

Choosing a fee-based



BY LAP-TIN TSUN

As the dust begins to settle on the outcomes of the Ripoll review and momentum for the removal of commissions continues to build, it is clear that many financial planners have already begun to shift their attention away from debating the merits of commissions versus fees, and onto how to best rebuild and redefine their practices to operate successfully in a new environment independent of commissions.

However, while opinions on the removal of commissions over the past year have elicited a full range of comments, by contrast, discussions on what planners need to do moving forward have been far more subdued to date.

But as the deadline of 1 July 2012 inches ever closer, planners are faced with the growing need to strike ahead and delve into the real detail on “what do I need to do to help my practice succeed in the future?”

Where the value lies

As business owners, one of our ongoing areas of focus is preparing our businesses for the future, both in terms of emerging opportunities and regulatory changes.

Therefore, the fee-for-service challenge, and the implications for the future of the industry, will have been lost on few planners.

That said, with what is such a complex and multi-faceted issue, the most common question asked is, “Where do I begin to tackle such a challenge?”

Certainly within our industry in the last 12-18 months, there has been a significant focus on the value of financial planning and financial planners to clients and consumers as the solution to the fee-for-service issue. This has been succinctly captured by the cleverly constructed motto – “it’s not about cost, it’s about value”.

However, does having a well-defined value proposition entirely resolve the fee-for-service issue?

While acknowledging that, without question, the value proposition of a practice forms an integral part of its success, there are certain obvious limitations to a singular focus on the value proposition as the primary solution to fee-for-service without consideration of other factors, including costs:

Value vs benefits

Value, by definition, is the sum of the direct and indirect benefits of a service for the customer, versus the total cost of the service to the customer. Therefore, value inherently considers and implies cost, and it is impossible to remove that from the equation.

When people say, “it’s not about costs, it’s about value”, the concept of ‘value’ that they are referring to is, in reality, the ‘benefit’ of the service. Therefore, if true value is a factor of benefits versus costs, then we are only looking at half the picture by ignoring the costs of our services to our clients.

Return on investment

As a business owner, if you were to make an investment of \$10,000 into your business, how much would you expect in return?

Undoubtedly, given the extra time and effort that usually goes along with any investment, you would reasonably be looking for at least a minimum of a two to three times return to justify the effort and risk of the investment.

Therefore, even as owners of financial planning businesses, we are constantly assessing the costs and benefits of our investments. If this is how we behave, why should clients be expected to behave any differently, to only consider the ‘value’ of financial planning without consideration of the costs involved?

Unprofitable value

Finally, and this is true of business and life in general, for there to be a fair and equitable transaction, both sides must derive mutual value from the transaction. And in the case of financial planning, the value for your practice is derived from the cost of your services.

Ironically therefore, the danger of a singular focus on the value proposition (value for your client) is that it risks depriving a fair return in value to your practice. What is the point of having the world’s most spectacular value proposition, if you cannot ensure that you can generate a sufficient return to 1) cover your costs, and 2) earn a fair profit?

Hence, the combination of value, benefits, and costs must be considered as an interdependent relationship for a business to truly perform optimally in a fee-for-service environment.

And if the value for your practice – the income from the services you deliver – is being impacted, it makes the most logical sense for us to begin the journey there.

A model for all seasons

If income, the very lifeblood of a practice, makes the most logical area of attention, then the fee model – the framework and structure through which this lifeblood flows – makes the most ideal point for us to begin with.

model

And undoubtedly, one of the most challenging areas for planners who are moving towards a fee-for-service set-up is choosing the right fee model for their practice from the available mix of:

- Asset-based;
- Time-based;
- Fixed price; and,
- Risk-sharing (performance-based).

This is an area fraught with danger, as the future success or failure of the practice rests on the selection of fee model for the practice. The selection of the right model has the ability to support and catalyse the growth and development of the practice; or if incorrectly selected, limit the potential of the business, and result in no small amount of pain and struggle for the planner, staff, and clients alike.

Vanilla or chocolate? Choosing the model for you

Because of the direct impact that the fee

model has on the very profitability and performance of a business, we owe it to ourselves and our businesses to get it right the first time around.

The reality is that the most optimal choice of fee model must be a carefully considered selection that reflects:

- The aims and objectives of your practice;
- The needs of your client base;
- Your service offerings for your client base; and,
- The operational costs of delivering those services to your client base.

It should not be dictated by 'what the next guy is doing', or the latest opinion or trend.

Therefore, to create the most optimal fee model for your practice, essentially you need to reflect upon and understand:

- What do you want to achieve with your practice? In the short-term? In the long-term?
- What defines success for you? For your practice? For your clients? And for any other

stakeholders you may have?

→ What are the types of clients that you wish to focus your practice on, and what do your clients value in terms of your service?

→ What is the core proposition of your practice, and what are the services that you want to offer to your target clients?

→ How effective and efficient are you at delivering your services to your clients? Do you have enough understanding and control over your service delivery to ensure that you can generate an equitable outcome for both you and your clients?

→ What is the right fee model that will, taking the above into account, best help to support and drive the growth and success of your practice?

