 500,000 in revenue per staff. A smaller firm may see these numbers as low as 250,000 or so. So it's important to compare yourself to firms of the same size. Over time, the productivity metrics have improved some, but not dramatically. Technology promised to give us more productivity, but somehow that didn't quite materialize. What has happened that over time, just the quality of client relationships across the entire industry has actually continued to improve. The average size of a client relationship continues to grow. And as a result of that, we have seen improvement in productivity more so than somehow operational efficiency, technology or scalability, creating better numbers. As a matter of fact, to be honest, I think we're in an industry that is very fortunate to be very profitable and successful, but not particularly easily scalable. We can always create a very profitable $5 million business, but it's not easy to scale that into a $50 billion business. Actually, it's incredibly difficult. So we got to keep that in mind that productivity has to be put in context. Some of the better numbers may belong to firms that just simply work with better clients, not necessarily that they're using a better process.

Catherine Williams: I think that's really interesting because the instinct when you think about those numbers and you think about the edge of that larger firms have around that revenue per full time employee, I think your instinct would be to assume, OK, well, clearly they've got great technology deployed. They've got workflow processes. I mean, they are leveraging and creating scale in a way that smaller firms can’t. And that's how you get to that number. But I think maybe to your point, one area on the income statements that we've gathered year over year in our Global Advisors study around that spend on technology as a percentage of revenue, it's actually been very consistent across faster growing firms, smaller, slow growing firms, big firms, small firms like that percentage is actually kind of the same. Now, we certainly see some differences in how they spend some of those tech dollars. But maybe I think that maybe supports your point that they're not necessarily doing something magical on the technology side or the workflow side that gets them to that scale, gets them to those metrics.

Phillip Palaveev: Yeah, it's I mean, it's a very interesting, fascinating conversation, I wouldn't propose to have the answers, but I do have a hypothesis and I can't help myself but remember kind of an old story from the Soviet days. Apparently NASA, the National Space Agency, spent millions and millions of dollars of developing what's known as the space pen. And the space pen is necessary because our ballpoint pens don't work in the absence of gravity, we need gravity in order for the ink to flow. So in the absence of gravity, NASA had to spend quite a bit of money developing the space pen that actually works in space. The Russians, in the meantime, just use the pencil. So actually, the story is longer than that. But it's simpler this way. That very often in advice, you can just use a pencil. If you look at the largest firms in the industry and you look at some of the smaller counterparts, they're essentially using a very similar technology and they're deploying that technology in very similar ways very often. I don't necessarily believe the technology somehow, dramatically and drastically is going to alter the economics of the business, at least not until somehow we fundamentally change the client relationships and the ways in which client relationships clients interact with the advisory firm.

To be honest, I'm a little skeptical of scalability because scalability very often destroys relationships. Scale and relationships are opposed to each other's concept. Things that are scalable are not necessarily closer, more intimate, more emotional, more empathetically connected. Frequently, I would say, look, you know, if you look at restaurants, the most scalable restaurants are chain restaurants. That's McDonald's and Burger Kings and Domino's Pizza, that they are scalable. I don't mean to disrespect those brands. They're quite delicious. But very few people take their spouse on their anniversary to one of those chain restaurants. We usually would seek a more intimate setting. You know, everybody kind of wants to go to the place where the bar "Cheers" where everybody knows your name. Most advisory firms, particularly independent advisory firms, as the concepts were created to be bar “Cheers" -- that's their competitive advantage, that everybody knows your name. They pay a lot of individualized, personalized attention to you. They really respond to your individual needs. All of that suggests not scale. In return for destroying our scale, we get incredible retention of clients. We have 98, 99 percent client retention. That's not true for actually the scalable business models. The things that are scalable also very easily replaceable. And in return for sacrificing scale, we also get profitability. Unfortunately, things that are very scalable very quickly become price competitive. Manufacturing being a great example of that. Manufacturing is very scalable, which means that it also competes on price extremely fiercely. Independent financial advisory firms typically forego scale to create intimacy, to create client retention, to create depth, to create ongoing dialogue. That's the reason why advisory firms talk about multigenerational clients versus an annual subscription. Kind of a long-winded speech that really means to say that, look, economies of scale are going to be relatively limited in our business. But there are other tools for managing the P&L to continue generating profitability and return on equity, because to me, those are the key concepts. As long as you're profitable and as long as you generate the necessary return on equity, how you get there is more of a secondary question. It's a question of strategy. It's a question of approach. It's a question of methodology. But if you can create the necessary profitability, a return on equity, then you're doing well and you should probably continue doing what you’re doing.

