AllianceBernstein

Execution Memo

Realizing Your Value

Today's Financial Advisors (FAs) are being forced to make tough decisions concerning the value they want to provide and the fees they can charge for services.

Understanding Fees and Value Today

Raising the price of services is a nerve-wracking decision fraught with potential consequences. In this Execution Memo we will:

- Consider the nature of that challenge
- Look at the four different drivers for how clients experience "value"
- Present a multi-step model for managing the conversation about fees and value

The issue of pricing your practice can't be ignored and won't go away. Pressures from across the industry are forcing prices downward and making it necessary for firms to augment corporate revenue. In addition, a new "key clientele" of the financial-services industry has recently emerged, the Baby Boomers. And, as Boomers approach retirement, FAs are faced with the problem that asset management in the "distribution" phase of life is significantly less lucrative than managing assets during the "growth" phase of a client's life.

These pressures combine to present the Financial Advisor with three choices for delivering value and charging fees:

- Stay the same and charge less
- Improve the practice's value slightly and charge the same
- Improve the practice's value significantly and charge more

There are circumstances in which Financial Advisors may be able to raise fees without increasing the value offered by their existing practice models. Consider the case of the Financial Advisor who is already offering tremendous value, but that value is not perceived by the client. If the FA can educate the client to perceive and appreciate the existing value proposition, he or she may be able to justify an increase in fees without offering anything more. However, in some instances this won't be enough and the FA will need to improve the practice's value in order to increase fees

Forward-thinking FAs recognize that they need to make tough decisions about changing fees and increasing revenues. They know that implementing those changes needs to become part of an ongoing "practice management" strategy, not just take place as a one-time conversation with clients.

The Problem with Charging More

Increasing fees for existing clients can be difficult. Mitigate the challenges by understanding the four drivers of value.

Raising Fees Can Be Challenging

Raising prices with new customers is relatively easy. The Financial Advisor describes the value proposition and service model of the practice, assigns a fee to that value, and the client agrees to pay that fee for those services. Raising prices with existing clients is much more challenging since the client previously agreed to a lower fee for the services. Given that in today's marketplace the cost for many services has actually decreased over time, (think cell phone rates, Internet charges, computers and consumer electronics) clients simply don't expect to pay more for the same services.

Laws of Supply and Demand

Price is also sensitive to the laws of supply and demand. There are more than 300,000 FAs chasing the small percentage of the United States population who has wealth that needs managing. Therefore, if clients become disgruntled, they can easily replace their existing Financial Advisor. This makes the conversation about raising the fee for services "difficult."

However, the conversation can be navigated successfully if the Financial Advisor understands the four drivers of value, establishes an ongoing strategy of education, communicates with each client about the value of the practice and manages the conversation with effective tactics.

Four Drivers of Value

There are four drivers of value: fairness, perceived value, appreciated value and actual value. All are important components of building an acceptable fee structure.

Fairness

The relationship between advisor and client is based on trust and goodwill. At the beginning of a relationship, basic trust must be established, and for the relationship to continue, it must be both maintained and cultivated over time. One expression of goodwill is the fees that the client pays. Every client will look at the issue of fees from two perspectives:

1. Am I being charged fairly or being taken advantage of?
2. Are my fees fair compared to what others are paying or am I being cheated?

A high level of trust is essential as the background for any conversation about increasing fees.

Perceived Value

Much of what you do every day takes place behind the scenes. In essence, you are "The Invisible Advisor." If the client can't see the service, he or she may not recognize its depth and breadth and therefore be unable to assess its value. This is why it behooves you to tell your client about the efforts you are making and the value you are delivering.

Appreciated Value

Even when services are perceived, they may not be fully appreciated. Therefore, you must also ensure that the client understands the magnitude of what is being accomplished. Seeing something and appreciating what it means are two different things. While both require intentional efforts in client education, for clients to appreciate value they need constant reminding/educating on the specifics of what you have accomplished.

Actual Value

Managing trust and educating clients to perceive and appreciate the existing value proposition ensures that the fees currently being charged remain a non-issue for clients. However, in order to raise fees, you may also need to provide additional value—something above and beyond what the client is already receiving. Part of your challenge is understanding which improvements in actual value the client will deem worthy of an increase in fees.

