Price Your Value.

HOW BIG IS YOUR TRIANGLE? Is It Balanced?

White Paper 2 in the Pusateri "Pricing Your Value Unapologetically" Series

PUSATERI "PRICING YOUR VALUE UNAPOLOGETICALLY" SERIES WHITE PAPER 2: HOW BIG IS YOUR TRIANGLE? Is It Balanced?

EXECUTIVE SUMMARY

Often the more complicated a business problem, the greater the need for a simple framework to address it. So it is with pricing financial services.

In our previous whitepaper, we defined Pricing Integrity as a function of three factors: fairness, consistency and transparency. We discussed why pricing integrity eludes many financial advisors. In this second in the series, we present the Value Price Perception™ triangle, a simple construct that some of the most successful financial advisors in North America have used to set their pricing, and manage their value and pricing strategies.

Pricing integrity, a simple concept, is surprisingly uncommon. We assert that advisors and firms often either overcomplicate the pricing process, or oversimplify it. Those who overcomplicate tend to look at many factors – real competition, perceived competition, real pricing pressures, imagined pricing pressures, etc. – without simply stepping back and looking at the value they deliver relative to the price they charge. Those who oversimplify tend to price by polling a few advisors in their branch, maybe benchmark a few competitors, and essentially make a very important business decision in less time than it takes them to research a stock recommendation.

We present and discuss the Pusateri Value Price Perception Triangle™, a concept that allows advisors to manage their business like a CEO by seeing how three key factors, value delivered, clients' perception of value and the pricing, align, support or undermine each other. We look at common Value Price Perception Triangles™ we have seen in working with more than 2,000 advisors on this concept. We discuss strategies that each of these advisors should deploy to create a more stable triangle, strategies that affect profitability and equity value of the practice. We additionally address how senior and field leadership at brokerages can use the framework to create smaller tweaks as well as non-incremental improvements to pricing and profitability within their firms.

Opening Beliefs

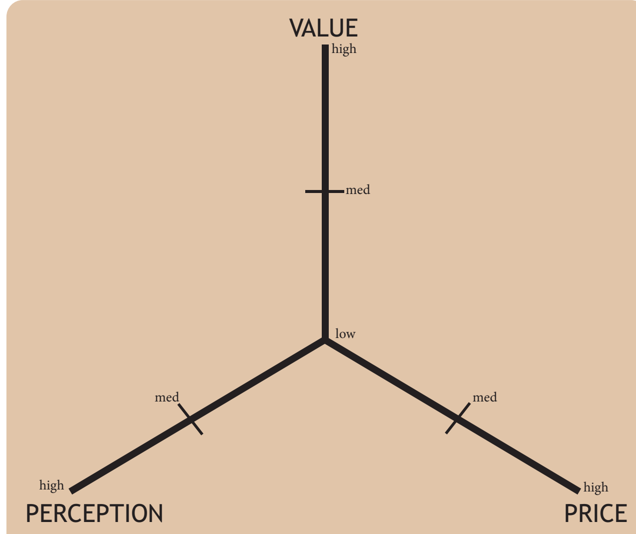
1. Far too many advisors who provide exceptionally high value concede pricing parity to mediocre providers.
2. The advisors who run the best businesses recognize that they need to pay constant attention to the value they provide, how clients perceive their value and their pricing.
3. Advisors often confuse the value they provide with pricing power. How clients perceive value is the real driver of pricing power.
4. Providing value and having clients perceive value are two entirely different matters and need to be examined separately.
5. Advisors can strongly influence, but can never control, how clients perceive their value. However, the subjectivity of value perception should not dissuade advisors from focusing on how they can influence a client's perception.
6. The brokerage firms should provide financial advisors with more benchmarks in three key areas: standards in value delivered, data and norms on pricing within the industry, and objective ways to measure client perception of value.
7. The lack of clear standards, data and norms confuses the marketplace. This in turn allows mediocre providers to overcharge and exceptionally good advisors to be undercompensated for their value.
8. Branch managers have more ability to set the parameters of pricing within their branches than they realize. Branch managers can define their brand by setting pricing policies.
9. Senior leadership of brokerages can likewise play a more active role in supporting and requiring advisors to align their value delivered, perception and price. Cost reductions in brokerage firms can mask the need and opportunity to reprice assets. The real opportunity for brokerages is to challenge, even require, advisors to price their services more fully. The industry will struggle to attain stable profitability unless it addresses the huge opportunity of repricing mispriced relationships.

