Price Your Value.

# PRICING INTEGRITY

## White Paper 1 in the Pusateri "Pricing Your Value Unapologetically" Series

Empowering organizations and individuals to discover, articulate and capitalize on their unique value.

pusateri
discover your value

# PUSATERI "PRICING YOUR VALUE UNAPOLOGETICALLY" SERIES WHITE PAPER 1: PRICING INTEGRITY

### Is Your Pricing Fair, Consistent, and Transparent?


## EXECUTIVE SUMMARY

Pusateri Consulting and Training has worked with investment advisors (IAs) throughout North America to answer the simple questions: What is your price? Have you priced your value fairly, fully and with integrity? How advisors discuss value and price with clients is one of the most important business skills they can develop. Some IAs do a remarkably good job of articulating both. However, most advisors still "wing" pricing discussions, which opens the door to a whole host of avoidable problems. This has consequences on the profitability of IAs and, by extension, their firms.

This white paper, the first in a series, defines and explores a key concept, pricing integrity. We define the three elements of pricing integrity, show how IAs and their firms often sabotage their ability to command the proper fees for value offered, and suggest a simple framework for establishing pricing integrity throughout their business.

We argue that IAs first need to decide whether they are low, medium, or premium value providers and should then price their services accordingly. The price you set as an IA is part of your unique value proposition, and defines your marketplace. To achieve pricing integrity, you need to align your value and your price. If you do not know your value, you likely cannot price it. That said, not all who know their value do a good job of pricing it. After defining pricing integrity, we discuss why it's so elusive and propose remedies to common behaviors that destroy pricing integrity.

# PRICING INTEGRITY

Consider the power of this statement:
*There is integrity to my pricing. I have carefully looked at the value I provide, and I can say with confidence that my pricing is fair relative to the value I provide.*

## The Challenge

Establishing pricing integrity should be the main goal of all advisors in setting their price. Pricing integrity rests on three factors: fairness, consistency, and transparency. Pricing integrity is, however, elusive. Advisors and firms often struggle to set, articulate, and defend their pricing. We argue that most of the pricing problems that confront advisors and their firms are self-inflicted. That is, clients do not demand pricing that lacks integrity. We explore the causes and symptoms of sub-optimal pricing and introduce a three-part Value Price Perception Triangle™ concept as a framework for pricing. We then discuss how advisors have set and defended their price, including correcting long-standing mispricing. Finally, we challenge some of the basic assumptions that are widely, but unnecessarily, accepted within financial services.

## Opening Beliefs and Observations

- Every financial advisor should aim to establish complete pricing integrity.
- Pricing integrity is a function of three factors: fairness, consistency, and transparency.
- Focusing on pricing integrity is one of the best, most justified and sustainable "lifts" brokerages and their advisors can create.
- Pricing is highly undisciplined in financial services, often casual and at times borders on random.
- Advisors as a rule do not apply enough thought, time, or rigor in pricing their services.
- Price should never be discussed without also discussing value.
- Most advisor pricing problems are self-inflicted: inconsistent, unnecessary discounting. The marketplace is not at fault; IAs and their firms create their own pricing problems.
- Firms – that is, full services brokerages – are complicit in creating the pricing problem.
- The emotional relief of setting, correcting and defending your price with confidence, unapologetically, is significant.
- Sample remedies are available. For instance, setting an annual fee minimum may be a radically simple fix to the pricing problem.

## Why Does Pricing Integrity Elude Many Advisors?

The most powerful sentence you can use when discussing fees with clients is: "There is integrity to my pricing." If this is so, then why can so few advisors say it?

We see four reasons. First, pricing an intangible service with an uncertain, but important outcome is obviously difficult. To counterbalance the uncertainty of investments, advisors need to be reminded that they can effectively promise a certain client experience – a rigorous process and service standards. Amos Tversky, a leader in behavioral pricing, proved that clients will pay a premium for certainty that exceeds a rational assessment of risk. Conversly, clients will discount uncertainty. Advisors are well suited to keep their clients' thirst for certainty in mind in looking at how they present their value.

Second, the individual nature of client relationships makes it difficult to predict the amount of attention, judgment and counsel an individual client will need. How can I set a uniform, transparent price when I don't know the attention requirements of each client? Adhering to a set client service process can mitigate the variation in time spent; however, as with most individualized services, the needs of each client varies.

