

CHAPTER ONE

COMMISSIONS

Throughout its evolution, the financial planning profession has ignored pricing as a business fundamental because our products and services have been priced for us. Fund managers and insurers have determined what prices we charge by the upfront and trail commission rates they set for their products.

Over time, many advisers have become unhappy with receiving commission—some because of the perceived biases with this model, some because of the inequities it creates in a business, and others simply because they don't want such a central business decision being made by a third party. More importantly, many advisers have discovered that often the amount of commission received has very little to do with the cost of providing advice, or the value received by the client.

Our profession has now evolved to the point where every financial planning practice owner will be forced to address this issue and determine how they will price their services. This book is designed to provide food for thought for advisers transitioning from commission to fees, as well as practical assistance with how to make it happen. Advisers are often disappointed to hear that there is no one-size-fits-all method

of charging for advice. The ideal pricing model must instead be determined by the stakeholders in each business and designed to suit their client base and the service delivery provided by their firm. While there is no single method of charging, there is a proven methodology and process that will allow advisers to create their own pricing model to suit their business and their clients.

Every business person has to go through a process to price their products and services at some stage, and most do it on a regular basis. A store owner has to determine the margin to apply over their cost price. An accountant or solicitor, even a plumber, has to determine their hourly rate and minimum job cost. Surgeons have to determine their fees for each operation they perform.

Whilst it is common practice for business owners to price their services, the challenges you face in a financial planning practice are quite unique:

- Apart from the fact that this process may be foreign to you, advice is intangible. What you are selling is your intellectual property, and the outcomes that you can help your clients to achieve. Clients are paying for your ability to help them define their goals and objectives, and then to analyse their position and work out *how* to achieve those goals. You then inspire them to implement your advice to *actually* achieve them; not once but over time. If you simply sold widgets, it would be easy to apply a margin to the wholesale price you pay for your stock and be done with it.
- Often clients don't understand what advice is—they have little idea of what to expect, and sometimes can't grasp just how important it can be and what an amazing impact it can have on their lives until they experience good advice first-hand. Problem is, they need to decide to pay for advice before they get to truly understand its value. So how do you create a pricing model that allows them to do this?

Let's not forget that financial planning is an outstanding business opportunity. You have no stock on hand, no need for warehousing, and there are few other businesses that can say on 1 January that they essentially know who their clients will be and what revenue they are likely to earn in the year ahead. Most businesses are reliant upon their next sale to put food on the table, whereas in financial planning, each new client adds to the pool of existing clients who pay you an ongoing retainer for your services.

Add this to the fact that it is hugely rewarding to work with people, to be in a position to give so much to your clients and really make a tangible difference in their lives, and you can understand why we put up with such frequent changes in legislation.

There is a reason why advice businesses achieve sale prices of 2.5–3.5 times recurring revenue, where other industries such as accounting are valued on a much lower scale. The traditional financial planning business achieves a great deal of leverage in its revenue. Trail commissions build up over time, and are not necessarily linked to service or time output from the firm, so many advice practices can continue to grow their income without having to grow their overheads. Contrary to what some may believe, this premium in business valuations is not simply a result of advisers receiving commissions. It's due to the fact that the nature of financial advice is not simply transactional in nature. Clients are seeking an ongoing relationship with someone they can trust, who will be there for them in the future, who will keep them accountable to the strategies they employ, and keep their financial plan dynamic in order to stay effective despite economic, legislative and their personal changes.

It is vital when creating a pricing model to replace a trail book or even an asset-based fee model, that you don't reduce the value of your business by removing this leverage in your income. The great news is, you can keep the leverage yet also increase the service levels to your clients, thereby reducing the attrition rate of clients leaving your firm, and increasing loyalty, and therefore new referrals.