"The industry will struggle to attain stable profitability unless it addresses the huge opportunity of repricing mispriced relationships."

Introducing the Value Price Perception Triangle™

In whitepaper 1, we defined the concept of pricing integrity as the ability to say this sentence with conviction: I have looked carefully at the value I provide and can say with confidence that there is integrity to my price. In order to have this important phrase in the wheelhouse of one's lexicon, advisors need to look carefully at the Value Price Perception Triangle™, the core concept to Pusateri Consulting and Training's Pricing Your Value program. We have presented the Triangle to more than two thousand advisors and leaders from the US, Canada and Australia, confirming that it is a tool of equal importance both to established, multi-million dollar teams and rookies.

The power of the VPPT is its simplicity. With it, an advisor can see where the opportunities and vulnerabilities are at a glance. The process of drawing one's triangle is invariably revealing to advisors – and often remains a key lens through which they look at their business. The visual simplicity creates "aha" moments, including:



Value Price Perception Triangle™
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1. "I do provide a lot of value to my clients. I just do a bad job of articulating it, so the clients have no idea."
2. "In comparison to world-class models of value delivered, maybe I do have material gaps in my offerings. I should rate myself lower on Value than I initially did."
3. "Once you get past my top 20 clients, who perceive my value as very high, I would say that many of my clients would rate me lower. I am creating brand tarnish by occupying too many points on the Perception axis."
4. "I need to focus more on my clients' Perception than I do at present. That's the real reason my pricing confidence is lacking."
5. "I rate high on Value and Perception, so the real reason I am mispriced is my own insecurity regarding my real value."

What are the most common advisor "triangles?" Which triangles (or business models) are strongest, or most vulnerable? How can an advisor create and sustain pricing power? After discussing each axis, we examine three advisor triangles.

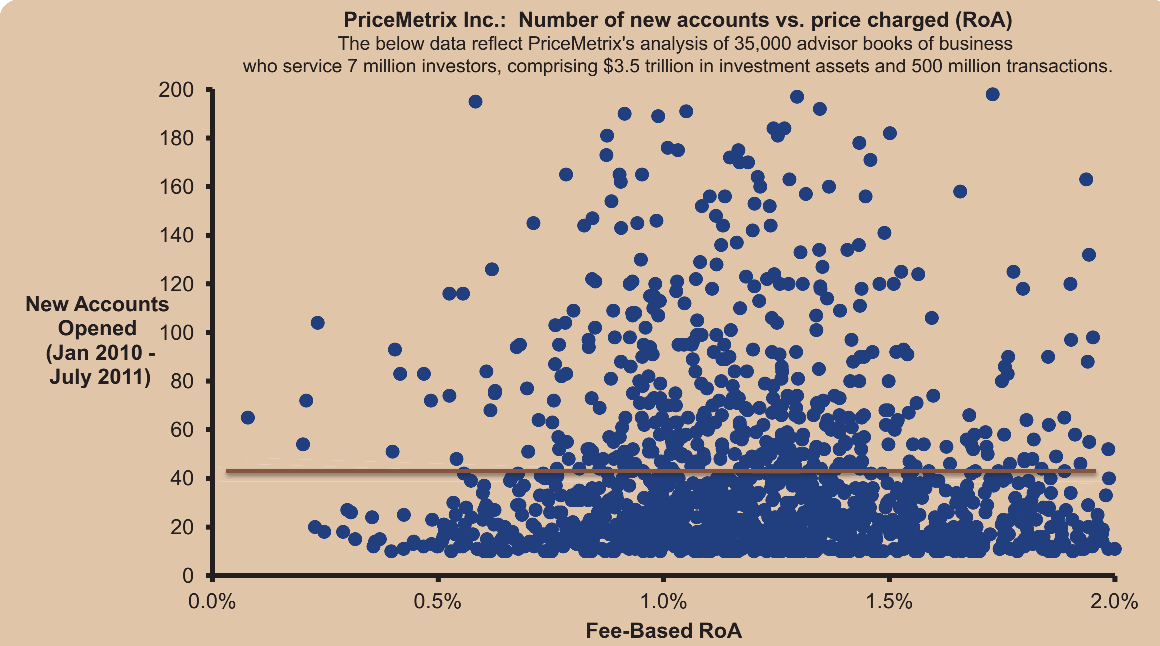
Value Delivered does not equal Value Perceived

