Automated investing

Key considerations
and opportunities for RIAs

MKT Market Knowledge Tools

About Schwab Market Knowledge Tools® (MKT)

Based on the leadership position of Charles Schwab & Co., Inc. in the RIA marketplace (nearly 7,000 advisors and over 25 years as of this printing), we are in a position to observe what works in successful advisory firms. Through Schwab's proprietary benchmarking and in-depth qualitative research with successful firms, we are able to discover and share best practices.

This white paper is part of the Schwab MKT series, an ongoing program of industry research reports, white papers, and guides from Schwab that are designed to keep investment advisors on the forefront of trends and competitive challenges facing the industry today. The MKT program delivers the kind of relevant and timely information needed for business planning.

About the 2015 RIA Benchmarking Study from Charles Schwab

Schwab designed this study to capture insights in the RIA industry, based on survey responses from individual firms. The 2015 study provides information on topics such as asset and revenue growth, sources of new clients, products and pricing, staffing, compensation, marketing, technology, and financial performance. A total of 1,007 advisory firms that custody their assets with Schwab and represent three-quarters of a trillion dollars in AUM participated this year, making this the leading study in the RIA industry.

The RIA Benchmarking Study comprises self-reported data from advisory firms that custody their assets with Schwab. Schwab did not independently verify the self-reported information. Participant firms represent various sizes and business models. They are categorized into 12 peer groups—7 wealth manager groups and 5 money manager groups, by AUM size. Unless otherwise noted, study results are for all firms with $250 million or more in AUM, representing the vast majority of total assets managed by this year's participants.

The study is part of Schwab's Business Consulting Services, a practice management offering for RIAs. Grounded in the best practices of leading independent advisory firms, Business Consulting Services provides insight, guidance, tools, and resources to help advisors strategically manage and grow their firms.

For more information

To learn more about these and other resources, visit the Practice Management section of News & Resources at schwabadvisorcenter.com. To learn more about automated investing, including the Institutional Intelligent Portfolios™ platform developed for advisors who custody with Schwab, please contact your Schwab Relationship Manager.

Contents

The growth of automated investing has generated extensive discussion and debate among financial services providers. Some observers say technology-powered investment platforms are poised to have a disruptive effect on the industry. Registered Investment Advisors (RIAs) in particular are taking notice. Automated solutions have the potential to change investor expectations about access to and the cost of investment management services. These changing expectations could have a ripple effect that extends to other facets of the advisory business, including how firms articulate their value, the channels through which they interact with clients, and how they rationalize their fee structures.

This disruptive effect, however, may not necessarily take the form many advisors initially expected. Rather than a threat to be countered, automated offers are increasingly seen as an opportunity from which advisors stand to benefit.

Many advisors have mobilized in response to the changing landscape, and are weighing the transformative effect that automated investment technology could have on their businesses. They are exploring how they might leverage third-party automated investment technology to serve certain segments of their client base more efficiently and profitably. Some of the early adopters are going beyond their existing client base and are proactively targeting new investor segments with an automated offer.

As advisors consider such options, they are also looking at both the technological and cultural implications of making a significant change to their offering. Integrating an automated, lower-touch model could require a substantial cultural shift to get staff to approach client service differently. Cultural and technological considerations are often intertwined: The extent of a firm's technology adoption and consistency of use may be helpful indicators of cultural readiness to incorporate automation. For firms that have already streamlined many of their operational processes, it may not be as big of a cultural leap for staff to integrate investment automation tools.

Regardless of whether a firm intends to incorporate a digital offer into its strategy, the emergence of automated investment management presents an opportunity for RIAs to sharpen their value propositions, reevaluate their client segmentation approach, and boost their integration of technology to deliver a modern client experience.

This paper is intended to help advisors evaluate their business and technology strategies as they consider how to prepare for and possibly participate in the automated investment movement. It examines:

- **Opportunities to leverage an automated offer**, from serving smaller accounts more cost-effectively to expanding into new markets
- **The importance of clearly articulating the value** an advisory firm delivers to its clients
- **How a thoughtful client segmentation strategy can benefit advisors and their clients** by better aligning needs, service, and expectations
- **How to assess whether a firm is ready**, both technologically and culturally, to adopt an automated offer
- **Considerations for pricing an automated offer**, including understanding cost to serve and communicating the fee structure to clients

Disruption is nothing new to RIAs. In fact, it's in the industry's roots, when entrepreneurial advisors challenged the status quo and won clients away from the traditional brokerage model. Now, many advisors see this shifting landscape as an opportunity to be disruptors once again. For while there is much about this market that is still taking shape, one thing is certain: There's no going back.

