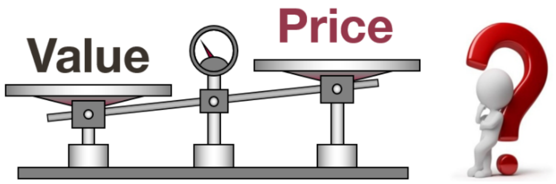

The Price is Wrong. What Next for Wealth Advisory Fees?

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Pricing is one of the hottest topics in wealth management at the moment. This has a lot to do with regulation, proposed or enacted (in both the US and Canada).

But regulation is only the catalyst for a change that is long overdue.

The 2016 Financial Performance Study released by IN Research revealed that only 2% of investment advisory firms employ 'value-based pricing', and 46% of firms do not charge additional fees for specific services.

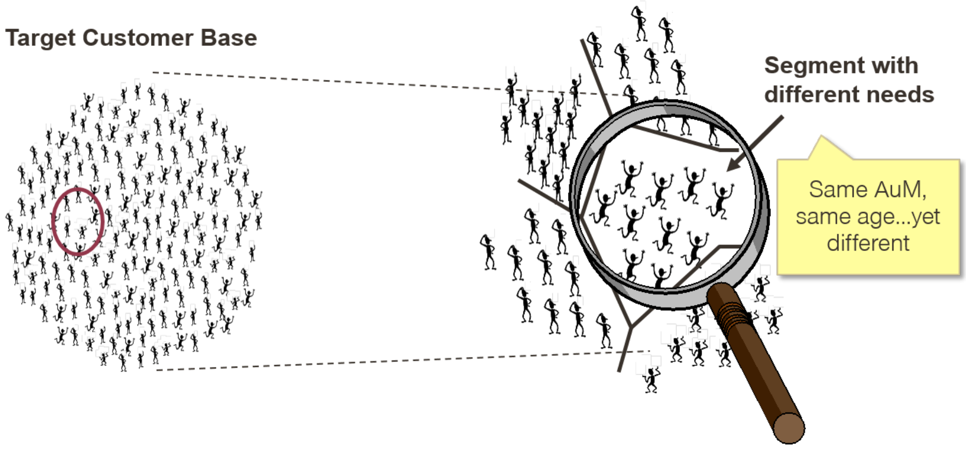
By not charging fees, advisors (counter-intuitively) are locking out **the very customers they need** in order to grow, as well as sacrificing profitable growth that is available today.

Smart pricing represents a big opportunity for firms who do it right. This article is the second in a series about how it can be done.

As we saw in part one, the beginning of any new proposition and pricing change should be a detailed analysis of customer needs and preferences - i.e. what customers **value**.

Why? Because when you analyze 'the customer', you realize that there is no such person. Different customer groups come into focus, with different needs and willingness to pay.

The value proposition should reflect this diversity, and so should the pricing model.

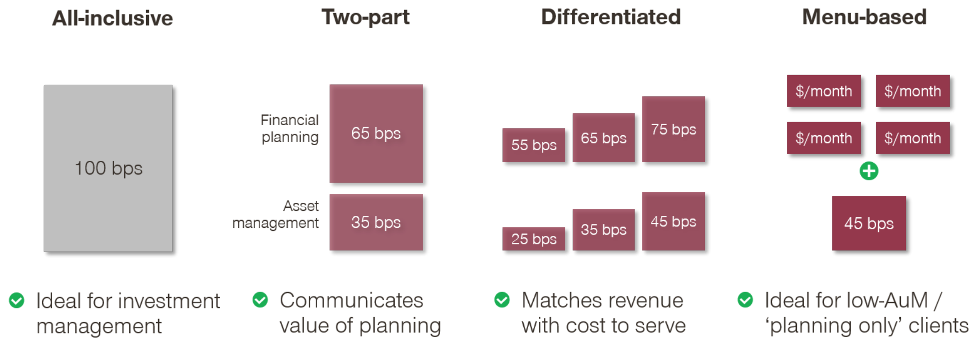


So what's on the menu?

In the ground-breaking report 'Fees at a Crossroads', SEI Advisors and Bob Veres make an eloquent case for evolving away from the trusty All-In AuM model, as well as setting out the alternatives.

The alternatives include **one-off fixed fees**, **periodic fixed fees**, and **hourly fees** (we exclude commissions and ticket-based fees – a can of worms for another day).

These building blocks can be mixed and matched to form a potentially limitless number of combinations.



There is no 'right' pricing model for the industry as a whole, but it should be possible to determine the 'right' pricing model for a given advisor.

Choosing your price model

As with everything, there are some general principles.