Let's disentangle two very distinct measures: the value an advisor actually provides versus how clients perceive an advisor's value.

"I know I have provided my clients with consistent and significant value over the life of the relationship and in one or more areas. As such, I am confident that I should charge a fee that reflects this value."

Where is the flaw in this thinking? The value delivered (or provided) by this advisor does not necessarily create pricing power per se. Rather, it is how clients perceive value that determines your pricing power. Clients need to perceive value in order to be willing to pay for it.

Advisors need to be neurotically obsessed with their client's perception of value. That is, they need to consider constantly how what they do for clients becomes appreciated, and more importantly, valued, by clients. The best providers of value often tend to be the worst articulators or presenters of their value. "My clients know everything we do for them…" is the dangerously naïve assumption when it comes to pricing. Conversely, some of the highest pricers are advisors who focus on client communication, and may mask over rather unimpressive value delivered. Both advisors are vulnerable to losing clients, but in very different ways.



PriceMetrix data show no correlation between lowering pricing and opening more new accounts
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Price Can Drive Perception

Price is part of your value proposition. Many advisors assume that a lower price increases the amount of assets they can gather. PriceMetrix Inc.'s data show no correlation between pricing level and number of new accounts opened. A Pusateri strategic alliance partner, PriceMetrix is a leader in helping wealth management firms enhance revenue growth, by enabling advisors to identify and take action on otherwise lost revenue opportunities.

If there is no correlation between lowering pricing and opening more new accounts, should the opposite approach be used? Consider the power of this statement, "I am an upper quartile advisor in terms of the value I provide my clients. I have priced my services accordingly aligned with the average price for other premier wealth advisors." Now consider the mixed message that this statement provides: "I am routinely rated as a top 25% advisor within my firm, from my clients' rankings. My price, as it happens, is cheaper than 75% of my counterparts, though." Of course, the client, if she accepts these assertions, could be thrilled: "I am getting a top-level advisor for a bottom-level price." More often, though, as clients would say or think: something's misaligned here. If the advisor is as good as he says he is, why would he price his services below average?

Cognitive dissonance, the ability of the mind to hold two competing and seemingly contradictory thoughts, is the mark of intelligence and nuanced thinking. However, buyers are not philosophers. If your claim that your value is premium and your price is below average, they will likely either believe that you are underpriced, or you are overstating your value.

Axis 1: Value Delivered

The process of plotting a triangle begins with the Value axis. Do you provide a low, medium or high level of value? Most advisors, not surprisingly, plot their value as better than medium. It is not until they inventory their value – that is, right down everything of value that they do for clients – that they can better assess whether indeed their self-ranking is accurate. Many advisors complain of a lack of benchmarks: How do I know where my value ranks?
To state the obvious, advisors need to know their value before they can price it. Advisors who are committed to knowing the value they deliver should do the following:

