

Second Opinion Creating the Virtual Financial Planning Firm Part 1 of 2



By **DAVID J. DRUCKER**

Fifteen years ago, there was no blueprint for the fee-only financial planning firm. Today there is a paradigm, or standard, and it's "Bigger is Better." As fee-only planners, we've found success by working hard and being members of a national organization that has brought us, and fee-only planning, very favorable press coverage. This has led to the growth of our firms, and growth is intoxicating.

The Bigger is Better standard

comes into play in how we handle the growth. And it's intertwined with the financial planning press' concept of value. Valuation gurus tell us that we must wean our clients from ourselves, the principals, and have them rely instead on our staffs. And because Bigger is Better, we shouldn't be shy about hiring staff. In fact, our success and growth might enable us to create a one-stop financial services firm that employs not only financial plan-

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ners, but CPAs and attorneys, as well.

But don't forget, the concept of value we are now urged to adopt requires that we create surplus cash flow. When we've achieved all of the above, we can sell our firms and retire. The measure of success is when you, the principal, are no longer doing financial planning.

And what's more, if you don't buy this line of thinking, remember that Merrill Lynch is breathing down your neck. Its thousands of Associate CFPs will be taking away your clients unless you have a larger presence in the marketplace. Sure, you're never going to be the size of Merrill Lynch, but the bigger you are, the better you will withstand its invasion of your market.

I have a problem with this scenario. Several problems, actually. First, I see the Peter Principle alive and well in the fee-only community. For those who have forgotten, the Peter Principle states that we eventually rise to our level of incompetence. It was originally applied to a bureaucratic situation in which a technical specialist rises to a middle management position because he/she demonstrates excellence at a technical specialty. Unfortunately, this has nothing to do with managerial skills, so this promotion is the last one he/she is likely to get.

Don't we do the same thing to ourselves? We start out acquiring the skills necessary to be good financial planners and, with success and growth, wind up with a host of managerial responsibilities that we are ill-trained to perform success-

fully. We have promoted ourselves into our new management positions. Peer pressure and the financial press have egged us on. Sure,

we can acquire the managerial skills we need, but, for many, this struggle will be the Rubik's Cube from which there are no further "promotions."

The second problem I see is personnel. As I said in a talk last year, trying to establish a de-

pendable team of employees is like building a pyramid out of marbles. Just when you think it's stable, one slips away and, in the smaller firm, that's all that's necessary to unhinge the whole operation, at least temporarily.

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"I see the Peter Principle alive and well in the fee-only community."

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- Emphasizing NAPFA members' roles as fiduciaries;
- Educating the public about the financial planning process.

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Why do we have so much trouble retaining good employees? First, we're in an entrepreneurial business. We're all individualists, and the people we hire often are, too. Once they reach a certain level of competence and confidence, they judge themselves ready to do it their way. They are destined to start their own planning firms whether we like it or not. And this

was true from the day we hired them.

Second, it is difficult to retain employees in a popular field such as financial planning. Financial planning and advisory services have been and continue to be a very desirable career path. So desirable, in fact, that labor supply often outweighs the job opportunities, at least among established fee-only

firms. Our employees are often eager to accept a low pay scale initially. But after a couple of years, if they haven't already left, they want more money than it costs us to replace them (training costs aside).

The popular solution to many of these problems is to give the employee an ownership interest. Problem is, if he doesn't agree with the way you run your business, he doesn't want to own a piece of it. Or, perhaps the opposite is true — she wants a piece of the business before you're ready to give it to her. Then that becomes a reason to leave.

Now I'm not saying that we should all be one-man bands. We need good people working hard for us. We need them to provide a quality service to our clients, to compete with the Merrill Lynchs of the world, to leverage ourselves so we can earn a decent living, and, if desired, to grow our practices. I'm just saying we're stuck with a "standard" for growing our firms that simply is not working for many of us.

Large staffs have obvious effects on the economics of the firm, too. The more people you have, the more computers you need, as well as phones, network nodes, furniture, and so on. Some firms don't use technology that would make them more efficient because they can't afford to provide the technology to all of their growing number of staff persons. (There's a chicken-and-egg situation for you.)

Many principals bemoan the fact that their gross revenues are growing at 30 to 50 percent a year, yet their own compensation never changes. If their expenses rise as

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fast as their revenues, and they can't even raise their own salaries, how will they create surplus cash flow?

