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The Robo-Revolution and Other Threats To The Way You Do Business

Are you aware of Robo Advisors? They are currently taking market share in the US – one firm Wealthfront is bringing in $100,000,000 per month. What do they do? They use algorithms to evaluate clients risk parameters and make Index recommendations including re-balancing all for .25% of assets. Does your business model bring enough value added to justify the extra fees your clients are paying?

The argument against Robo Advisors succeeding is the need for individuals to have personalized service. I agree most people want personalized service especially the older clients. Two groups that are using Robo Advisors in the US are those working at the technology companies and pro athletes (see "Wealthfront deal with 49ers is a big marketing score"; Investment News). They are young and high income clients that trust and are comfortable with technology.

When I came into the industry 20 years ago I could open an account over the phone, the account form was one page, I did not need a signature and I could buy the client an investment before I got a cheque. Have times changed? I often ask myself – with all the regulatory changes – who is better off? But that is a discussion for another paper. The point is times are changing.

When we combine this Robo/technology threat with the changes in regulation and the financial product distribution industry it probably means we have to make structural changes to our own business model.

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THREATS TO YOUR BUSINESS MODEL

Consider the following threats to the way you currently do business:

1. Many consumers currently consider investment advice a commodity. They see little difference between an independent advisor or broker or a bank or a "career agent". That is why many will deal at the bank with an advisor with 15 – 20 ……… hours not years of experience. The reason is the amazing branding banks have done (they have had a 100 years!). Banks are trusted. The advisor might leave but the bricks are still in the same place therefore who sits in front of the client has become irrelevant.

2. Consumers are getting used to "shopping" for financial products. Many check out term insurance prices and follow their investments on the internet. How many of your clients have or will leave the institution where they have their mortgage for 1/8 of 1%.

3. Historically investment managers do not beat the Indices especially on a risk adjusted basis. According to the Economist (August 9, 2014) based on two studies in the Financial Analysts Journal (July/August 2014) that fewer than 25% of managers even last 5 years. The main reason cited for under performance is that the managers are compared to all of the other advisors – therefore they are not trying to beat the index they are trying to beat the average.

4. Right now there is a large part of the population being neglected by conventional advisors. They are the younger person with little savings now. These are the people who use technology for every facet of their life. They depend on technology and that way of life. Will they continue to use technologies for their financial decision making when they have lots of money?

5. Technology is cheap now and always getting cheaper especially on a per transaction basis and cost of storage. The economy of scale is significant as there can be hundreds of thousands of clients but they can be slotted into a finite number of boxes where the algorithms do the bulk of the work.

6. The middle of the distribution channel – broker, dealers, mga, exempt market dealers – is squeezing advisors. They are cutting payouts and pushing costs and liabilities down to the advisor. While they are raising revenue expectations they are also cutting payouts. Lower revenues and higher expenses appear to be the trend. The survivors who will thrive are the advisors who are willing and able to change and adapt.

7. Trust. The industry has done very little to place the advisor in the community's mind eye as a knowledgeable, helpful and trustworthy professional. As a CFP I wonder where and what that organization is doing. I see very little return on that "investment" both from my perspective and from the "client" perspective.

I am sure I am missing many other threats but the above should give us all pause. Until the early 90's the consumer marched down to the closest bank or credit union and got a guaranteed double digit return. Then they all poured into mutual funds and basically got double digit returns through the 90s. Expectations of the consumer were off the charts. "Snap back to reality!" The 80s and 90s were not the norm. Now consumers realize if the long term returns are going to be 6 – 8% that if they can reduce costs they are actually increasing returns.

INDUSTRY DISRUPTORS

The white paper by Deborah Fox of the Fox Financial Planning Network "How To Build A Robo-Shield For Your Financial Advisory Firm" describes how Robo Advisors are disrupters of the status quo. The four stages of Industry Disruptors are:

- Stage 1 – The Disrupter enters the Industry – a few years ago there was the start of robo advisors but no one took them as threat to the status quo.

- Stage 2 – The Disruptor gains transaction in the Industry – The disruptor captures a small but significant market share. The status quo takes notice.

- Stage 3 – The Disruptor becomes entrenched in the Industry. More disruptors pop up. The top firms in the status quo implement evolutionary changes to their business model.

- Stage 4 – The Disruptor forever changes the Industry. The firms that evolve out of the status quo will thrive. Those that don't evolve lose market share or cease to exist.

Though still at Stage 1 in Canada, Robo Advisors may be close to Stage 3 in the US. The US has been very fee sensitive for a while but certainly it is becoming an issue in Canada as well.

