Future-proofing your pricing

Beth Braverman, 05/20/2019

A new slew of pricing options keeps you ahead of market pressures

The financial advising industry is changing dramatically, from a flood of new FinTech competitors to regulatory swings. One aspect of the industry that *hasn't* changed much, however, is how (and what) registered investment advisors charge for their services.

Eight in 10 RIAs still bundle their fees into an assets under management (AUM) model. The same percentage of RIAs haven't adjusted their median fees since 2012 (and don't foresee doing so anytime soon).[1] This general approach can hinder profitability for firms that offer more than just investment management.

That's not the only potential problem with hanging onto the old model — the recent growth seen in client bases and revenue may not be sustainable much longer. RIAs face a potential one-two punch: Boomer clients are entering draw-down mode and an aging bull market could mean an increased pullback risk.

Among advisory firms surveyed, 17 percent cited pricing pressures as one of the top challenges to future growth.[1]

But there are ways for firms to be proactive and ready for whatever comes.

Ditch the discounts

"Pricing remains an area of great opportunity for advisory firms," says Eliza De Pardo, senior consultant with FA Insight. "More active management of a firm's pricing model can support greater profitability and better safeguard a firm under a range of market conditions."

While firms have left their fee schedules largely unchanged for years, many offer ad hoc discounts to accommodate specific client needs. Taken in total, those one-off discounts can end up having a considerable impact on a firm's bottom line.

Incorporating a la carte pricing, whether done on a per-hour or per-service basis, may also help firms avoid fee discounting, a practice that has been steadily eroding profits; the median revenue collected on assets decreased seven basis points between 2015 and 2017. Offering unbundled services may allow firms to bring in fee-sensitive clients without putting additional pressure on their profit margins.

"In the past, people were primarily concerned with their investment returns," says April Rudin, president and chief executive of The Rudin Group, a financial services marketing firm. Sure, that's still true, "but portfolio management has really morphed into holistic financial planning beyond just investment advice, and holistic financial planning requires a different pricing strategy."

The commoditization of investment management creates an opportunity for advisors to further showcase (or develop) other services they offer and illustrate their value to clients. Consider financial plans, for example — only about one in four firms that prepares financial plans consistently charges for the service. Firms that do charge for financial plans collect an average $2,500 apiece.[1] Other areas that might command separate pricing include estate planning, college savings strategies or tax analysis.

Rudin advises the firms she works with to re-examine their pricing model once a year to make sure it still reflects the services they offer and is competitive with what others are offering. It is also important to look at fees across their client mix. "That doesn't mean that their financial advisors should be making pricing changes every year," she says. "But advisors need to think about themselves as entrepreneurs. Entrepreneurs think about what their revenue goals are for the year."

Make it custom

Charging for custom services means figuring out how to price them. The AUM model is straightforward, which is one reason for its staying power. It's easy to explain and simple for clients to understand, which is key in an era of increased demands for transparency around fees.

That raises the bar for new pricing strategies: Any new model must convey exactly why specific services carry the fees they do. That begins with a hard look at the services and products you offer and an assessment of the value each service provides to clients, along with their profit margins and cost bases.

"A pricing strategy provides a firm and individual advisors with a framework and clear guidelines for how to charge clients," De Pardo says. Not only will this lead to better consistency, she adds, but clear pricing guidelines can also help you meet your profitability targets.

In addition to a la carte pricing, firms might consider a tiered AUM fee model, offering, for example, a different price structure to first-year clients (to entice them into the firm) or to those with lower income or assets. The fees charged and the services offered could shift as clients grow their net worth or have more complicated advisory needs.

Strategies such as a la carte pricing and tiered fee schedules allow RIAs more flexibility to create packages tailored to the needs of a specific client. That customization not only adds value for existing clientele but may also bring in new clients who can more clearly see how their needs align with the firm's service offerings. It also gives firms an advantage over robo-advisors.

"There's so much more that goes into financial planning than just managing portfolios," Rudin says. Financial advisors need to be confident about explaining that firms that offer roboadvisor services, for example, are just offering one type of investment strategy, largely. "Firms need to understand how their full-service financial planning services stack up against a roboadvisor and how they add value in terms of relationship and human services beyond just an algorithm."

The niche premium

Transitioning to more dynamic pricing also provides advisors an opportunity to home in on a niche, another potential path to increased profitability. Targeted firms (where more than half of clients meet specified target criteria) experienced 25 percent higher revenue growth and 35 percent higher client growth than all other firms.[1] Common targeting criteria include things like levels of investable assets, life stage, occupation, income and geographical location. But all advisors will have their vision of clients for whom their skills are best suited.

Targeted firms outperform for a couple of reasons. They save on marketing and business development because their campaigns are more focused, and those tailored messages resonate, turning prospects into clients. Targeting a specific clientele also allows for more competitive pricing, since advisors can charge a premium for their expertise in a specific subject matter or with a certain type of client.

“As a firm expands its service offering, the underlying cost of advice will change and a pure AUM pricing model may no longer adequately compensate for the advice provided,” De Pardo says. “Other complementary models may also be required.”

How to talk about pricing with your clients

For people who make a living having difficult conversations about money, advisors are surprisingly reluctant to talk about their pricing models.

“It's common for advisors to be nervous about discussing an increase in fees with clients,” says De Pardo. “These conversations can be uncomfortable, but they're very necessary.”

Follow these steps when you're introducing a new pricing strategy to your clients:

- Be transparent and specific. Make sure the messaging around your new pricing system is easy to understand, and that it allows clients to recognize the value of the services you offer. “Everybody wants to know what they're paying, and what they're getting for it,” says Rudin.
- Communicate early and often. Introduce the new pricing model a few months before it goes into effect to give clients time to digest the information and reach out with questions. In addition to emails, you might set up phone calls or in-person meetings to discuss exactly how the plan will affect each client.
- Get ready for gripes. Not everyone will be on board for the change. Consider potential objections ahead of time, and plan how you'll respond to them. For example, a client might balk at a price increase if they're unhappy with recent portfolio performance. “To respond, the advisor might highlight all the other areas of advice that were delivered and how the client's situation has advanced as a result of the broader advice provided,” De Pardo says.

[1] “The 2018 FA Insight Study of Advisory Firms: Growth by Design,” TD Ameritrade Institutional, 2018. (Found here: http://fainsight.com/#!research-studies)

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