1. Complete a Total Value Inventory™: list all things of value their team and they individually do for clients. Pay particular attention to the non-obvious, but important. For instance, counsel on a business sale, counsel on family wealth dynamics, educating the less financially sophisticated, advocacy in negotiations for clients, due diligence on various investment or lending options are all highly valued by clients yet advisors often myopically point to investment portfolios as the sole source of their value. A one-two page Total Value Inventory™ becomes both a sales and pricing tool when presented to prospective clients.
2. Define their Service Model: The best wealth advisory teams not only have high service standards, they have developed a service model which details how they work with clients, at the start and more importantly throughout the relationship, and on multiple touch points. Often, these are anticipatory service models, ones which anticipate the needs of clients before the client requests something. In a word, service models sell. They also help to justify pricing.
3. Find differentiated offerings: What do I do that no one else, or few others do, or do as well as I do, in my marketplace? This is an important question to answer. Differentiation creates pricing power. Advisors can better compete on value, not price, if they can show that they offer something that others in the marketplace do not offer.

"Differentiation creates pricing power."

Axis 2: Price

The haze that surrounds pricing financial services is truly amazing. Very few clients know what they are paying. Half have no idea, and most of the other half can only roundly state the price they pay. By one leading brokerage firm's study, only 5% of clients could accurately identify what they pay. Even fewer clients know the levels of discounting they receive. Clients do not know what they are paying. However, this client lack of pricing clarity may be easier to understand than why most financial advisors price without accurate and rigorous competitive pricing data. Many advisors go further and treat 1% as the upper range of pricing in their marketplace. This position limits their profitability and does violence to the facts: in every market in North America, the upper quartile pricers' average price on accounts from $250,000 to $20 million is more than 1%, ranging from 2.08% for balanced $250,000-$500,000 to 1.3% for $20 million-$25 million accounts, per PriceMetrix data.

Advisors need to know whether they are low, medium or high priced, relative to their peers. Guessing is no longer necessary, given internal brokerage firm and third-party data sources available. We encourage advisors to determine whether they are low, medium or high value providers and price according. For instance, saying "I am a premium value provider and am priced accordingly 25% higher than the average," is a remarkably powerful statement. Price is part of the value proposition. To misalign price with value levels is to confuse the buyer. Few industries operate with more misalignment between price and value levels than brokerage.

Relative pricing is only one lens through which advisors should look to price. For example, advisors should also look at their price as a fair capture of the absolute value they provide on an ongoing basis. Is my price fair considering the benefits, measurable and qualitative, that my clients gain? Further, advisors should be aware that pricing robustly during wealth accumulation modes is effectively a pre-payment for advisory services to clients in decumulation mode. We hear many advisors struggle with the ethical quandary that the clients who need them most, retirees spending down their wealth, encountering health expenses, become less profitable at the very time they need the advisor's counsel more than ever. Third, advisors should price the risk they and their firms immediately assume when taking on each client. These risks include risks of lawsuits, risks of compliance complaints, and the risk that, at some point every 3-5 years, that client will have his or her own black swan event, which will require the advisor and his or her team to provide extraordinary, possibly emergency level services to handle an unforeseen financial, business or medical problem the client encounters.

Pricing strategies for advisors:

1. Determine whether you want to be a low, average or premium provider of value. Decide whether, if you intend to be a premium provider of value, you intend to charge premium pricing.
2. The simpler the cost structure, the more trusting a client will be. If it takes more than one sentence to describe, then client will be wary of complicated structure. Some advisors do leave a range of pricing, as they examine various factors. This is acceptable. What is not acceptable to discerning clients is to get the sense that the advisor is effectively acting like Priceline, extracting the highest fee possible given each particular clients' willingness to pay.
3. Explain how you set your price. Clients do not necessarily want to work with the lowest cost provider. But they want to know what they are getting and what they are paying. The lack of clarity on a fair benchmark causes clients to request pricing discounts, as a hedging strategy against the uncertainty they have in knowing what it is they are paying for.
4. Challenges to prices should be seen as requests to validate value, not as demands to discount.