**"This is the most powerful sentence you can use when discussing fees with clients: 'There is integrity to my pricing'. "**

Third, many IAs lack competitive pricing data. IAs have priced their services and products for years without the benefit of peer pricing data. Most IAs set their prices by speaking with a handful of IAs in the branch, often with no other reference point. Pusateri has formed a strategic alliance with PriceMetrix Inc., a Toronto-based software firm that provides the only longitudinal overview of North American retail wealth management pricing data. PriceMetrix data enables IAs to use industry aggregate pricing data to run their businesses like CEOs.

Fourth, buyers are confused and skeptical. They face a baffling array of financial services firms that all claim to offer the same outcomes, while many providers explicitly question the value of paying more than discounted pricing. Further, most potential clients will have read articles that fundamentally question the interests of financial services firms, stating that financial firms work for themselves, not you. This low-grade skepticism can cause clients to question and doubt the fairness of an advisor's price.

## How Do Advisors Sabotage Their Pricing Integrity?

We would argue that the psychology, casual assumptions, passivity, and force of habit of the advisors, managers and senior leaders are the real saboteurs of pricing integrity, not the marketplace. Surveys of wealthy (+$1 million in investable assets) consistently reveal that price is neither the main hiring nor firing driver in selecting their financial advisor. As rule, clients do not look for the lowest cost provider. Clients do, however, want to know what they are paying for and what they are getting for their fees. A simple request from clients. Nonetheless, advisors continually make these six unforced errors that undermine their pricing integrity:

1. Compete as low-cost providers as rookies in order to win business.
2. Provide discounts to show special status of client, whether discounts were requested or not.
3. Decide that all assets under management are accretive and thus, in competitive situations, drop fees to match lower cost providers.
4. Decide to price in mid- to low-levels in order not to make price an issue of contention with clients, as a preemptive way to defend their value when performance lags.
5. Adopt an asymmetrical approach to commissions: charge commissions only when the trade proves a winner, and discount, sometimes to cost or below, any sale of a security that lost value.
6. Run an inconsistent book of business, where each commission or fee arrangement varies from client to client, perhaps influenced by the advisor's assumption of what that client would bear in terms of fees.

---

**"To be blunt, the best pricers are not necessarily the best financial advisors. In addition, the best advisors are not necessarily the best pricers."**

---

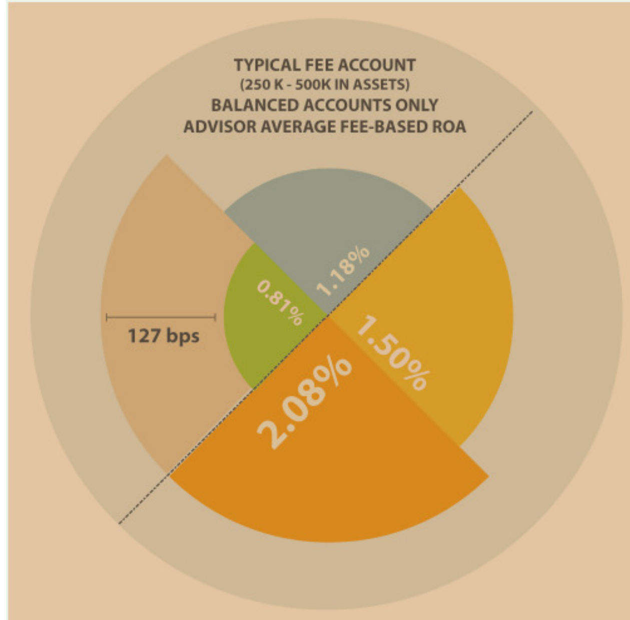
Underlying these causes are often powerful attitudes that either consciously or unconsciously affect how advisors set prices. Challenge an IA who is underpriced to explain why and it becomes clear that the IA's often complex attitude toward their value, and even their self-worth, are the important price determinants. In short, at the core of pricing inconsistency we find that advisors are not fundamentally convinced that they provide significant value to their clients.