This brings us back to the question of valuation. Whose definition of value are we trying to satisfy — our own, or those of folks who are frequently quoted in the financial press as valuation experts? If your true values are aligned with growth, and you've got the skills to pull it off, go for it. Forget everything I've said because it doesn't apply to you. But for those who feel like they've been spinning their wheels for years, consider this: How much time could you have spent improving services to clients, strategizing about how to stay one step ahead of Merrill Lynch, and simply changing your firm to meet

the changing world around you if you didn't have to waste one minute dealing with employee problems?

*"How much time
could you have spent
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to clients ... if you
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one minute dealing
with employee
problems?"*

Many of us have apparently forgotten an important lesson from Business Administration 101. Of course, it wasn't framed in the context of a service business because we didn't have a predominantly service economy (at least not when I was first studying business). The lesson was in terms of manufacturing, but it's no less valid for firms like ours. And that is -- don't make something yourself if you can buy it better and cheaper from someone else. Let's now put that in words the owner of a fee-only planning firm can relate to — don't create a staff function in-house that can be accomplished better and less expensively by an independent business person.

There is a new model for the fee-only financial planning firm. I doubt that it will ever replace the "standard," but it might make those light bulbs go on above a few readers' heads. It's the Virtual Financial Planning Firm.

"Virtual" is a word that's tossed around a lot these days, and means different things to different

people. The definition I will use is borrowed from *The Virtual Corporation* by William H. Davidow and Michael S. Malone (HarperBusiness, 1992). Messrs. Davidow and Malone say...

"Traditionally, for something to be virtual means that it possessed the powers or capabilities of something else...we have extended the idea of virtuality one step further to reflect what is going on around us today...a virtual corporation...will appear almost edgeless, with permeable and continuously changing interfaces between company, supplier, and customers...even the very definition of employee will change, as some customers and suppliers begin to spend more time in the company than will some of the firm's own workers...it is [perhaps] better to talk of the virtual corporation in terms of patterns of information and relationships."

This is all the more thought-provoking when we realize that it was written before the World Wide Web became a household phrase.

Some of the concepts in this definition may be a bit vague. Let me try to put them in clearer focus for you. My concept of the Virtual Financial Planning Firm appears in the real world as a firm that is extremely nimble. It isn't burdened by heavy overhead, committee-think, or employee problems. It makes full use of the Internet and other communications technology to be almost instantly accessible to both suppliers and clients. As a result, response times are minimized so that clients feel important and cared for, and the bonding process is accelerated.

Perhaps the most distinguishing
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NAPFA ADVISOR EDITORIAL AND ADVERTISING POLICY

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feature of the Virtual Financial Planning Firm is its use of labor. It finds in most instances that an employee is less advantageous than a "free agent" (used synonymously with "supplier" or "partner"). A free agent is another business owner, whether a simple independent contractor or a corporation, that is better suited to perform a function our virtual firm would have entrusted to an employee in the past. The free agent is chosen because it does the job better than an employee can do, cheaper than an employee can be paid to do it, or both.

How can this free agent be both better and cheaper? you ask. It's not that surprising, really. If I hire a secretary, I must pay his salary and payroll taxes, give him benefits, vacation leave, and other things that cost me time or money. I must provide him with a computer, a high-quality printer, and other expensive toys. I have to train him, sometimes not just in my methods, but in more elementary things such as the Windows operating system or applications software. If he's not right for the job, I risk a lawsuit in dismissing him.

Now, suppose there was a person or company who said to me, "We're expert at what we do. The services we offer include not only secretarial work, but bookkeeping, airline reservations, meeting scheduling and other admin functions. We don't need to be in your office to do it as long as you're facile with

e-mail and the Internet. We have all of our own equipment, software, office space, and access to as many of our own employees or independent contractors as we may need. We charge a flat hourly fee for the work we do, so you don't need to be concerned about any of the ancillary costs of having your

*In next month's
NAPFA Advisor,
David Drucker will
profile three fee-only
firms that are living
proof of the
possibilities of being
Virtual Financial
Planning Firms.*

own employee. And, if you're not satisfied, there are no strings...since we have competitors, we have to do a good job at a fair price and intend to earn your trust."

This would be quite different from dealing with an employee, wouldn't it? Yes, you say, but don't you still have to hire such a firm, acquaint it with your way of doing things, and supervise it? True, but it's a different experience because the independent provider is

entrepreneurially motivated. This provider is often much quicker than an employee to come to the realization that your client's satisfaction and welfare form the yardstick for measuring the success of what it does.

What are the economics of such an arrangement? Using virtual assistants doing admin work as an example, it's been my experience that they might charge as much as twice the base hourly salary you would pay an employee, but, by the time you factor in the employee's add-on costs, training time, coffee breaks, and occasional inefficiency, the free agent is cheaper. And I've often found that the free agent is faster, too.