Axis 3: Perception

Value delivered becomes pricing power only if it translates first into clients' perception of value. Too often, advisors assume that value delivered translates into clients' perception of value: they must know what I do or would do for them.

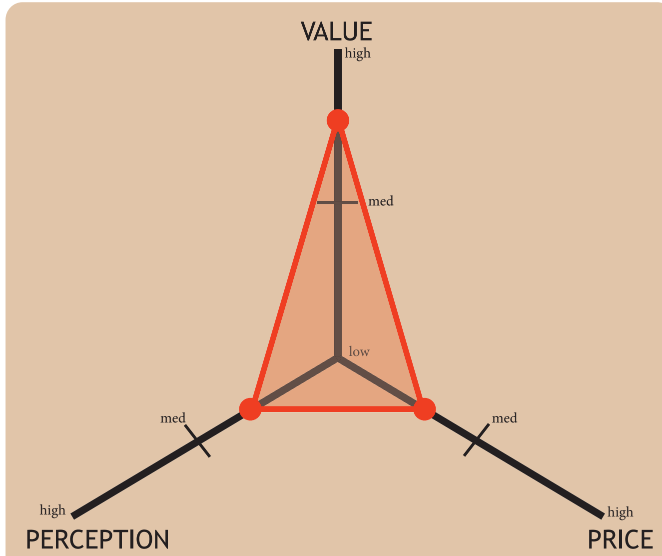
How do you know how clients perceive your value?

1. Conduct a Relationship Time-Out™: sit down with your clients and ask them seven key questions about how they see you and perceive value in the relationship. Why did you hire me initially? What would you say I do for you? What is the value I provide? How do you measure the real value in our relationship? Are there gaps in what you want me to provide you with?
2. Showcase client successes. Without betraying confidentiality, speak to the complexities and challenges you have resolved with or for other clients. Doing so reinforces your value, validates their decision in working with you, and educates them on what you do of value for your clients.
3. Quantify your real value. Did you cause your clients to stay invested in equities at the bottom of the markets in 2009? Have you addressed tax and estate inefficiencies? These should be easily quantifiable points of value, and thus should be presented to clients to reinforce their perception of your value. Showing that the measurable value delivered is fractional to your price can dispel client skepticism on your value.

Value Price Perception Triangle™ Examples: Do you know anyone who looks like this?

Let's look at various advisor triangles, each with different strengths and vulnerabilities. Do you see yourself in any of these advisors? What would you do if you were one of these advisors? How would you coach them? Would you want to compete against them?

Advisor 1: The Philanthropist



Value Price Perception Triangle™
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Here we see an advisor whose value delivered is well above medium, veering toward high. However, the client perception and price ratings are low, certainly below middle. It is indicating an advisor who provides an exceptionally high amount of value, but whose clients don't perceive value, and perhaps as a result, commands an equally low price. What's going on here? The advisor could simply be a bad communicator: I do good work quietly. My client must understand this. Each time an FA adds value, what we call a value inflection point, an opportunity to reinforce client perception occurs. But if the clients are unaware of it, the new value translates neither into a higher perception of their value, nor by extension, pricing power.

Ms. Philanthropist became all the more common in 2008. In the worst equity markets, Ms. Philanthropist provided more value as the markets declined, yet the clients saw less and less value in their accounts. As a result, these advisors felt little ability to raise their fees to reflect the value they actually provided. What they should have done, of course, is to narrate to the client all of the value being provided in tough markets. At the very least, this would have created a greater likelihood that the clients would appreciate the added value being provided, and reward with greater willingness to pay more, then or when account values recovered.