## Data Show A Surprising Range in Low and Premium Pricers

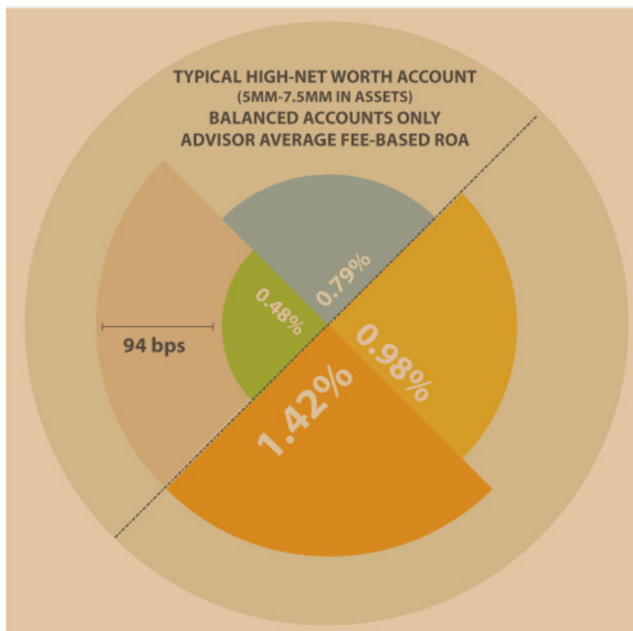
A remarkable range exists in pricing advisory services. PriceMetrix data show a 127 basis point gap between the top quartile and bottom quartile of fees on balanced $250K-$500K accounts. All accounts are balanced portfolios – stocks and bonds – so one can assume that the underlying portfolios are basically the same. As similar as the accounts are, we see a very wide range in prices charged. In the top quartile, advisors charge 2.08%; in the bottom quartile, the average is 86 basis points (see Graph 1.1). Are the top quartile advisors providing more than double the value as the bottom quartile pricers?

Interestingly, this gap between top quarter and bottom quarter pricing in much larger accounts, $5 million- $7.5 million shrinks, but not by much (see Graph 1.2). We still see a 94 basis point range, with the highest pricers charging 1.42%, or $71,000 a year on a $5 million account, when the lowest quarter of advisors charge little more than institutional level pricing at less than 0.5% (48 bps), or $24,000 a year, on a $5 million account. Suffice it to say, $47,000 is a large range in fees. What explains this gap? Does it reflect the gap in value provided? Not necessarily. Pusateri does not find, as one might expect, that the lowest pricers provide the least value, and the highest the most. Often the lowest quartile pricers provide robust wealth planning, financial counsel, active investment management, and equity trading. Moreover, those who price at 48 basis points, we believe, are not pricing the risk that they and their firms assume in managing the accounts.

Further, many advisors are shocked to see that a quarter of advisors are able consistently to price even $20 million accounts at 1.3%, or $260,000 in fees a year. Clearly, a good deal of clients are convinced that their advisor provides them with more than a quarter of a million dollars in value a year. This may seem a stretch until one considers the fees – often hidden – that traditional and alternative asset managers would charge on accounts for which they do not provide – in contrast with financial advisors – individualized service, counsel and customization. To make