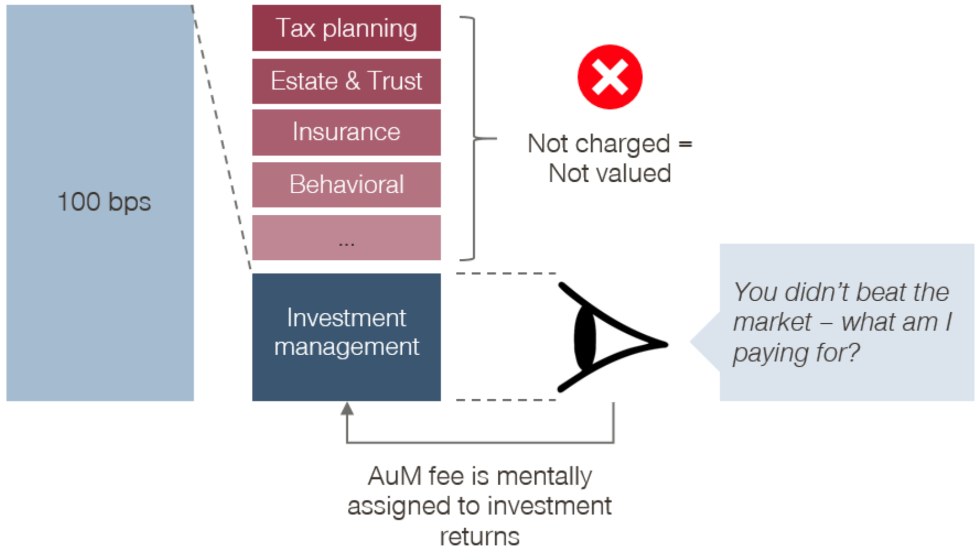
Before getting to these, we must again stress that the ultimate proof of any pudding is testing with customers.

We have learned from many years experience that this step is necessary *whenever* an organization is contemplating a pricing change, or any change to its offering. In fact the process never ends, as the customer base has an inconvenient way of changing its needs and preferences over time.

With this caveat in mind, we can make a first pass by thinking through the psychology of pricing.

Price metrics have different mental associations, meaning that they work well for some services but not others.

The AuM % fee, for example, is a psychologically frictionless way of charging and paying for investment management. But it is a very poor way to charge for up-front planning work.



Because up-front planning is – by nature – up-front, it is hard to justify charging the same amount in the second year, when the financial plan is unlikely to require the same amount of work.

How about ongoing planning advice, or the ability to contact the advisor with ad hoc inquiries? Surely this justifies a boost to the AuM fee?

Problem: clients will pay more according the amount of assets they have with the firm, **not** the amount of ongoing planning they require. As we saw in the last article, this is not a 1:1 correlation.

Clients would be, in effect, punished for bringing assets to the firm. Put another way, clients have a incentive to move assets to a lower-cost investment manager while still receiving the full benefits of ongoing planning advice.

What is the solution? Simply: **link price to value**.

Linking price to value: an example

One solution is the three-part fee – which reflects the three-part nature of the value offering.

Investment management = AuM % fee

Up-front planning = one-off fixed dollar fee

Ongoing advice = monthly or quarterly fixed fee

proposition differs from a lower cost provider.

Furthermore, clients who do not wish to receive a given service can deselect it.

This way the customer avoids the fee, and the advisor avoids the cost to serve for that particular service – a win-win that is not possible within the murky, ambiguous confines of the all-in fee.

Protect your existing base and build your future

"But I don't want to nickel-and-dime my most profitable clients!" you might say.

Not a problem. Higher AuM clients can (if they wish) continue with their existing model. But - and here is the good part - you can now let them know that the fixed fees have been waived thanks to their loyalty and valued status.

Loss aversion (=dislike of fees) is a deep human instinct. We have seen in other cases that waiving fees turns the table on loss aversion and reinforces the client relationship.

Waiving fixed fees for high-AuM clients will have a minimal effect on profitability, but a powerful effect on customer loyalty. Apart from anything else, it provides an incentive for them to keep their AuM balances high.

As well as being a **retention** measure, fixed fees are also an important **acquisition** measure.

For wealth managers looking to grow outside the traditional target market of older asset-rich clients, introducing fixed fees creates the possibility of accepting clients with low assets who would previously have been unprofitable.

The asset-poor customers of today will be the asset-rich clients of the future – and they will likely belong to the first advisor who will accept them.

Pricing structure is only the first step

The **price metric** is not the end of the story. Within a fee category, there can and should be different **price levels**, corresponding to the quantum of value delivered.

Discounts as well - if left to the individual advisor's discretion - can turn into a free-for-all with differing rules applied and little effect other than to deplete margins. Done the client relationship (e.g. commitment to higher contributions).

Is getting all of the above right a difficult procedure and fraught with risk?

You bet it is – particularly for larger institutions. In our experience, it can take anywhere from months to years, and as noted above, the process never ends once and for all.

With cumulative pressures of regulation, technology and competition, the choice is not whether to change, but when.

Viewed more positively, the return on all efforts in this direction will be profitable, sustainable growth.

Where next?

One of the great advantages of the all-in AuM fee was its simplicity. This simplicity is not reflective of the variegated nature of client needs and willingness to pay – and its day is over.

Which raises the next question: if the value proposition of the future involves choice for the customer and more nuanced pricing, how will advisors – let alone the customers themselves – cope with the additional complexity? Aren't things difficult enough to understand already?

They certainly are, and that is why **Presentment** is the final component in any proposition and pricing initiative.

More details in the next post - coming soon.

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