Catherine Williams: So with that, let's talk about operating profit, profit margin maybe is a better way to say that, but is there a threshold? Is there a target? What do you see that sort of delineates those that might be operating in the healthy space versus unhealthy?

Phillip Palaveev: The rule of thumb has always been 25 percent or higher after fair compensation to the owners of the business, which is a very important statement, but after fair compensation to the owners, 25 percent profit margin or higher has been kind of always the rule of thumb for advisory organizations. Now, on the upper end of that spectrum, I mean, I have observed over the years organizations that have more than 50 percent profit margins. It is possible. However, I would probably say that, look, once your operating profit exceeds 35 percent, there's a reason to start scratching your head and wondering, are we underinvesting in people, are we hiring enough or are we doing enough? Are we missing something? Now, that doesn't mean that you are, but that's when you start asking the questions. We also got to recognize some aspects of our business are very scalable. As much as I said no scale. Well, there is scale. The biggest source of economies of scale typically is the investment management division or investment department. If you are actually in the business of managing assets for advisory and non-advisory clients, you may see some very significant economies of scale. Mutual funds and investment management companies achieve great economies of scale when they can attract high levels of assets. So if you take a firm that has a very sizable investment management component, you may see higher profit margins, but you also see perhaps higher volatility of revenue. If you take a firm that doesn't do any investment management, only focuses on wealth management, advisory relationships, outsources investment management, then generally speaking, you see a firm like that operate between 25 and 35 percent profit margin.

Catherine Williams: Are there times when it can make sense to go below that threshold, certain activity occurring in the business that warrants at least a temporary hit to that profit margin?

Phillip Palaveev: Possibly, possibly, but we've got to go back to, what's a healthy business. So a healthy business, first of all, provides clients with everything they need and everything they deserve. That means that the business is able to procure all the resources necessary to provide that service to clients. So it's not healthy to operate a business where you can't hire the people the clients need to have in front of them. It's not healthy to operate a business that can't afford to buy the technology that's necessary to generate the right outcome. So long term, you've got to have enough profit to buy the stuff you need, in order to deliver the stuff that your clients need. The same is also true for a healthy business needs to reward the owners so that they want to and choose to continue to be owners. Because owners have to sign the lease, owners have to register with the state, the owners have to pay the taxes. Owners have to be an employer. Owners have to meet with regulators. Owners have to respond to all of the risks of the business, including downturns, such as what we just observed about a year ago. So you've got to reward the owners for being owners. Otherwise, at some point the owners will stop being interested in being owners.

Phillip Palaveev: So to generate sufficient return on equity, that's why you need the 25 percent profit margin. The return on equity is meant to be a long-term concept. So for a period of time, if the business needs significant amount of investment that will pay off in the future, it's OK to go to a lower level of profitability because somewhere in the future we are going to experience higher level of profitability. But you've got to be very, very careful. Are we investing in the future or are we just committing a mistake that perhaps we'll continue committing for many years to come?

Catherine Williams: One area that that comes to mind that I'd love for you to talk about is this area of owner's compensation. How does it show up? How can it be a potential challenge within the financials and that what does it look like when it's right sized or balanced out?

Phillip Palaveev: Yeah, I mean, probably we need to kind of very quickly go over owner compensation and what we mean by compensation. So let's clean up our terminology a little bit. If I'm an owner of a business, that I happen to be, first of all, I derive income from that business. I want to emphasize the word income. Income is what I take home. Income is what shows up on my K-1 or some on my tax return, some combination of tax forms. So income is what the total amount of money I generate for being involved in this thing. This thing being my practice. Now I can probably, and I should probably split my income into at least two sources. One source of income is my job, because I am the CEO of The Ensemble Practice, which happens to be a job. It's a real job. I actually have to do stuff and that job occupies my time, my attention, my energy, whatever talent I have. Not a lot, but some, you know, everything that I put into it. Theoretically, this business that I'm part of could be owned by somebody else. I mean, there were parts of my personal history as a consultant when I actually worked for a company. I worked for Moss Adams, and Moss Adams paid me a salary in return for my efforts. The same is true for owning a business. As a business, you're a business owner, you're still a quasi-employee. And as an employee, you need to be compensated for your effort, just like you would have been in the open market. And that's the important part, just like you would have been if you work for somebody else.

Catherine Williams: Mm-hmm.