The Problem of Increasing Actual Value:
The Value Compass

I am an expert about:

- **Tactical Investing:** How to Navigate the Capital Markets
- **Managing Wealth:** Creating, Transferring & Managing Complex Decisions
- **Financial Planning:** Your Goals, Your needs & How to Achieve Your Desired Outcomes
- **The Financial Services Industry:** The Breadth and Depth of Solutions Available to You

Preparing for Your Discussions

Before you discuss raising fees with your client, prepare to clearly show your client the value you add. These three principles can help.

Discussing an increase in fees with a client is a potentially difficult event. By increasing a client's awareness of and appreciation for the value you deliver, you can manage the conversation more successfully. Consider following these three principles, which are all centered around education and communication.

Three Principles

Principle #1

Invest time and energy regularly to communicate about your "hidden" activities, become more visible and manage perceived value.

- "This is what we did for you recently:"
- "This is what we are doing for you now:"
- "This is what we expect to do for you in the near future:"

Principle #2

Invest time and energy to educate clients about your processes, increase their understanding of the breadth and depth of your services, and manage each client's appreciation of your value.

- "This is what we do—and how we do it:" (reveal the mechanism)
- "This is how the typical advisor works—and here's how our process is better!" (demonstrate a superior standard of practice)
- Show—visually and in detail—how you execute on your principles and point of view

Principle #3

Consistently use existing communication channels to manage awareness and appreciation of value.

- Educate new clients during discovery and intake
- Provide at least one annual Client Review (two is better)
- Call systematically with periodic "check-in" conversations
- Use research and market updates available from your firm
- Schedule a Monthly Capital Markets Update—these make great client events

Six Steps to Effectively Manage the Fee Conversation

You may be concerned about how clients will react when discussing an increase in fees. If you are properly prepared, the rest will seem that much easier.

Step One: Select Low-Risk/High-Opportunity Clients

It is impossible to feel confident about navigating these high-risk conversations until you've experienced the process many times. This is why you should live the adage "Practice makes perfect." As your trial runs, select 10–15 clients who have already confirmed their appreciation of your value. Use the following checklist to find low-risk/high-opportunity clients in your practice.

Five Evidence Criteria

(Behaviors of low-risk/high-opportunity clients) (2 or more criteria should be present)

- The **client has made a personal referral** to the practice in the past 18 months
- You have **solved a specific, painful problem** for the client in the past 12 months (does not have to be investment related)
- You have had **more than 4 meaningful conversations** with the client in the past 6 months
- You have conducted a client review in the past 3 months in which you **significantly refined** more than one aspect of the investment plan
- You have conducted a client review in the past 3 months in which the client **spontaneously reported** being highly satisfied with the investment outcomes and your services

Step Two: Determine How You Will Increase Actual Value

While clients will be reluctant to pay more for the same services, they may be willing to pay more for improved and expanded services. An important step in the conversation about fees is showing the clients how you will increase the value they are receiving.

Four Methods of Increasing Value

1. **Broad Range of Solutions: "Standard of Practice" Model.** As clients grow older and move toward retirement, there are many additional solutions and services that become relevant. Expanding the scope of services and solutions regularly offered to clients at different life stages is one way to increase the actual value. This expansion of services can become the meaningful improvement of value that makes a new fee more palatable.
2. **Tactical Investing: Navigating the Capital Markets.** Refining the investment process to cope with more volatile markets represents a second way to increase value. Expanding to a broader range of asset classes or more sophisticated models for deploying assets can be presented as an improved value that merits a slightly higher fee.
3. **Financial Planning: Client Goals and Achieving Desired Outcomes.** If you haven't integrated comprehensive financial planning into your relationships, this can represent a significant improvement in actual value. By re-profiling existing clients and introducing the financial plan as a valuable refinement of the larger investment process, you can justify a fee adjustment.
4. **Managing Wealth: Wealth Creation Events, Wealth Transfer Processes and Navigating Complex Decisions.** If you haven't developed advanced capabilities to service wealth creation and wealth transfer events, the deployment of these specialized consultations can also justify an increased fee.

