Pricing advice

Value-based strategies for pricing financial advice services

Damon Riscalla

Pricing has always been a complex area for advice firms. It requires getting the right balance between maximising profitability and having a competitive offering that enables you to win new clients.

Complicating things further is that a blanket approach is not feasible in an industry where client needs and service requirements are different depending on the individual.

As a start, price can be very misleading. It is easy to compare fees, yet difficult for clients to discern the value of one service in comparison to another. There is a tendency for many people to associate price with process rather than outcomes.

Consider two mechanics—who charge the same amount—one highly experienced and capable with state-of-the-art tools, and the other an apprentice with older tools and limited experience. The former may be able to assess and fix your mechanical problem within minutes whilst the latter may take hours to achieve the same outcome.

In this scenario you may feel aggrieved at paying the experienced mechanic the same amount as the apprentice—it does not feel quite right to pay the same amount for minutes of work versus hours of work. As an industry, we need to remind ourselves—and our clients—that it is years of experience that have allowed us to achieve the required result more quickly.

Why do we need a pricing strategy?

It is important for every business owner to regularly assess their pricing methodology to ensure that it is still the most appropriate. The pricing decision for financial planners is particularly important given that financial planning services are a discretionary purchase. Moreover, many of the underlying activities involved in producing quality advice are hidden from a client's view.

The right pricing methodology enables you to articulate your value, maximise profitability, work to capacity and attract the right type of client.

The current state of play

In research published in their *2023 Financial Advice Report*, Investment Trends has found that advisers charged their most recent client an average amount of $2,700 for full financial advice, where assets held were $770,000. However, the reported cost of providing this advice was actually $2,900, putting advisers in the red straight away.

Another 2021 study by the Financial Advice Association Australia (FAAA) and Core Data found that FAAA members charged an average of $2,671 to prepare a Statement of Advice (SOA) and another $3,757 for ongoing advice. In stark contrast to these figures is the amount people said they were willing to pay for the same advice—in 2019 this figure was $340, down from $530 in 2018 and $750 in 2017.

Clearly, a large disconnect exists between the cost of advice and the willingness of clients to pay for it. Better fee transparency can result in better customer understanding of the value of your services. Historically consumers have been conditioned to 'free' or low-cost advice, which was often subsidised by commissions or other forms of payments. This perhaps created a misconception about the value of a financial adviser.

Whatever pricing structure your business chooses, implementation will be critical. A good idea implemented badly could fail.

What to think about when it comes to pricing predictability

If you are a larger business with more fixed overheads or large staff numbers, then predictability of an income stream each year may be important. Knowing that you can cover substantial overheads even if markets turn for the worse can be advantageous for planning. In this scenario, fixed pricing packages may be most suitable.

Capacity

Often advice practices will alter pricing models to attract new customers, preferably those with a higher net worth. Before changing their pricing structure to attract new clients, every firm should consider the 'Move up or move out' approach. This involves moving up the bottom end of your client base into a more profitable service offering. A large tail on an advice book can be dangerous, as these are the clients where things may be more likely to go wrong or might demand more of your time. If these clients do not wish to engage in a more meaningful way, then consider removing them from your business.

Cross subsidisation

Financial planning is very much about personal connection. Many advisers have clients they like and personally get along with, and as a result, they can unwittingly give these clients far more service than what they are actually paying for. Generally, when this happens it comes at the expense of other clients who do not receive as much service as they should for the fees they pay. Before changing pricing structures, you should consider whether one set of your clients is cross-subsidising the other—if so, you should correct this before doing anything else.

Service differentiation

If you currently offer a range of service packages—for instance, both fixed fee and percentage of assets under management (%AUM)—you should assess whether there are significant differences between the levels of service you offer. Why would a client pay thousands more for one extra review a year or a generic newsletter? Consider whether your client service packages are sufficiently differentiated—if not, you may need to re-evaluate your offerings before trying to move clients up on service packaging.