CNBC released their 50 Disruptor List for 2014 recently (http://www.cnbc.com/id/101734664). All were technology companies and 11 were directly related to personal financial planning. One firm; Personal Capital does a financial plan, investment plan and the client can track all their expenses through the same site.

The other elephant in the room is CRM2 which I get calls about daily. Many think it will force advisors out of the business but I personally give advisors much more credit than that. I feel the effects will not be as dramatic as we fear. The key to not having to compete on price is to have consistent and excellent service. The second part of your value proposition has to be clearly communicating that value to your clients. If you are constantly competing with "what and where is cheaper" than your clients are viewing what you bring to the table as a commodity. Your clients will be looking for the cheapest.

YOUR BUSINESS MODEL

An important issue to remember is that technology like Turbo Tax or Quick Tax did not put accountants or tax preparers out of business. But the accountants who did not evolve into a more sophisticated business model did feel the pain. There are always disruptors in every industry. It is important to look at your business model and your skill set and figure out how you can change your business to bring a value added proposition to your clients.

Here are some ideas to reduce the effects of CRM2 and/or Robo Advisors and /or any other disruptor:

1. Your business model has to reflect your strengths. Are you a generalist? Maybe a financial planning model. There are many successful business models in our industry but the model has to fit your strengths.

2. Know your target market. Know who they are, where they are and what they want (need). I think too often we define a market by the size of their savings. It is impossible to only prospect million dollar accounts because the owner can be from all walks of life. Your target market is who more than how much. If you are targeting trades people or brain surgeons – than you will know where to find them. The other factor is what are your interests? Your best clients will be the ones with the same interests. I have a friend who

translated his love of cars, boats and snowmobiles into specializing in the transportation industry.

3. Know your Service Proposition and how to communicate it to clients. How are clients treated? How many touches? How many appointments? Be sure your team is on the same page. Compensate staff based on the service of clients expected and provided.

4. Be more than a one or two trick pony. Don't just work with investments and insurance to replace income. Bring more to the table. If you have a situation outside of your comfort zone – have a referral ready (Center of Influence). That can cover mortgage, income tax, property insurance, debt management, estate planning, succession planning, etc. – become the relationship manager for all things financial.

5. If you have a speciality and are in a niche market than that should be communicated to your target market. Your target market may be other professionals to refer to you. Know your value added.

6. CRM. This is the most important feature (especially to increase value) no matter what your business model. This gets everyone on your team on the same page. This is both in the client's personal life and their financial life. You should know that Bill is a hockey fan and that his mortgage term is up in 3 months. One of the most ignored facets I encounter is advisors who want to grow their business but do not have a prospect list. Build a list with social media. In addition, the more you know about your prospects – the better chance they become a client (especially if their interests are congruent with yours).

7. Use technology as a way to lever sales and service. Financial planning, contact management, investment analysis, income tax software, etc. can all

be used to efficiently and effectively help you with your clients. Present information with charts and graphs – most people are visual learners.

8. Have a Strategic Marketing Plan. Make social media part of your marketing. It does not matter who your target market is as you can create touches with clients and build a prospect list. Host client education and appreciation nights. The more touches the better. Some experts say as high as 70 contacts a year. Your marketing plan should have a referral program; identify centers of influence, charitable function projects, etc. The most important aspect = measure and monitor the results comparing budgeted and actual. Analyze how you are doing and know which areas to improve. Everyone says to me – "I need more referrals" but when asked they do not have a plan to achieve more referrals.

9. Think outside the box. Offer free financial planning advice to your client's adult children. Show them the benefit of starting early. Have their tax returns done. What differentiates you from your competition? Find the value added and tell everyone.

10. Educate and communicate. Tell your clients the different options they have available to them. Explain products and compensation and alternatives. Make your clients feel you are not hiding anything.

11. Clearly communicate your value added every chance you have. You and all your employees should be able to concisely and clearly explain your value proposition.

12. Bottom line – don't have a book of business; have a business.

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CONCLUSION

In conclusion the industry is changing dramatically. As an aside; but an example of industry changes are the current regulatory problems with Warren Buffett's Berkshire Hathaway. Mr. Buffett's motto has always been put trust in your people but be careful who you trust (isn't that great). Well they have been late filing reports (that don't mean anything except to lawyers at the SEC I guess) on some of their investments and have been fined. Mr. Buffett has always been proud of the fact that he runs BH on a skeleton staff and does not use a computer (easy for him with his brain). But it looks like the processes of head office may have to change.

For those of us without Mr. Buffett's personal capacity we have to adjust and change our processes sooner rather than later.