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SENIOR CONSULTANT

The Voice of the Investment Management Consultant

Speaking the Unspeakable: The Marketing Opportunity of Our Lifetime

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I am asked at least 20 times a week by successful fee-based advisors if there is a better way, other than through trial and error, for them to build their practices. They have had to cobble together their own technology, create their own investment process and build their own administrative and technical support staff around a division of labor that plays to their strengths in client acquisition and service. They want to enhance their investment process to better manage their fiduciary responsibility, but their supporting organizations do not acknowledge fiduciary responsibility. They want to operate much more efficiently, but improvements in operational efficiency are very expensive and are only achieved by trial-and-error, often requiring significant capital outlays for technology, with uncertain results. Why are advisors who want to fulfill their fiduciary responsibilities, who want to engage their counsel for an on-going advisory fee, who want to address and manage a broad range of investment and administrative values as required by regulatory mandate, not better supported by the financial services industry? They have to be experts in technology, fiduciary responsibility, process management, staff management and development, and client acquisition and services. Each advisor must reinvent the wheel every step along the way. Shouldn't the industry play a role in supporting the advisor in adding value and in fulfilling their fiduciary responsibility? Why isn't this level of support institutionalized? From the prospective of the financial services consumer and the financial advisor, there isn't a good reason today why advisors are put in an untenable position of not having the tools and resources necessary to fulfill fiduciary responsibility and to help each client achieve their goals and objectives. This is especially true when fee-based advisors are paying their firms 60% or more of their gross revenues for their support.

WHY ARE ADVISORS WHO WANT TO FULFILL THEIR FIDUCIARY RESPONSIBILITIES, WHO WANT TO ENGAGE THEIR COUNSEL FOR AN ON-GOING ADVISORY FEE, WHO WANT TO ADDRESS AND MANAGE A BROAD RANGE OF INVESTMENT AND ADMINISTRATIVE VALUES AS REQUIRED BY REGULATORY MANDATE, NOT BETTER SUPPORTED BY THE FINANCIAL SERVICES INDUSTRY?

We are at a turning point in the financial services industry that requires significant structural changes in how business is being done. There is no secret that commission brokerage rates continue to decline at a rapid rate, over 60% in the past decade alone. The transparency of the internet makes it clear to the consumer that no value is being added in commission sales. So, why should the consumer pay several hundred dollars to execute a trade when the same results can be achieved for $10 or less? The solution is not for firms to envision the average financial advisor doubling their productivity to a million dollars or more in gross revenues which, in actuality, may not translate into the advisor even maintaining their earnings of a decade ago with just a quarter of the envisioned production. If commission brokerage rates approach zero, as many electronic crossing networks (ECNs) are planning, there is no number of trades that would make the commission sales business economically viable. Though no one wants to speak of the unspeakable, the only way for the industry to grow and prosper is for the financial advisor to engage their counsel for an on-going advisory fee and to add value by addressing and managing a broad range of investment and administrative values as required to fulfill fiduciary responsibility. The client is well-served, the advisor is well-served, and the industry is well-served. But, this is far easier said than done, as it would require a radical change in the culture, structure, and technology of the financial services industry. Instead of

executing trades in volume and distributing financial products, financial services firms would empower their advisors to add value by addressing and managing a broad range of investment and administrative values necessary to fulfill their fiduciary obligations. The role of the advisor and the counsel they provide are greatly elevated, but it also requires a totally different advisor support infrastructure. Of course, this new advice business model is completely politically incorrect and certainly inexpedient to advance advice within commission sales organizations. It is disruptive because it threatens the money, power and status of today's product management organizational structure, around which the financial services industry was built. Though there is an interest in firms supporting "in principle" the concept of the financial advisor adding value, "in practice," the industry's product management organization structure will never subordinate its interests to an objective investment process that is product neutral at best and, at worst, is not supportive of their products at all. What has resulted is wrap fee programs, or advice in a product silo like mutual funds or managed accounts. This embraces "in principle" the concept of adding value, but in fact does not add value because counsel is just limited to the mutual fund assets that clients have in a mutual fund wrap fee program and not the wide range of all client holdings, incorporating all assets and liabilities. Of course, clients don't care how complex or difficult it is for firms to empower their advisors to add value. They just want their advisors to add value. The transparency of the internet makes adding value a consumer mandate, and advisors and the firms supporting them must either respond or be replaced by those who are more committed to the prospect of adding value. This is a rare defining moment for advisors and their firms which, by necessity, advisors see far more clearly than their supporting firms.