OK, but what does an entire Virtual Financial Planning Firm using free agents in lieu of employees look like?

I'm aware of a couple of virtual firms run by NAPFA members, and there are probably many more. (If yours fits the description, please e-mail me so that we may set up a formal ideas exchange.) The firms I will introduce you to are New England Investment Management of Stamford, Conn. (principal: Robert Horowitz, MBA, CFA), Financial Alternatives of La Jolla, Calif. (principal: James Freeman, CFP), and yours truly, Sunset Financial Management, Inc. of Albuquerque, N.M.

Next month we will meet these principals and learn about their firms in more detail. ■

David J. Drucker, MBA, CFP, is president of Sunset Financial Management, Inc., in Albuquerque. He writes monthly on a variety of financial planning topics for NAPFA and his clients.



NAPFA Members Explore Potential of Virtual Financial Planning Firm

Part 2 of 2

Last month we discussed the concept of the virtual financial planning firm and noted that there are at least a couple of such firms within the membership of NAPFA. This article will profile three of those with which I'm familiar: New England Investment Management of Stamford, Conn. (principal: Robert Horowitz, MBA, CFA); Financial Alternatives of La Jolla, Calif. (principal: Jim Freeman, CFP); and yours truly, Sunset Financial Management, Inc. of Albuquerque, N.M.

Horowitz has been a fee-only planner since 1991. He is the sole employee of his firm, which works for 25 clients. Jim Freeman has also been a fee-only planner since 1991. He and his brother, Dave, are the sole employees of their firm, and work for about 50 clients. And because I have been fortunate enough to have received more than my fair share of press lately, you probably already know more than you ever wanted to about me and Sunset Financial. The raw stats are that we have about 50 clients also, and I've been a fee-only advisor since 1983.

All of us have similar, distinct tasks that must be accomplished by our firms, including trading, account management, planning and

paraplanning, secretarial/administrative, portfolio monitoring and reporting, and bookkeeping. (We are not forgetting business planning and visionary activities, but will assume the principal is going to be involved in these regardless of business structure). Exhibit 1 (see page 26) shows how we implement each of these functions.

Becoming a "virtual" firm gives practitioners the "freedom and inclination to compensate their principals generously."

-- Dave Drucker

Administrative support

Horowitz (New England) shares an employee (though she is not on his payroll) with several businesses in close proximity to him, and he also employs an off-site virtual assistant. Financial Alternatives has a private arrangement with an individual, independent contractor to do its admin work as well as other functions. Sunset uses Gal Fridays in Akron, Ohio, one of many virtual assistance ("VA") firms growing up around the country.

New England's virtual assistant

does everything that's not client sensitive, e.g., sending out the firm's newsletter or booking airline tickets. The assistant was located through a newsletter service to which the firm subscribes, and is paid on an hourly basis.

While Horowitz can give and receive some assignments to the VA through face-to-face contact, Financial Alternatives and Sunset pick up the phone, or use e-mail and other forms of electronic dissemination of work, since their assistants are in different cities or time zones. While all of these admin solutions work well, Horowitz believes his arrangement carries the disadvantage that if his on-site assistant is not capable in all of the requirements of her job, he cannot readily replace her without losing economies of scale, since her employment is shared by several firms and her hiring or firing is not his sole decision.

Bookkeeping

The three companies have substantially different bookkeeping practices. New England does all of its own bookkeeping, while Sunset retains bill-paying (done electronically) for maximum control over

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money outflows. Financial Alternatives has a second independent contractor (a private arrangement with a friend) doing all of its bookkeeping, and Sunset has a retired CPA bookkeeper who sends out invoices and maintains its accounts receivables. The bookkeeper sends

Sunset updated accounting via a Quickbooks file attached to an email every two weeks.

Account management

All firms that do discretionary asset management need someone to assist in account management, i.e., opening new accounts, closing

old accounts, transferring assets, retitling accounts, and so on. This is one of the most difficult functions to entrust to a free agent, due to the confidentiality of the information. While one may not have much hesitancy in hiring a virtual
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tracking and reporting done by its CPA firm, Financial Alternatives by an ex-dbCAMS employee, and Sunset uses Asset Management Solutions of San Marcos, Calif.

Using the Web for Marketing, Operations

Hand-in-hand with the virtual nature of their operations is the development of sophisticated Web sites by New England and Sunset. Horowitz finds a Web site to be a great, non-threatening way for prospective clients to get to know the

firm, by first going to its Web site for general information. Sunset posts its ADV and all of its marketing information on its Web site. NAFPA referrals with email addresses are automatically pointed towards Sunset's Web site to find information on its services, its principal, etc.