Phillip Palaveev: So the job that you're doing as an owner is worth something. How much? Well open one of the many excellent compensation surveys and they will tell you what's the compensation to someone who is employed to be an adviser, who is employed to be a CEO, who is employed to be a chief operating officer, or any of those titles. Then the second part of your income is going to be not compensation, but the return on equity. That's, quote unquote, your dividend for being invested in the business. So let's say for the sake of argument, let's say I generate 400,000 in personal pre-tax income. Let's say for the sake of argument that someone in my position would normally be paid 200,000 in compensation. That's the job that I do. The other 200,000 in compensation would be the dividend that I generate as an owner of The Ensemble Practice. So it will be one, return on labor, and one, return on investments.

Catherine Williams: Mm-hmm.

Phillip Palaveev: Now, if you are a one and only owner of the business, perhaps this entire calculation is not particularly relevant. Does it matter if you have a $50 bill in your left pocket or a right pocket? You can move money from left to right pocket. It's still your money. Doesn't matter that much. But the moment you have a partner, it becomes actually very important what pocket the money is coming from. Imagine, Catherine, before I was the only owner, I was taking home 400,000, 200,000 in compensation, 200,000 in profit. Imagine for a moment you became my partner and somehow now you own, let's say, 60 percent of the business. Notice that as a 60 percent owner, you own 60 percent of the profits. To calculate profits, we need to pay me first. If we say capturing your 60 percent owner of 400,000, which is my income, that means that my personal pre-tax income now is only 140,000. In other words, I just sold you a portion of my job and jobs should not be bought and sold. Jobs belong to the person that is actually doing the work. So really, the new owner, if you were to come in and be a 60 percent owner, you will participate in 60 percent of the 200,000 in profits, not the 400,000 in income. And that's why the moment you have even one partner, it really becomes important to benchmark your compensation as an employee of the business and make sure it's right, because it affects your profit and your profit affects your partner..

Catherine Williams: You know, this area, this conversation comes up a lot with advisors we talk with who are contemplating stepping into the M&A space of some kind. To your point, they're a single owner right now, they're looking to perhaps merge or maybe in some cases be the seller to an acquirer. And often that's where this conversation comes home to roost. So what are you seeing? Is this an area that firms are figuring out that as you are looking at a potential acquisition, what are some of the areas that you would say pay really close attention to on this if you are looking at growing through this process of taking on a partner or merging with another firm?

Phillip Palaveev: There's a tendency once again, if you have a partner, you're already keenly aware of these dynamics and you're probably working on these dynamics quite a bit. If you have 20 partners, you probably are extremely aware of these dynamics and you've worked on it for quite some time. So the largest firms in the industry have already figured this out and they figured it out a long time ago. They continue to spend a lot of time and attention making sure that they pay their partners and their owners properly so that they can actually allow for their investors to generate the necessary return on equity. And frequently, large firms also have institutional investors that are really keenly focused on making sure the profit is right. Unfortunately, the smaller firms that are transitioning from one owner to two owners or being sold to a new owner at times can be a little oblivious to it and between you and me because obviously nobody else can hear us, right? It's not like this is being recorded.

Catherine Williams: Exactly.

Phillip Palaveev: Individual books of business appear to be overpriced from that perspective, you hear multiples of revenue that are approaching a level that suggests to me that someone's selling their job. They're not just selling the transferrable profitability that our book of business generates. They're actually selling their job. If you think about it, if, let's say, normal profitability is around 25 percent. Right. That means that let's say a multiple of eight times profit, EBITDA, is the same as two times revenue. Right, mathematically two times revenue. Two times 25 percent times eight equals the same numbers. Right. So if we hear multiples of EBITDA about eight times, that suggests about two times revenue. That's the equivalent. However, in the individual books of business market, quote unquote market, because it's kind of an interesting market. It's not unusual to hear multiples as high as three times revenue, which if normal profit is 25 percent, that will suggest multiples of EBITDA of 12 times. That's a multiple that even the largest firms will be dreaming of in some scenarios. And that seems to be accessible to the smallest of books of business, which should be the exact opposite, to be honest. Some of these multiples, first of all, some of these multiples kind of look and smell like smoke and mirrors. Are just some numbers being made to look better than they really are? But some of those numbers also would suggest to me that some people successfully are selling their job, and that means that somebody is buying a job and they probably shouldn't. But that's for them to determine. In economics, I think they call that the winner's curse. And it's the tendency in a competitive bidding auction for the winner of that auction to overpay.

Catherine Williams: What are the repercussions of that, do you think, in your opinion?

Phillip Palaveev: I think what happens in business is if you overpay for a business, then that depresses the future return on equity for quite some time. Obviously, everything you acquire becomes part of your equity. And if you spend too much acquiring your equity, then your return on equity in the future will perhaps be depressed.