- **Another Valuable Expertise:** _____ .

Regardless of which strategy you use as a framework for proposing a new fee, the premise is the same: a client will be reluctant to pay more for the same services but may be perfectly happy to pay more for meaningfully improved services.

Step Three: Determine the Fee Adjustment and Test

Part of being well prepared for the conversation with each client is knowing exactly what fee you are proposing. As discussed, a client is likely to assess the fairness of the fee from two perspectives: "How does this compare to what I have been paying over time?" and "How does this compare to other people like me who are getting these types of services?" A successful conversation ends with the client feeling that the new fee is fair according to both assessments. Use the following checklist to "test" your proposed fee for fairness:

- Is the increase fair compared to the previously charged fee?
- Is it fair compared to what other investors are being charged?
- Have your clients been thoroughly educated, and are they able to fully perceive and appreciate the value they have received?
- Is the new fee fair given the increased value you are proposing?
- Do you feel totally confident that this fee is a fair value for your services and that your clients are fortunate to be working with you?

Step Four: Managing the Conversation

Now it's time to talk to your client. In order to propose a new level of service that will justify a new level of fees, you'll need to explain why you feel an adjustment in approach is required.

Remember, people don't like change—even positive improvements can be distressing. If you want your clients to embrace a change, they will need to understand why the change is necessary and to feel that it is their need, not yours, that precipitated the change.

Typically, new services are required because of changes in the:

- client's life (usually due to the normal aging process) that have created a new set of needs
- capital markets that have created a new set of challenges for the advisor to navigate

By describing the changes (either in the client's lifecycle or the capital markets) and then explaining what adjustments in the servicing model are recommended, you'll be able to introduce the new fee that will be charged and close the new relationship.

Describe the Strategy

There are two ways to frame the fee adjustment when you introduce it to clients. You should adapt your approach depending on individual circumstances.

- **Framing the fee adjustment because of changes in external market conditions:**
  "Mr. X, **because of increasing volatility and changes in market dynamics**, I need to recommend the following adjustments to my clients…"

- **Framing the fee adjustment to address necessary changes due to life events:**
  "Mr. Y, **you are about to experience** an important milestone in your life, _____ . When clients in my practice go through this life transition, I need to recommend some changes in the way we do business together, because…"

  "Ms. X, **you recently experienced** an important milestone in your life, _____ . When clients in my practice go through this life transition, I need to recommend some changes in the way we do business together, because…"

Step Five: Frame the Change—Anchoring

It is important for you to "anchor" the proposed fee to the larger context of fees in the marketplace. While clients are willing to pay more for an increase in perceived and appreciated value, they aren't willing to pay a lot more than what others are paying for a similar service.

After discussing the perceived and appreciated value of the practice as well as the proposed new relationship between you and your client, use something visual to show how the proposed fee compares to other, similar services. When discussing the proposed fee, do so in the same matter-of-fact manner as the rest of the conversation.

Script

"Mr. & Mrs. X, you can see some investors are paying this much—and even *this much*—for this type of service. Because I want my clients to receive a truly superior value for the fees they pay, I've priced my services here. This is much less than other clients are paying for the same type of service."

Step Six: Close the New Relationship

After preparing effectively for the meeting, ensuring that the new fee is a fair reflection of the value being delivered, and framing the new fee both in relation to a new vision of the relationship and in the context of how similar services charge, you can now close the conversation. It is important to confirm with the client the decision that has been made.

One way to soften the impact of a new fee relationship is to suggest a "check-in" meeting in six months. This allows for a softer "close" and a chance for the client to try the new relationship without feeling that a permanent commitment was made. It also gives the client a time frame in which to raise any concerns—something that is unlikely to happen unless there is a breakdown in trust or an absence of perceived and appreciated value.

Script

- "Does this make sense?"
- "Do you see how this will allow us to address your needs as you navigate these next several years?"
- "Let me make a proposal: would it make sense for us to proceed in this way for the next six months? That will give us a chance to get started, and then we can check in and see how it feels to work together this way."

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