Partners handling the portfolio reporting and/or asset management duties for these firms can all get the same downloads from Schwab or other custodians that the princi-

pals get in-house. This enables these partners to get the information into Centerpiece, Axys or dbCAMS, as well as to track the status of transfers or new accounts. Additionally, with software like Schwablink, they have access to forms needed to set up new client accounts.

As the portfolio reporting agent works with the downloaded data, he also reports to the principals. Horowitz's accountant emails him updated Axys files once a week,

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Secretarial/ Administrative	Shares a common, non-employee admin person with other small businesses in common office space along with a virtual assistant off-site.	Performed by "independent contractor #1" through private arrangement.	Gal Fridays 1170 Sutherland Ave. Akron, OH 44314 330-753-8881 (www.galfridays.com)
Bookkeeping	Does own accounting on Quickbooks.	Performed by "independent contractor #2" through private arrangement.	Uses private bookkeeper for client billing and separate CPA for tax return prep, both based in Bethesda, MD: Sunset pays own bills
Account Management	Presently looking for an outsourcing arrangement.	Performed by "independent contractor #1" through private arrangement.	The Family Firm, Inc. 4720 Montgomery Lane Bethesda, MD 20814 (private arrangement)
Planning/ Paraplanning	Presently looking for an outsourcing arrangement.	Some performed by "independent contractor #1" through private arrangement.	The Family Firm, Inc. 4720 Montgomery Lane Bethesda, MD 20814 (private arrangement)
Trading	Does all of own trading.	Does all of own trading.	Done in conjunction with YieldQuest Investment Group 3575 Piedmont Road Atlanta, GA 30305 888-465-8440
Portfolio Monitoring/Reporting	Performed by New England's CPA firm.	Recently this function was subcontracted to an ex-dbCAMS employee.	Asset Management Solutions 1645 S. Rancho Santa Fe San Marcos, CA 92069 760-752-1177

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assistant for mailings — even mailings to specific clients discussing proprietary matters — giving a stranger access to your clients' account information is not something one should take lightly.

New England is presently looking for a means of outsourcing this function, and has been deterred

thus far by the reasons mentioned above. Horowitz feels some urgency to establish a partnering relationship for this function since client needs in this area are quite often a "hassle," requiring immediate responses for wire transfers or other services clients often need in a hurry. He is quick to say that an

opportunity exists for a virtual assistance firm to perform many related tasks needed by the virtual financial planning firm rather than limiting services to just admin or asset management functions — something along the lines of an "operations processing pool" that would work for a number of advisors.

Portfolio management

Financial Alternatives and Sunset both have private arrangements with individuals to carry out the portfolio management function. The same independent contractor Financial Alternatives has used for over six years for its admin work also does this work. I have a private arrangement with my former firm (now called The Family Firm, Inc.) to continue using the asset management employee who worked for me when I was a part-owner of that firm. That arrangement will end June 30, 2000, and I will need to establish a new asset management partnering arrangement.

New England is also searching for a paraplanner relationship, while Financial Alternatives and Sunset use the same partners for these functions as for asset management.

Trading

All three firms have satisfactory trading arrangements. As a CFA, Horowitz prefers to do all of his own trading. Sunset subcontracts about 40 percent of its trading activity to YieldQuest Investment Group of Atlanta, which specializes in bonds and closed-end bond and equity funds. Financial Alternatives does its own trading but also relies on YieldQuest for fixed income securities.

Portfolio reporting

None of these firms run their own portfolio reporting software. New England has its portfolio

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* Thornburg Value Fund Ranks #1 out of 248 mid-cap value funds for the 3-year period according to Morningstar Principia as of 1/31/99.

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while Sunset is able to automatically download updated Centerpiece data nightly from Asset Management Solutions's server via an efficient Web transfer utility.

In addition to Web sites, another staple of the high-tech virtual financial planning firm is its push for the paperless office. All three firms use scanners with image retrieval capability to some degree. Sunset is currently finishing up the scanning and disposal of *all* client records, past and present, for which the SEC does not require originals to be on file.

Computer systems necessary for the virtual firm are, likewise, simpler than are required in most firms with large staffs. While "servers"

must be state-of-the-art, internal networks can be bare bones. New England doesn't even need an internal network, while Financial Alternatives and Sunset find peer-to-peer networks more than adequate for tethering their respective three- and two-computer systems.

Much of the communication between the firms and their partners takes place in the form of email, so high-speed modems and fast Internet connectivity are important. Centralized databases, though, may be somewhat less important than they are when many employees occupy adjacent workspaces and must enter or retrieve data on common clients to or from a common database.