Catherine Williams: I'd love to talk for just a moment around G2, again, another area that that we're having lots of conversations, seeing a lot of interest, some activity, this idea of getting equity into the hands of G2 for purposes of ultimately succeeding the business to them. So when you do think about it. If G2’s listening now, right, what would you say to them relative to assessing the financials of the business that they're being asked to write a check into or potentially take over at some point down the road? What would be some key areas you'd think you'd want them to pay attention to?

Phillip Palaveev: First of all, understand very well what you’re buying. Meaning, please obtain the financial statements, please examine them carefully, please obtain a copy of the ownership agreement, shareholder agreement, operating agreement. Please understand and read it carefully. Please be very familiar with the strategy of the business and all the sort of the obvious questions about vision for the future of clients being served, competitiveness, pricing and so on. In other words, treat this as an investor. These are people who are incredibly highly educated on how to evaluate an investment. Don't forget that education just because it's a privately owned stock doesn't mean that the rules, the same rules don't apply that were part of your CFA or CFP course. Because take a look at the historical profitability, take a look at the ratios, ask the obvious questions about how this business will perform in the future. As you evaluate that investment now, you know, you kind of have to be clear with yourself as a G2. You know, it's easy to discuss risk return relationship when it's in a spreadsheet. It's very difficult to experience risk return relationship when you actually have to put your own money into the business.

Catherine Williams: Mm-hmm.

Phillip Palaveev: If you're buying shares into a privately owned business, you have to realize you are taking a risk and no one can inoculate you from that risk. It's not unusual for me to hear questions such as, well, what happens to our business when we have a recession? When the answer is, what do you think happens? I mean, you are a financial advisor. Why would you even ask that question? You should know this. We know what happens and that's the risk. But that's why we need 25 percent profit margin, because when the times are not as good, we are going to use that profit margin to serve as a buffer against recessions, declines of revenue and so on. If we have a 10 percent profit margin in good times, we are going to have losses when times are not so good. The second part of this is also think like an entrepreneur. If you see shortcomings in a business, you can certainly criticize them. But also take a look at can I actually fix these things almost like, you know, think as a construction guy looking at a house going like, OK, if I buy this, he has some issues, but can I actually fix them and make this into a wonderful place? And if you can, that's when you're going to create your wealth. That's when you're going to create even better return on investment, even better return on equity. So kind of have a problem solving approach, not just a critical approach At the same time, though, I think owners, founders have to be realistic about the value of the business. It's a question of affordability, but it's also a question of existence. An advisory business only exists as long as it has clients and it has advisors. And by the way, if we lose the advisors, we're going to lose the clients. In order to have advisors, we need to compensate them well for the work that they do and we need to provide them with opportunity. If we have a business that has trouble retaining the talented advisors that service our clients, we're not going to do well. And in our industry, the best advisors are seeking to be owners of the business. They're seeking to participate in the value of the business that they create. So if the expectation in most firms is to be an owner and to be a partner, and if you're the one of the few businesses that does not offer that opportunity, you may find it harder to retain people. I would much rather sell five percent of my business at a steeply discounted value to my best partners, so that they can continue to be involved in that business, so that I can continue turning around and perhaps selling the rest of the equity to my investors at a much higher valuation than to tell my partners, no, you cannot be an owner because the price is too high and then watch them walk away. I almost suggest, you know, let's say roughly half of the equity of an advisory business sort of belongs to the best contributors to that business—advisors, operation managers, technology people, the best sort of the best players on the team. And if we carve out half of the equity and say that really belongs to the best players on the team and that equity needs to be transacted at levels that allows them to actually purchase it and benefit from the return on investment, then I think we can turn around and say, well, the other half of the equity could belong to pure investors. They're perhaps not involved in the business. And those pure investors perhaps will pay higher rates because they don't have to come to the office. They don't have to roll up their sleeves. Their return on equity is still going to be very high and they're still going to reach their targets. But they don't actually have to sit in client meetings. If you almost think of it as two classes of shares that you have to work your class of shares being worth something and then you don't have to work here, we'll just send you the money class of shares. That's probably worth a little bit more. And to be honest, that's the capital structure that we're seeing over time become somewhat standard, especially amongst the large firms. Something like 40 percent of the largest firms in the industry these days have some equity participation from institutional investors. I think that's very much becoming the norm.

Catherine Williams: It's what we're seeing as well, too, it's interesting to watch that evolution over the last even three to five years.