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The disconnect between advisors and their firms wanting to add value is cultural. Technically, banks, brokerage firms, insurance companies, financial planning firms – any firm engaged in commission sales – are structured so that advisors do not render advice to their clients. Advisors just make clients aware of investment alternatives, and the client must exercise their own judgment – in effect, relying on their own counsel. Commission brokerage firms assume no accountability for their advisors' recommendations, maintaining any advice rendered was incidental to trade execution. Technically, it is caveat emptor, or "buyer beware" for, if no advice is rendered, then no responsibility is implied or assumed. This minimizes fiduciary responsibility/liability but also diminishes the role of the financial advisor and the counsel they provide at a time when the transparency of the internet is greatly elevating the value of professional investment and administrative counsel. Thus, advisors are compelled to add value precisely at a time when their supporting firms will not even acknowledge that advice is being rendered. This is a cultural problem that requires a structural solution. There must be a way for firms to acknowledge the fiduciary responsibility of their advisors, to acknowledge the advice being rendered and to actively support their advisors in addressing and managing a broad range of investment and administrative values as required by regulatory mandate. If not, a new generation of firms will emerge, like a Nashville-based PowellJohnson, that will empower the advisor to add value and fulfill their fiduciary responsibility. This is as sure as the sky is blue. The first rule of marketing is – find what the investor wants (i.e., value added) and provide it. Are there any investors who don't want value to be added?

What's so perplexing is why advisor support firms don't see that this new advice business model is a far superior business model economically than today's conventional commission sales business model. The recurring fee revenues associated with advisors engaging their on-going counsel commands three times the earnings multiple than that commanded by commission brokerage. And, because the new advice business model leverages the financial advisor through process and technology, it has a streamlined organizational structure at half the cost of commission sales. So, why don't our industry's largest firms "get it"? It's cultural. It is irrational for large, highly successful organizations to propose anything that would radically change their core business model, which has achieved a massive market capitalization, especially if it requires the organization to excel at things they do not understand. Thus, this is an opportunity for advisors and a new generation of support firms to emerge, that think like owners and not like employees.

Have you ever wondered why all the value associated with your good work accrues to the shareholders of the firm supporting you and not to you, the advisor who actually established and built the client relationships that drives your firm's market capitalization? What if there were a firm built around the new advice business model, where you had a healthy slug of the equity you created? A 500-advisor firm with each advisor having a half billion dollars under advisement, would actually have a larger market capitalization than Merrill Lynch, with only a fifth of the assets, because it would have three times the multiple and half the cost. Most importantly, if that firm were publicly traded, an advisor who followed the firm's methodology (faithfully using its processes and technology) and who

had successor management in place, would have a liquid exit strategy with an attractive market valuation. There is nothing a major firm could do to respond in kind without diluting its market value. This is an opportunity for advisors to get rich beyond their wildest dreams, to become an owner, a highly-valued colleague, rather than an employee with little or no influence on the value proposition their firm supports. The convergence of market events is indeed compelling for the financial advisor. You have already performed the most difficult task – you have well-established client relationships awaiting you to provide a much higher level of counsel.

So, is there a better way for successful advisors to build their practice and engage their counsel for ongoing fee? You bet there is. But it doesn't necessarily have to be a new generation of firms. Established firms have a vested interest in being responsive to changes which are reshaping the course of the industry. But we shouldn't count on major firms being the leading change agents. They will only change when the financial and competitive pain of not changing becomes greater than the pain of the radical and highly disruptive change required. Thus, the early success of the new generation of advisor support organizations is assured, as the major firms struggle to catch up, if they can, with the new rules of competition that require value to be added and fiduciary responsibility to be fulfilled. At some point, the major firms will have to respond but only after losing many of their leading and most promising advisors, giving up significant marketshare in the most important market segments where all the assets are, and likely losing significant market capitalization to advisors who seek to fully capitalize on their good work in engaging their counsel for a fee. The fear of fiduciary liability by major firms will be preempted by the fear that they will be relegated to serving the mass market investor who has less than $100,000 in assets. The mass market accounts for 90% of investors but less than 10% of assets, and is where fee-based counsel is not economically viable unless the advisor is a salaried employee.