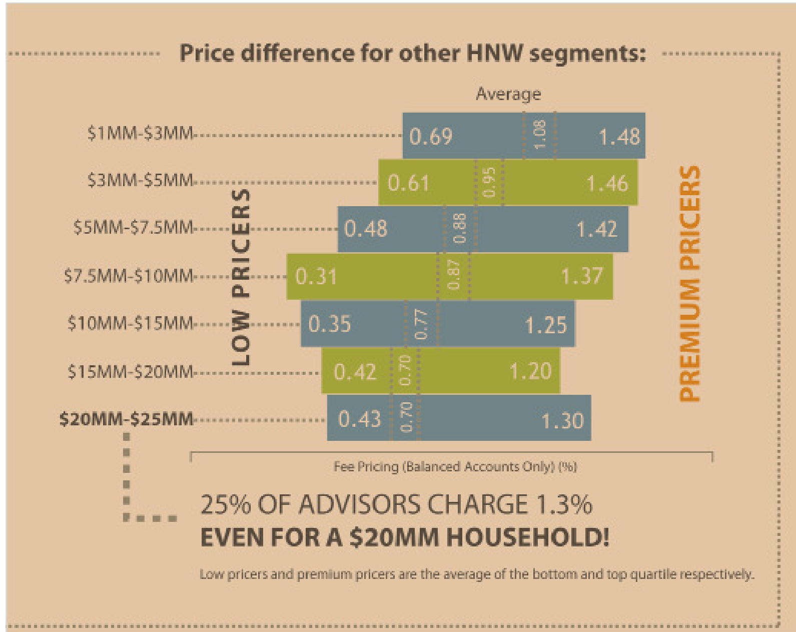



***Graph 1.1***
*Copyright PriceMetrix 2012*




***Graph 1.2***
*Copyright PriceMetrix 2012*

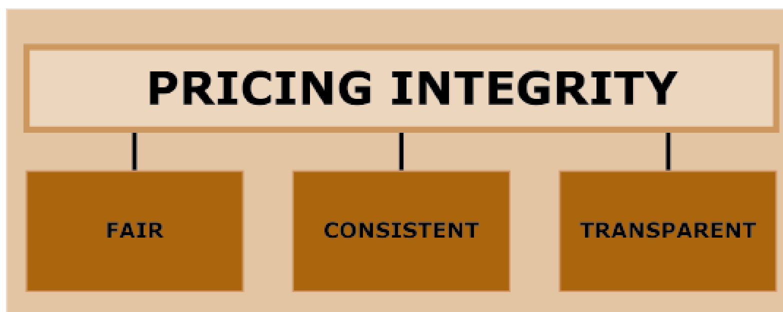
plain a few observations here from Graph 2: 1) top quartile advisors continual charge and continually justify more than 1% in fees on $1-$25 million accounts; 2) fees do not compress much between $1 million and $10-$25 million accounts; and 3) bottom quartile pricers price at a level that implies little to no incremental value to institutional asset managers.




*Graph 2*
*Copyright PriceMetrix 2012*

## PRICING INTEGRITY: DRIVEN BY THREE FACTORS

Integrity in pricing is driven by three factors: 1) fairness, 2) consistency, and 3) transparency. Let's focus for a moment on the concept of fairness.




*Graph 3*
*Copyright Pusateri Consulting 2012*

### Is Your Price Fair?

**"Only mutually profitable relationships endure."**

Fairness is admittedly a difficult concept. Fair for whom? In our view, fair pricing must be mutually fair — fair to the advisor and fair to the client. Moreover, though it rarely features in the discussions we have with advisors, the price also has to be fair to the firm. What constitutes fair? Here is a simple definition: exchanging value for fees where the value delivered is either equal to, or exceeds, the fees charged.

One of the challenges in pricing financial services is the uncertainty of one – but only one – of the deliverables: investments. Just as in medicine, clients or patients are paying for expertise and judgment; a guaranteed outcome cannot be promised. Fair pricing should allow for a sustainable delivery of services. Assuming that the client wants to retain his or her relationship with the advisor, it is in the client's interest to pay a fee that ensures that the advisor will not only stay in business, but will not be required to take on too many clients to stay sufficiently profitable.

## Consistent? Would You Want Your Clients to Discuss Your Fees at a Cocktail Party?

Is your pricing consistent? The simple test of consistency is this: if your clients were gathered at a cocktail party and decided to compare the fees that they pay you, would you feel comfortable? In other words, would they conclude that you are charging each client an equitable amount? We should note that consistency does not simplistically mean that you charge each client the same amount. We need to assume that clients would be comparing similar relationships with you: similar complexities, similar services, similar asset levels. Said another way, if your value varies markedly between what you provide one client from another, different pricing levels do not undermine pricing consistency. It is worth noting that lack of pricing consistency is not a sign of lack of professional integrity; however, it does make advisors vulnerable to criticism. While legacy pricing for long-standing clients is often the result of a sense of loyalty advisors feel, a desire to reward clients who gave them business earlier in their careers, it can lead to massive and unjustified pricing inconsistency.

Again, pricing consistency is not the same as price uniformity. An advisor may provide varying degrees of value to various clients, and as such, could well charge different levels. Price consistency simply means that for the same levels of value provided, you charge a consistent fee.

## Transparent: How Clear Are You About How You Get Paid?

Is your pricing transparent? Do your clients know what they are paying? What they are paying for? How you are generally compensated? Do you receive any hidden fees or incentives to recommend or sell certain products?