One argument that many advisers have used to support commissions is that their clients wouldn't be able to afford them if they had to pay a fee. This is due to the reality that wealthy clients subsidise the less well off in a client base. Whilst most advisers generally accept this, I'm not sure the wealthier clients would if they were given the choice. What is most troubling from a business perspective, is that in many cases, advisers have not kept track of the extent to which this is happening and when they analyse the business, they discover that in fact the ratio of wealthier to less-wealthy—profitable to loss-making—clients is not in their favour. By creating an appropriate fee model and being disciplined in charging it, along with selecting clients based upon their propensity to pay and ability to receive value from you for those fees, you can ensure that your business is profitable and that you (or your successor) will be around to continue providing advice to those clients who need it, over the long-term.

So regardless of whether you're undertaking this process by choice or have been forced into it by legislation, *congratulations* on taking action. We understand that you may have change fatigue right now. You dealt with the changes introduced with FSR, you've just got through the GFC, and now this has hit you. Take heart that it is an excellent opportunity.

We guarantee you that undertaking the process to create a pricing model will be beneficial to your business. Whilst it is a significant investment in time, it forces advisers

to reflect not only on how they deliver their advice but how they manage their entire business, which invariably leads to some degree of improvement. Most businesses achieve a significant return on this investment.

If there is more than one adviser in your business, we would encourage you to get them to read this book too, and assist you in creating your pricing model, for two reasons:

1. They know your business and your clients so they can provide insights and assistance, but more importantly,
2. They will also have to put your new fee model in front of clients, and if they have been engaged in the creation of the model, they will be more likely to embrace it and will have better success at implementing it.

If you've chosen to only purchase this book and not the other tools in the Pricing Advice Program, you may find greater success if you call upon the support of someone you trust who is external to your business. This may be a PDM from your dealer group, a BDM from a fund manager, or perhaps another adviser outside your practice. Evidence in our pricing research showed that those advisers who sought external assistance achieved better, faster results from their transition to fees.

The advice of someone outside your business can be invaluable. Someone who is not emotionally connected to your business and clients, someone who has experience with what else is working in the marketplace. Someone who can hear your words through a client's ears and give you an objective interpretation. They may give you some jewels of insight that you hadn't thought of, or they may simply be useful in allowing you a sounding board to discuss your thoughts out loud.

One thing you may already know is that the conversations you will have with your clients and the way you position your advice will likely change. Now that they will be charged in a more transparent fashion, clients will be more inclined to want to see value for the fees they pay. You'll need a good strong value proposition, and you'll need to be able to clearly relate that value to each individual client.

It is vitally important that you go through a process to create the fee model for your practice, rather than adopting someone else's model, or worse, simply converting the amount you receive as trail commission into an asset-based fee.

The simple fact is that if you have been running a business based on trail income, and you have not applied minimum ongoing fees, you will have a legacy trail book of clients. These are those people from whom you don't receive enough revenue to warrant

giving them a full review service. As a result, these clients don't get serviced at all, or perhaps receive a newsletter and access to you if they need it. Until now, that book has subsidised your cashflow, so you may have been able to run at a profit, and effectively charge your new clients subsidised fees.

With the changes in legislation and subsequent consumer sentiment around commissions, you can expect that while it is unlikely that your trails will be 'turned off', you will experience significant attrition from your trail book as clients flock to transfer their funds to nil-commission products. In order to remain profitable you will likely need to start charging more for your advice.

The best way to gain the confidence to do so—and create some degree of accuracy in what to charge—is to undertake a process that analyses the costs to run *your* business, and the needs of the client market that you work with. Once you undertake this process, you will find it becomes much easier to start charging what you're worth.

Speaking from experience...

**Allison Dummett, Director, Adviser Services and Development,
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“Times are different now. When Bill* started in business some 30 years ago, his only overheads were a suit, a car and a phone—he later told me the life company provided the phone! So no wonder he was happy to write business and just get paid via a commission—virtually all payments were profit. But for the young guy who bought his business it's different. He has a million dollar debt to start with, plus office and staff costs. Of course his approach to pricing will need to be different.”

*Not his real name