Strategically, the advisor here needs to continue providing remarkable value, but focus more on client perception:

- Shift focus to articulating value, making sure the clients understand the real value of the work he or she is doing on their behalf. How can this be done? As discussed earlier, we suggest conducting Relationship Time-Outs™, an interview where clients really reflect on the value they perceive in the relationship. Client advisory boards are another very powerful tool to put into place, as they invariably provide valuable feedback on what advisors should do more of, stop doing or add as an additional point of value.
- One surprising approach, but often effective, is to change price to force a client to reevaluate and see the value delivered. "For years, we have quietly provided extraordinary value. We believe we have affected your financial and business successes in these five areas.... We remain confident that our value will continue to exceed the norms in wealth services. We have long underpriced our services. We have made a decision that our services will now range from 1.5%-2.0% fees for assets under management, which we believe will remain fractional to our value…"
- Be candid in repositioning the value provided: "I have done a poor job of telling you what we have done on your behalf. Over the last three years, however, we have accumulated significant 'wins' for you on many fronts: lending, investments, business counsel, tax and estate, ironing out the difficult family financial dynamic. In fact, we

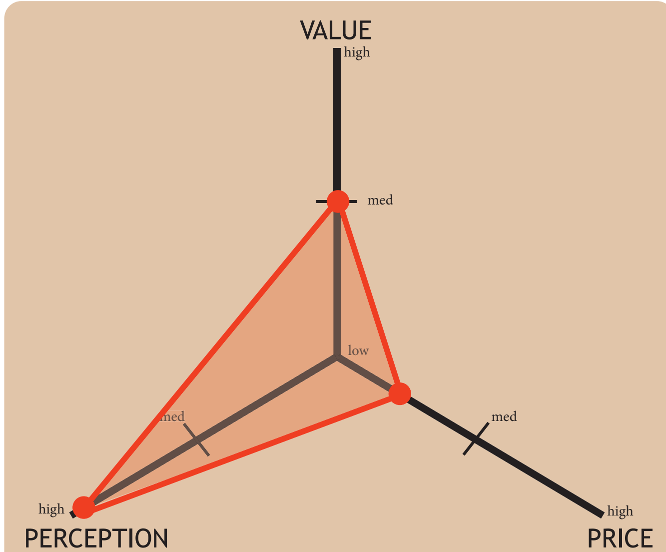
have quantified the value. In managing $800,000 over three years, we have provided an incremental $120,000 in investment successes and through renegotiation of your debt and rethinking your taxes, we have saved your family $37,000. Importantly, we are just getting started, and have every belief that we will be able to provide you with even more value going forward."

Pricing courage — that is, the conviction to charge fully for the value provided — is absolutely essential for advisors with low pricing and low client perception of value.

"One surprising approach, but often effective, is to change price to force a client to reevaluate and see the value delivered. For years, we have quietly provided extraordinary value. We believe we have affected your financial and business successes in these five areas...."

Advisor 2: The Social Butterfly

Clients love Mr. Butterfly. He's very sociable, well regarded in the community and approachable. He's always asking the branch manager for money for client engagements. Service and responsiveness are highly honed skills his team and he employ. He may have material gaps in the depth of his knowledge of certain products and solutions, but he has surrounded himself with good experts and is conversationally proficient on many matters.



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So why, if his clients adore him, does he price his business as low as he does? Mr. Butterflies typically tells you that he gives his clients a lower fee because they are his friends. He may selectively discount for friends. And there is some truth in this answer, but it masks another reason: the advisor knows he could be providing even more value.

Branch and sales managers often bang their heads against the wall, trying to get Mr. Butterfly to reprice higher. In our experience, the key to helping these advisors gain comfort in pricing their services more robustly is to help them enhance the value they deliver. It's often unrealistic to expect a highly social, great communicator to become obsessed with learning technical financial skills. The better approach for Mr. Butterfly is to partner with one or more of the legions of technical experts in financial services who desperately need to team with a great client service person. With the value inflection point of adding a new team member, these advisors tend to become much more open to repricing their services to capitalize on their clients' perception of their value.