Phillip Palaveev: Now, when I say half and half, I mean, it could be 60/40, but some amount of equity has to be available for the best players in the team. And I think if you do that, then you allow for the possibility for external investors who, of course, are also very beneficial and very instrumental in the growth and success of the firm.

Catherine Williams: And we certainly have seen a correlation in our global advisor study between with firms who have not just transitioned equity from G1 to G2, but really have a purposeful, multigenerational view on that and are actively pushing equity into the hands of the broader organization. And those firms tend to be in that higher growth, higher revenue quartile with our study, whether there's actually a straight-line correlation between the two, not sure. But we do see those both in play very much.

Phillip Palaveev: You can't really be a large firm without very thoughtfully and deliberately approaching the issue of continuity succession, and actually I'm going to borrow a term that I've heard mostly from Tim Kochis, the notion of a permanent firm. Tim Kochis, founder and former CEO of Aspiriant, Rob Francis very eloquently also speaks on the same issue. They talk about Aspiriant being a permanent firm, meaning that they will always be there to provide clients with the service that they expect and they need and they deserve. And in order to do that, they will take the steps necessary to secure the talent, participation and collaboration of the partners and advisors that they need. That's kind of the necessary approach is to think of the firm as a permanent resource. And in order for the firm to be a permanent resource, it has to actually think about what happens with equity, what happens with the best people we have. And it's actually not a surprise that some of the more active acquirers in the marketplace are spending enormous time and attention actually exactly on developing the next generation.

Catherine Williams: Really embracing it, yeah.

Phillip Palaveev: It's not just give them equity, it's actually give them equity, but also teach them how to be good business owners and managers and leaders in the business, I, I keep saying that I can give my car to my kids, but before I do that, I need to teach them how to drive. Otherwise they just going to hurt themselves. And the same is true for being a business owner. If you're going to give someone a share of the business, particularly if they're going to operate that business, they've got to know what they're doing. They've got to know how to drive the car.

Catherine Williams: Well, I think as evidenced by our conversation today, and you mentioned this earlier, it's not just looking at that P&L, it's not just thinking only about how profitable are we, but really recognizing there are multiple factors that will either lend toward a healthy, vibrant organization or could detract from it, whether it's the people, the clients, the talent you have, how you're handling equity and compensation. So thank you for that. And I think it would sort of be easy if there was just one place to look within a business and then you could make that determination around, are you healthy or not? But I think as we've talked about, it really does. There's lots of different areas that you have to hit on in order to really achieve that.

Phillip Palaveev: You know, there's a lot to be said and perhaps in an entire different conversation about advisory businesses taking on debt in order to tackle equity transactions and some of these succession questions. We have mostly focused on the P&L, but I kept repeating that there are financial statements. Most of all, a balance sheet. And the balance sheet of an advisory firm can be very straightforward with no debt at all. But more and more advisory firms are actually taking on more complicated, complex capital structures. Many organizations are actually borrowing capital either to invest in growth or to retire founders or some combination thereof. In some of the capital may come from private equity. It may come from equity transactions. Some of the capital may be borrowed. You may be utilizing both. There's some very interesting conversations to be had around, how much can you borrow? How much of your cash flow? There's another financial statement, your statement of cash flows. How much of your cash flow can you actually use for succession versus operating the business? How much of the cash flow can be taken out of the business versus how much needs to remain? We can have another hour. Just talking about balance sheet.

Catherine Williams: We could and we probably should, because I agree with you and I think it's an area that, as you said, many firms are contemplating taking on debt in order to pay out G1 or make an acquisition, whatever it can be. It obviously is, you know, a number of different reasons why they're looking at that. And then what kind of debt do you take on? What's the form of that debt? And then certainly how much should you take and what we could easily do a whole other hour on that. But it's an important component and it's worth mentioning.

Catherine Williams: Well, Philip, thank you so much for joining us today, and I want to remind our audience, let our audience know that they can certainly connect with you via LinkedIn. I absolutely recommend that anyone listening today checks out The Ensemble Practice, your first book, your second book "G2: Building the Next Generation" in terms of what it really means to build a vibrant, healthy ensemble business. So great, great books to check out for those of you that are interested. And then, as you've mentioned, that the G2 leadership program, seven years in with that. I know I have a team member going through the program right now. It's incredibly valuable to learning, really, what does it take to operate in in the advisory business today. And so really a powerful program there. But, Philip, thank you so much for your time today and for it as well, for our audience to find out more information about Dimensional and how we work with advisors and investment professionals, you can check us out on Dimensional.com and we will catch you next time.

Phillip Palaveev: Thank you so much, Catherine. Always a pleasure.

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