Value proposition

Aligning your pricing methodology with your value proposition is important. If investment research and selection along with bespoke portfolios is a big part of what you do, then a %AUM-based methodology may be preferable. It will reinforce to your clients that you believe in your ability to deliver strong investment performance and are prepared to link your fees to your performance. Conversely, a value proposition focused more on strategy and service can easily be centred around a service package/flat fee structure.

Client base age and risk profile

When thinking about how to maximise firm profitability, the average age and risk profile of your clients need to be considered. If your average client is in the retirement phase and continually drawing down on assets, then a %AUM fee will decline significantly over time. Conversely, a younger client base with a higher risk appetite would provide an increasing revenue stream on a similar pricing structure.

Frameworks for pricing

To help determine your pricing, there are a few frameworks to begin with. For example, whether you are using flat fee, cost plus, or a %-based AUM, understanding your cost to serve will give you a better indication of how much you need to charge to cover your costs.

Cost-based pricing

When estimating fixed costs per client you calculate your entire amount of fixed costs and then divide this figure by the maximum number of clients your business can service. As a rule of thumb, most businesses believe that 120 clients per adviser is the ideal amount. Of course, if you have multiple advisers in one business you may benefit from economies of scale with fixed costs falling.

Fixed costs include things like rent, dealer group and compliance fees, professional indemnity, software tools and electricity bills.

You can take a similar approach to the variable costs involved in a financial planning business. The main variable cost for any service business is staffing. We have used an average working week of 40 hours with 46 weeks per year available—allowing for public holidays and annual leave.

To accurately gauge staffing costs you should consider the activities that each staff member is involved in for each level of service package that you offer. This may include research, fund manager updates, implementation, platform administration, dealing with external bodies such as the ATO or Centrelink, client seminars and webinars and ad hoc queries. You should also consider the complexity of the client's situation, as dealing with trusts, companies, charities etc. with complex needs will be far more time-consuming.

The quote

In a changing climate for financial advice, practices need to be clear about their value and ensure their pricing reflects the important services they provide clients

Damon Riscalla, Betashares

Betashares' national head of practice development, Damon Riscalla, has over 26 years' experience working with financial planning practices, including some of Australia's leading firms. In his role, Damon partners with financial advice practices to enhance the value delivered to clients and develop their businesses. Damon holds a Bachelor of Law, a Bachelor of Business, a Diploma of Financial Planning, and a Grad Diploma in Applied Tax and Financial Planning.

The quote

The technology offered by leading platforms enables transparency and, more importantly, portfolio personalisation at a scale not previously thought possible.

Value-based pricing

Value-based pricing is a concept whereby the price charged to clients for your services revolves around the perceived value of the services rendered to the client. It is a reflection of consumer perception—as opposed to being derived from your cost to serve. The bigger the benefit to the client (and the more you can substantiate this) the more you are able to charge.

When it comes to demonstrating value, it is useful to remember that clients will more easily see value in services that they directly experience. This means that tasks such as investment research, para-planning, and platform administration will not be valued by clients unless the effort involved in these activities is explained to clients. If a large part of your value proposition relies on investment selection and monitoring of investments, you will have to work even more diligently to express your value, as much of this work is not seen by the client.

Value is much easier to display when it feeds into how a client can achieve their financial aspirations—you can do this by modelling the client's outcomes pre and post your advice.

We can often fall into the trap of underestimating value because we undertake tasks so often.

As an example, we may complete hundreds of risk profiles per year with clients. Because we undertake them so frequently, this exercise may lose its value to us, but we need to remember that a client will undertake this only once a year. Having the chance to understand their own risk profile and resulting asset class mix is incredibly valuable—it is just up to us to remind clients.

Final thoughts

In a changing climate for financial advice, practices need to be clear about their value and ensure their pricing reflects the important services they provide clients.

These pricing decisions will have a large impact on the profitability and sustainability of a business, and as such deserve considerable analysis from any business owner. While they can be altered and amended over time to suit the changing characteristics of a client base, it is far easier to prescribe the correct methodology from the start.

Factors such as stage of life, client demographics, business capacity and current industry regulations should all be considered. **FS**

1. FAAA Submission on CP332 Affordable Advice, 2021.