Illustrating this using a simple, hypothetical example, let's say that we are looking to build a new practice with the following characteristics:

- To grow a small (two-planner), stable,

Page 36 ►

FEE MODEL COMPARISON: THE PROS & CONS

The following is a quick comparison of the strengths and weaknesses of the different fee models to assist in assessing their suitability for your practice:

Model	Advantages	Disadvantages
Time-based	<ul style="list-style-type: none"> → Transparent → Easy to understand → Can easily be broken down into smaller parts → Unconflicted in interests of client 	<ul style="list-style-type: none"> → Limited scalability → Can become expensive for complex work → Risks supporting inefficient operators
Asset-based	<ul style="list-style-type: none"> → Explicit alternative to commissions → Share in asset growth 	<ul style="list-style-type: none"> → Can still be confusing for some clients → Requires focus on 'investable assets' which may conflict with interests of client → Rewards 'FUM chasing' → Share in asset decline → Confuses expectations in clients of planners' performance vs market performance
Fixed-price	<ul style="list-style-type: none"> → Transparent → Easy to understand → Certainty for clients → Encourages efficiency → Unconflicted in interests of client → Relatively scalable 	<ul style="list-style-type: none"> → Can be costly if priced incorrectly → Provides less room for error in service delivery → Difficult to administer
Risk sharing/ performance	<ul style="list-style-type: none"> → Directly aligned to client's objectives, not FUM performance → Unconflicted in interests of client → Retains upside reward potential for planner 	<ul style="list-style-type: none"> → Difficult to value for valuation purposes → Risks for failure to deliver

Choosing a fee-based model

community-orientated practice with the ability to generate a stable income for all employees in the business;

→ Acting as a partner/coach to assist clients through their most common needs from cradle to grave;

→ Servicing young working families, including assisting them with their financial planning needs throughout the core years of their lives, focusing on wealth creation/accumulation, debt management, and risk protection; and,

→ Using a range of standard and straightforward services which can be delivered with some level of efficiency and scalability (given the familiar focus on superannuation, risk, and investments).

Taking this simple profile into consideration, a brief assessment already highlights that, as part of the filtering process, an asset-based fee is not the most optimal choice in this situation (contrary to certain viewpoints that asset-based is best for every situation). The initial target client profile is not asset-rich; nor is the range of services required by this client base of sufficient complexity to justify an asset-based fee structure.

Given the size of the practice, it is also a difficult stretch to quantify how a small practice has all the necessary resources and range of expertise to justify the holistic servicing of a client, which is where asset-based fees are generally more appropriate.

This leaves us with an hourly-fee or fixed price fee as the most likely models remaining. Given the desire to develop a longer-term, community-oriented business that focuses on looking after clients throughout more of their lifetime, then this easily argues the case for an ongoing service fee, for which an annual fixed-price service, possibly tiered for differing levels of requirements, is a well-balanced fit.

On the provision of initial planning services,

given that the client profile (young working families) is clearly defined, that the needs of this group have a high probability of being very similar (we'll assume this for the sake of the example), and that the practice can operate the majority of the key services relatively efficiently and effectively, then there is flexibility for any initial planning fees to be set on an hourly-based or fixed-price basis, depending on how efficiently and cost-effectively the practice can deliver those core services.

And so, with a simple example, we can illustrate how (with a bit of fine-tuning on the exact pricing) we can create a fee model that we can be confident will deliver a value-adding outcome for the client and a profitable result for the practice, but which also aligns to the longer-term goals and objectives of the practice.

Obviously, a greater level of detail sits behind this cursory example and it, in turn, springboards a whole host of additional questions and issues. However, the above example illustrates how this level of self-reflection and analysis is essential in driving the required insight that, when combined with an understanding of the

inherent strengths and weaknesses of the fee models, will assist you to select the model that will best support the success of your practice and deliver the outcomes that you seek.

The journey is long, but the future is bright.

As we progress further along the fee-for-service journey, it is vital, both as individual businesses and as an industry, that we adopt a robust and structured approach in working through the process of transitioning to fee-for-service to enable us to get the best possible outcomes for ourselves and our clients.

As the latest chapter in the story of the financial planning industry, fee-for-service stands to open up many new and exciting opportunities for planners who are ready to invest in the future. Spending the extra time and care to ensure that your practice is aligned in both your proposition and fee model will ensure that you set your practice up on the right path to achieving greater levels of profitability and success in the future. ♦

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1. What should a practice consider when trying to resolve the fee-for-service issue?

- a) The combination of value, benefits, and costs as an inter-dependent relationship.
- b) What a client considers to be 'good value' financial advice.
- c) The practice costs associated with providing financial advice.
- d) Which fee model your planners will most easily adapt to.

2. When choosing a fee model for your practice, you need to consider which of the following?

- a) The aims and objectives of your practice.
- b) The needs of your client base.

c) Your service offerings for your client base.

d) The operational costs of delivering those services to your client base.

e) All of the above.

3. Potentially confused expectations by a client between a planner's performance and market performance is a common disadvantage of which fee model?

- a) Time-based.
- b) Asset-based.
- c) Fixed price.
- d) Risk-sharing/performance.

4. Transparency and ease of understanding are potential advantages of which fee models?

- a) Time-based and asset-based.
- b) Time-based and fixed price.
- c) Asset-based and fixed price.

5. Which of the following is a potential disadvantage of a time-based model?

- a) It risks supporting inefficient operators.
- b) The impact of asset market decline.
- c) It is difficult for clients to understand.
- d) All of the above.