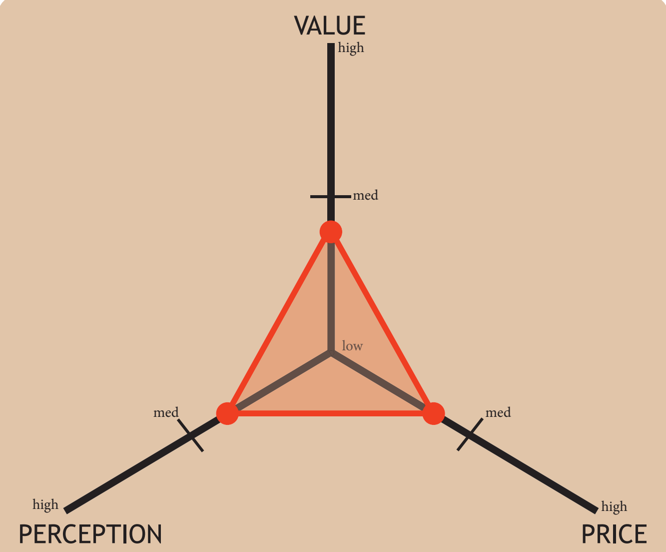
Other strategies to move Mr. Butterfly out on the pricing axis rest with the firm itself: changing a compensation model, such as shifting to fees, or limiting the number of clients with whom the advisor would work with going forward. The bottom line is that this advisor has untapped pricing power, but only if he focuses on enhancing his value delivered in parallel with a change in price.

Strategies:

1. Change the mindset to focus on providing more substantial value and less commoditized offerings, in order to defend against competitors calling the client's attention to value gaps.
2. Partner with skilled value providers who are highly contented to deliver value in support roles.
3. Firms can shift their compensation models to effectively force this advisor to reprice clients.

Advisor 3: Mr. Volume / Low Contact

Low price. Low perception. Low value delivered. A brilliant model for some commoditized industries where there is a limit to how much value a client would perceive, this model rarely works in full services financial services for the simple reason that it's nearly impossible to gain the high volume to make this model work. Full service financial advice is a lot less scalable than many advisors imagine. Even discretionary accounts require individualized attention. Mutual funds or ETF providers can succeed with this triangle, but then, mutual fund managers have no personalized contact with the end clients. We have seen many advisors overestimate the scalability of their business. They thus take on too many clients, as each relationship produces little revenue, and the piling on of too many accounts, of course, further strains the advisor's ability to provide more value and to service the clients.



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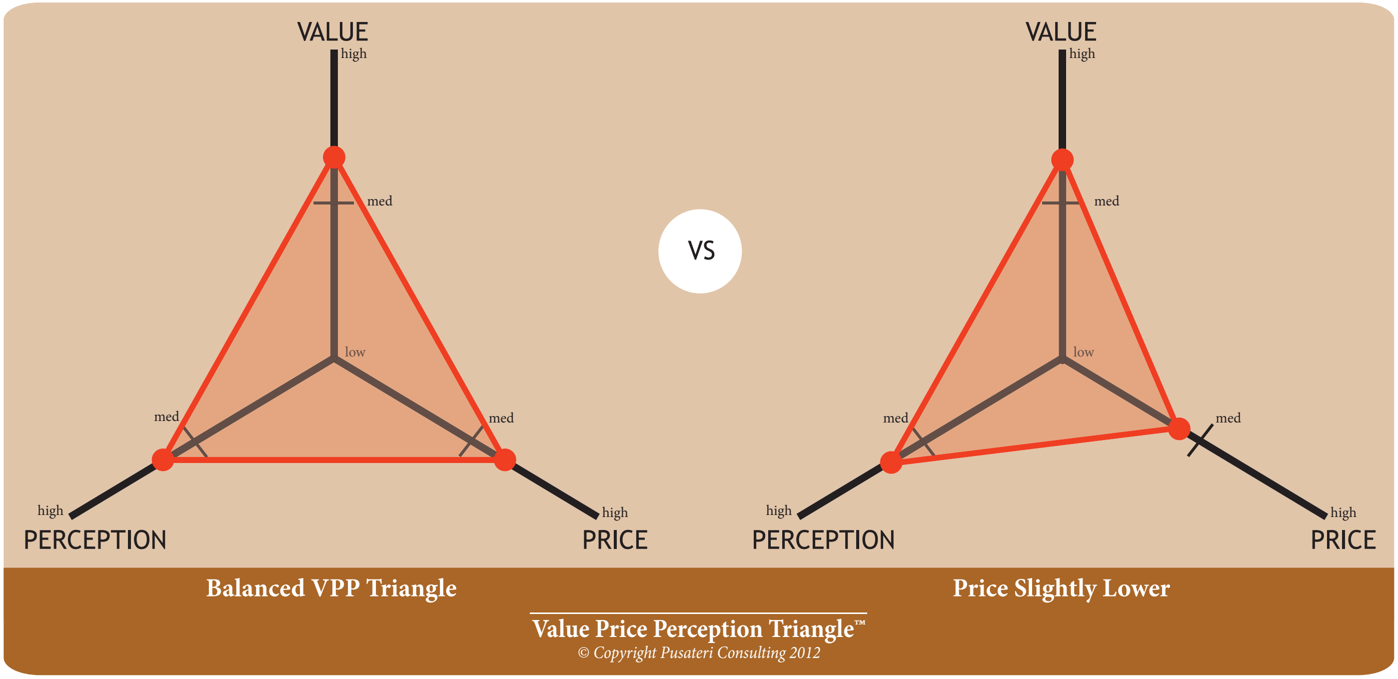
Strategies:

1. Recognize the near impossibility in a high-touch, full service business to compete and win on providing on low price, high volume offering. Only pure traders and institutionally-oriented advisors can make this model profitable.
2. Validate whether clients are contented to receive low service, low value levels. Consider whether this is the value proposition they expect. If it is, this model can prove sustainable. Bear in mind that any client can file a complaint. Is the risk of a complaint worth a low profit relationship?
3. Should this advisor want to change his or her model, a radical rethinking must occur. Often, the best strategy is to overlay a financial planning process into each relationship, as a means of deepening an understanding of the client and recalibrating client expectations of value.



Should a Triangle Be Completely Balanced?

We should note that some advisors would prefer not to capture every bit of their perceived value and value delivered in their price. In other words, they'd rather price slightly below the level that their client perception would allow. Any triangle that allows for sustainable value delivery and which has pricing integrity – meaning the price is mutually fair to the provider and client; transparent: the client knows the price and how it has been set; and consistent – is a stable business and acceptable reality. Thus, some advisors who choose to run slightly imbalanced triangles can claim pricing integrity as much as those with the three legs of the triangle completely aligned.

Summary Strategies

1. Advisors need to know their Value Price Perception Triangle, and be honest with themselves as to where they are, and where they should be. The triangle should reveal the opportunities and vulnerabilities in your book of business. It should also provide you with a framework for continually rethinking what you do for clients.
2. The triangle should allow you to see the difference between providing value, and getting credit for it with your clients. You should be equally focused on doing both.
3. Avoid overwhelm. Figure out where you can improve your business first. Find a strategy that you can implement for one axis right away.
4. Branch managers should be actively involved in coaching advisors to create the correct VPPT for themselves. Branch managers can also set a range of acceptable triangles within their branch.
5. Wealth services firms' senior leadership should set clearly defined standards for value delivered, clients' perception and pricing policies. Firm leadership has more ability to affect standards of value and pricing policies than leadership often realizes. Firms allow too much pricing discretion, and thus too much brand tarnish. They do so mainly out of fear that constraining pricing prerogatives of advisors will cause advisors to move their businesses to other firms. This approach undermines brand, profitability and lacks fundamental courage and conviction in their firm's value proposition to advisors and clients. Firms would be well served to tighten pricing bands for advisors. We believe the firm that does this may actually experience a first mover advantage, not disadvantage. Advisors often quietly request that their firms narrow the pricing flexibility advisors have.