Some of the innovative means of data-sharing with partners that Financial Alternatives has implemented include using pcANYWHERE to allow partners to phone into a server on which client records are maintained, and using the file-synching mechanism in Goldmine, its database software, to ensure that client records are identical on the computers of both the firm and its partners.

Finding partners

How does one find good virtual partners? Some partners target NAPFA members directly. YieldQuest Investment Group and Asset Management Solutions, for example, were both exhibitors at

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South Region Conference

the **BIG** picture

A Return to Comprehensive Financial Planning

Don't miss this opportunity to take a fresh look at the major issues in comprehensive financial planning today. Attend this year's South Region Conference – The Big Picture: A Return to Comprehensive Financial Planning.

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- "Wealth Management Index[™]," by Ross Levin
- "Financial Issues of the Elderly," by Karen Schaeffer
- "Practical Approaches to Using Morningstar Principia," by Palmer Jones
- "Whatever you Do, Don't Look There," by Kenneth L. Fisher
- "Cause and Effect Trusts," by Myra Salzer
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Participants can also enjoy a basketball tournament, yoga sessions, and attend a two-hour ethics class that meets CFP continuing education requirements.

The Big Picture will be held November 11-13 in Atlanta.

To get a copy of the full conference brochure or obtain other information, call Margery Wasserman at 800-366-2732 or Conference Chairman James E. Pearman, Jr. at 540-342-7102.

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the national conference in Washington, D.C. this past summer, and YieldQuest advertises regularly in the *NAPFA Advisor*.

Virtual assistants are everywhere. I found mine by happenstance through an article in *Ticker* magazine, but you can also locate VAs at various Web sites, such as <http://staffcentrix.com/sitemap.htm>, or www.gava.org/whois.htm. Financial Alternatives found its virtual assistant through a home-based business association. There are many individuals providing professional secretarial services out of their homes who can be located through one of these associations.

Friends and even clients sometimes make good VAs. Many qualified women leave the workforce to raise kids, or simply retire, and may want to return to work with maximum flexibility at home. If they are computer literate, they're ideal as VAs. Financial Alternatives has had success going this route, and Sunset is now interviewing an old friend of the family to take up its asset

management function when its contract ends with The Family Firm, Inc.

Many Benefits Accrue

All of these firms agree that they have the freedom and the inclination to compensate their principals generously. Instead of using only SIMPLE or 401K plans that were affordable (and non-discriminatory) for large staffs, these virtual employers can maximize benefits for their one or two owner employees. Sunset, for example, has a combined profit-sharing and money purchase plan for which it maximizes contributions, and plans to eventually replace those with a "one-man" defined benefit plan. It also has a medical reimbursement plan with no cap on the medical expenses it can cover for its principal and his family.

Another economy enjoyed by the virtual financial planning firm is office space. Both New England and Financial Alternatives have commercial offices, but they are scaled down to their needs, which don't include staff space. Horowitz

believes a commercial office is necessary for the types of clients he serves; Freeman believes he could operate from home office space as effectively as he could commercial space; Sunset finds its three-room home office suite ideal for the type of clients it serves (widows and retired couples). An added benefit to the home office is the opportunity it gives the principal to take a portion of his compensation as payroll tax-free rent.

In fact, the economics of the virtual financial planning firm, in general, often lead to greater profitability than do those of the traditional, mid-sized fee-only firm. This allows the principal to take more out of the company, to lower fees to competition-beating levels, or some combination of the two.

And lest you still think that Bigger is Better, consider this. In its recent annual release of its "Best Financial Advisor List" for 1999, *Worth* magazine both scaled back the number of advisors from 300 to 250, and gave a new emphasis to large financial services providers. This had the combined effect of significantly reducing the number of independent and, particularly, small financial advisors from its list. Yet, two of our three subject firms in this article made the 1999 *Worth* list.

There might just be something to this virtual financial planning concept. ■

Letters to the Editor

The NAPFA Advisor welcomes Letters to the Editor responding to any published article or facilitating and enhancing the discussion and debate of difficult and controversial issues facing the fee-only planning and advisory profession. All copy should be submitted on your letterhead and signed. Please include a copy of the letter on 3 1/2" disk and state what word processing program was used. All correspondence and submissions should be sent to the NAPFA Administrative Office, 355 W. Dundee Road, Suite 200, Buffalo Grove, IL 60089-1974.

David J. Drucker, MBA, CFP, is president of Sunset Financial Management, Inc., in Albuquerque. He writes monthly on a variety of financial planning topics for NAPFA and his clients.