The successful fee-based financial advisor has never been in a better position because there are now better ways emerging to build their practice. A new generation of firms is emerging that acknowledges fiduciary responsibility, that not only provides the processes and technology necessary to add value but provides the technical and administrative support necessary to facilitate the continuous, comprehensive counsel required. This new generation of firm actually understands investment policy, the asset/liability study, real-time information, the division of labor within your practice and the empowerment of the financial advisor to add value through well-conceived investment processes, resulting in a preemptive value proposition for each of the eight major market segments of the high net worth and institutional markets.

Does this mean the major financial services firms are toast? No, but it does mean they can no longer operate in a vacuum. They must not be fearful of disrupting the status quo. They must become more responsive to their fee-based advisors or will lose them. It means the major firms must incur the pain of streamlining their organizational structure around the appropriate processes necessary for adding value in each market segment they wish to cultivate. It means that some advisors, who serve the mass market investor with less than $100,000 in investable assets, may become salaried employees with a cap on total compensation to make advice economically viable for the mass markets. It means that advisors who have the skills to compete on the depth and breadth of their counsel will advise more assets than they ever dreamed. And, ultimately, it means that trade execution will become a commodity that should not be much more expensive than inventorying a can of soup in a supermarket.

We all know that there are real constraints that determine success or failure. Certainly, whether it is even possible for one to add value is a major determinant of success. Today, only a very small number of the 650,000 licensed financial services professional are capable of adding value and fulfilling their fiduciary responsibility. The self-appointed, major-firm market leader in advice points to 1.4 managed accounts per client as a measure of their preeminence; yet in doing so, we all see how far the industry has to go. In actuality, only about 20% of that firm's advisors account for most of its assets, and a few hundred are engaged in high level counsel. It is this latter group which has cobbled together their own processes and technology necessary to add value, who are the industry's true pioneers, who are leading the way.

There are only 15 million households in the U.S. that have more than $100,000 in investable assets that account for more than 90% of U.S. wealth. If the average advisor can provide continuous, comprehensive counsel to 100 clients, there are only enough clients to sustain 150,000 of today's 650,000 licensed financial advisors. By extension, there are tremendous rewards for early adopters because their success greatly reduces the pool of available clients for those advisors who may choose to follow. The only way to win a client is to offer a better value proposition which either elevates the counsel provided and/or drives down cost. By being an early adopter, scale and pricing work in your favor. Much like the institutional market, the high net worth market is becoming a highly competitive zero-sum game. In order to win business, someone must lose business. This favors those skilled at addressing and managing a broad range of investment and administrative values. Now is a uniquely opportune moment to redouble your efforts in engaging your counsel for an ongoing advisory fee. With the right support, your competitors are not able to compete with the depth and breadth of your counsel. Over the next five years, you will advise more assets, add more value, win more clients and make more money than you ever dreamed. You just need to think and execute outside of the box in which you are presently, either with or without the support of your firm. This is not a matter of opinion; it is the reality of the marketplace that can make you rich if you simply apply yourself to the unfolding opportunities afforded. My hope for you is that you will have the presence of mind to appreciate how profound this opportunity is to build a massive practice and that you will unceasingly pursue every opportunity afforded by the marketplace while it is still so ripe for execution. This is truly a once-in-a-lifetime opportunity, and we have the good fortune to fully capitalize on the opportunities unfolding.

The strength of the U.S. economy in the world economic order is that the free enterprise system exploits bureaucracy and rewards innovation in ways not possible in a closed government system. Good ideas take on a life of their own, and in the process, their leading proponents get rich. How about the idea of financial advisors engaging their counsel for a fee, assuming accountability, adding value and fulfilling their fiduciary responsibilities? Do you think clients would be interested? Sounds like a plan. ■

Notes

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