Clients want their advisors to be as direct as possible about their price: "Tell me what I am getting in value and what I am paying for value." The recent financial crisis of 2008-2009 heightened client skepticism about the integrity of financial services, making transparency more important than ever.  We believe strongly that the brokerage firm that gets out ahead of the growing regulatory pressure to reveal and explain fees could differentiate itself very positively in the marketplace. To date, we have not seen any US or Canadian brokerage firm boldly set pricing transparency standards, nor articulate them to the marketplace.

One can make two points against complete fee transparency: 1) that clients would simply rather not know what they pay, i.e., ignorance is bliss. Advisors have stated that some clients report preferring not to see what they are paying for, especially when accounts are not growing in value, 2) one can argue that some other businesses do not have complete fee transparency, so why should financial services?

These points may be valid; however, when it comes to total transparency, the risk/reward ratio skews to the reward side for a number of logical and emotional reasons. For one, fees in financial services are unduly complicated and clients show tremendous gratitude toward advisors who lift the veil on fees. Two, client skepticism is warranted in many instances where hidden or unfair fees are embedded in financial products. Being thoroughly transparent about fees can eliminate much of this skepticism. Three, the act of being even more transparent than is required or expected can have built trust and position the advisor as an advocate for the client, not a participant in a mildly adversarial role between sellers and buyers of financial services.

The fee discussion can also branch off into a broader discussion of compensation in financial services, which clients often find educational. We should note, too, that revealing your fees in a candid manner does not mean you need to discuss the profit margins in your business. Ultimately, the best way to determine the level of detail you provide when discussing your fees can be dictated by putting yourself in the client's shoes: how much detail and transparency would you like an advisor to reveal to you?

## SYMPTOMS OF LACK OF PRICING INTEGRITY

### Where Do We See Pricing Integrity Breaking Down?

1. **Two-tiered, legacy pricing.** Advisors charge two different levels of pricing: a full or fair price with new clients and a legacy price, generally at a much lower level, with long-standing clients. Most advisors resist repricing long-standing clients like the plague. As a result, many operate two-tiered books of business. Most are justified when it comes to repricing long-standing clients. However, they have a misplaced fear that their clients will not accept the new price. Advisors who fail to reprice existing clients, but successfully charge new clients more, may be able to rationalize two-tiered pricing. However, they cannot claim to have price integrity.
2. **Unnecessary, casual, and inconsistent discounting.** We worked with an advisor who claimed on day one of our program that he did not discount. On day two, he examined his PriceMetrix report and discovered that he had provided $600,000 in discounts on fixed income trades to some clients. When challenged on why he gave away a large amount on discounts that clients neither saw on their statements nor asked for, thus did not likely value, the IA said he did so merely because he liked the clients. Implicitly, he did not provide discounts to other clients for similar

trades. The inconsistency of discounting undermined his pricing integrity.

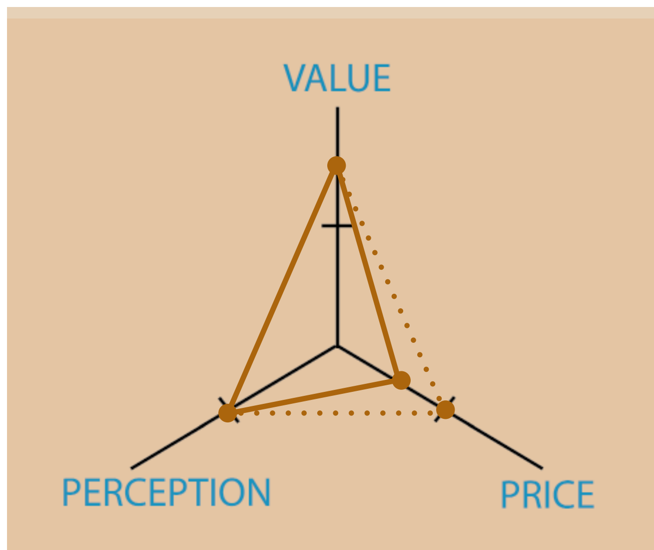
3. **Post-honeymoon neglect = overcharging.** Some advisors charge high fees, but fail to provide ongoing value beyond the initial honeymoon phase with clients. We call this "autopilot pricing." We see it most often in fee accounts. Clearly, this violates the concept of fairness. The lack of fairness symptom tends to be a client saying "I never hear from my advisor," or "I only hear from him when he wants to upsell me." Advisors who do this tend to focus on new account acquisitions. Many, in more honest moments, marvel that their clients stay with them or they are not surprised by high levels of client attrition.
4. **Excessively low pricing that fails to reflect the value delivered and risks assumed in a client relationship.** Many IAs take false comfort in pricing themselves well below what their clients would be willing to pay. They assume that pricing below the norm means their clients will never leave as a result of price. This is a false assumption. Surveys of $1 million clients show no correlation between price levels and client retention. Only 4% of HNW client cite price as the key reason they choose an IA, and only 1% cite price as the reason they fire advisors. What really drives firing decisions is a lack of communication between a client and advisor or a client's dissatisfaction with their investment performance. Advisors who price unduly low fail to factor in the risk they and their firms assume. This casual approach to risk is blithely irrational when one considers the firm's and advisor's risks borne with each account.

## REMEDIES

### Setting Price Requires A Close Examination Of Value: Introducing The Value Price Perception Triangle™

Determining price obviously requires an examination of value. However, value must be looked at from two perspectives: 1. what is the value you deliver as an advisor, and 2, how do your clients perceive your value? Finally, once you plot these two points on two axes of the triangle you can see how your price is relative to the value you provide, or deliver, and relative to how your clients perceive your value.

Advisors find this simple Value Price Perception Triangle™ an immensely helpful tool to examine the interplay of the three factors that contribute to pricing integrity (see Graph 4). In coaching more than 500 IAs through



***Graph 4: Value Price Perception Triangle™***
*Copyright Pusateri Consulting 2012*

the process of Pricing Your Value™, Pusateri has observed certain notable trends. For one, advisors tend to rate themselves high on the value delivered scale. We either deal with a certain degree of grade inflation, or advisors who are prepared to engage in intensive coaching indeed deliver above average value inflation is the more likely explanation. When challenged with what we would consider world-class standards of advisory service standards, most IAs acknowledge that they can increase the value they deliver. We do not see a consistent pattern of self-rating inflation on the perception or price axes. We will explore the Value Price Perception Triangle™ in further white papers.

## CONCLUSION

Recognizing how avoidable, costly and frustrating running businesses without pricing integrity is, advisors and their firms should make setting and upholding price discipline a priority. The downside of doing so is negligible. The upside can be significant. Paradoxically, correcting and clarifying pricing with clients actually reinvigorates the client's perception of the advisors value. Conversely, the repercussions of not addressing pricing integrity at best create a low grade stress on advisors and firms, and at worst, can challenge their ability to deliver against their value proposition.

### Concluding Thoughts:

- Setting your price once you know your value should be relatively easy.
- Truly knowing your value and articulating it with confidence drives pricing success.
- Price should never be discussed in the absence of value.
- Pricing should not be an ongoing cause of stress.
- IAs should be willing to walk away from clients who refuse to accept their value and price, rather than compromise their pricing consistency.
- Your price should continually challenge you to live up to your value proposition.

Empowering organizations and individuals to discover, articulate and capitalize on their unique value.

Pusateri Consulting and Training is a global boutique consulting and training firm that challenges financial services firms – brokerages, private banks, asset managers – and their client-facing advisors – to know, price and sell their value with high levels of confidence, passion and speed. Driven by the belief that there are no shortcuts to creating sustainable advantages, Pusateri develops multi-year relationships with leading US, Canadian and global financial services firms. Powered by PriceMetrix data, the Pusateri Pricing Your Value coaching process asks advisors to look at the interplay of the value delivered, value perceived, and price charged. Recognizing that business success depends on how confidently key conversations occur, the program focuses on five key pricing discussions. Client firms have shown 300% to 500%+ ROI on the Pricing Your Value program.

About the Author: Giles Kavanagh is a Managing Director with Pusateri and is responsible for leading major organizational initiatives in North America and globally. He has spearheaded Pusateri's research and development in the pricing arena.

**Pusateri Consulting and Training/Pusateri Canada**
**1.716.631.9860**
**Giles Kavanagh - giles@pusatericonsulting.com**
**Leo Pusateri - leo@pusatericonsulting.com**

**www.pusatericonsulting.com**

**Price Your Value.**