Exploring the opportunities

What do RIA firms stand to gain from introducing an automated alternative into their traditional service model? Advisors have identified two key opportunities:

- To better serve existing smaller relationships or sub-accounts belonging to core clients more cost-effectively, resulting in more time to focus on and grow the firm's ideal client base
- To create an offer for serving new clients who might previously have been turned away

Some advisors envision a phased approach, starting with migrating a portion of their current client base to an automated investing platform and, when it proves viable, eventually expanding to new segments. The ultimate goal with this offer, though, is to free up time to continue delivering highly personalized service to their highest-value clients and to grow this portion of their business.

Whether a firm chooses to leverage a third-party offer, build its own automated model, or take a wait-and-see approach, an examination of the opportunities that automated investment management presents is a worthwhile exercise that can help firms sharpen their focus.

What is automated investment management?

Because there are many players in the space, including both direct-to-investor and advisor-branded solutions, automated investment management takes many forms, with varying degrees of human interaction. There are, however, a number of common elements:

- A sophisticated web interface with mobile access
- A paperless onboarding process
- An online questionnaire to assess an investor's risk profile and investment goals
- Analytic-powered algorithms that construct portfolios from a prescribed set of investment vehicles based on the client's risk profile
- Automatic rebalancing and, optionally, tax loss harvesting

Though algorithms are making the investment decisions, there are some very bright investment minds behind the scenes devising the formulas that automate those decisions. It's unlikely, however, that clients will ever come into contact with them. Ultimately, automated platforms are all about driving efficiency and scale by allowing little to no human interaction or customization, which translates to a low price for the investor.

Serving existing clients more profitably

When considering an automated offer, many advisors will think first about how it might help serve a certain segment of existing clients more cost-effectively. An automated offer can, for example, provide a way to serve smaller "accommodation" relationships more profitably by aligning servicing costs and fee structures with the client's needs and revenue contribution to the firm.

> "In the future, we could use an automated platform to enhance our service to existing clients and to target new audiences. In the near term, we see using it to work more efficiently with smaller clients with less complex reporting and day-to-day servicing needs. I think many RIAs have a large cohort of such clients because we're in the business of helping people, not turning them down."
>
> —Eric Sontag, Sontag Advisory

Although most firms have stated account minimums, they will often waive those minimums to accommodate an established client's referral, friend, or family member. In fact, Schwab's 2015 RIA Benchmarking Study revealed that 89% of firms reported serving clients with assets below their stated minimum—and often at a loss.[1] The amount of time required to service these relationships is often disproportionate to the revenue they generate. Many advisors are evaluating moving these clients to a lower-touch, automated offer not only to reduce their cost to serve but also, and perhaps more importantly, to free advisors to focus on larger accounts with more complex needs. Such migrations may have tax consequences that will impact the decision.

Legacy clients brought on early in the life of a firm—perhaps before a stated minimum was in place, but who now fall well below the minimum—represent another set of candidates for an automated offer. Advisors may be reluctant to terminate these relationships out of respect for the clients' loyalty and early confidence in the firm, but at the same time they realize they can no longer profitably provide the current level of service. An automated offer could be a viable solution to continue to address these clients' needs while maintaining profitability.

Within an advisor's existing client base, incorporating an automated offer presents a solution to a problem—how to manage less profitable relationships, or even manage the smaller accounts of ideal clients more efficiently. Looking beyond the opportunities with existing clients, an automated platform also has the potential to open up new channels of growth.

Opening the door to new investors

A digital offer can enable advisors to extend the benefits of independent investment management to clients who might previously have been turned away because they could not meet a firm's minimums and/or profitability goals. With automation, a sizable reduction in the cost of service is possible depending on how a firm structures its offer and which value-added services it may choose to layer on top of it. This scenario assumes that the digital offer would include fewer touchpoints or value-added services than the advisor's core offer. This could enable firms to proactively pursue new segments of investors that might have been unprofitable previously but that could now become potential sources of growth for the firm. Prospective clients who could be targeted with an automated offer could include those who:

- **Have a lower level of investable assets** than core clients, and thus likely have less complex needs
- **Prefer a technology-driven experience** that may include self-service tools and virtual or electronic communication rather than in-person meetings
- **Are high-net-worth yet more price-sensitive**, and may be less interested in or not in need of many of the additional services that warrant higher pricing

Some advisors are also considering introducing an automated offer in order to more proactively engage clients' children who may one day inherit their parents' wealth, but do not currently have the level of assets to warrant the services of a core offer. A digital investment management platform would enable an advisor to cost-effectively manage portfolios for these children (often adults) while keeping them engaged with the firm. By developing these relationships, advisors increase the likelihood that the children stay with the firm when they do become the beneficiaries of intergenerational wealth transfers and have more complex financial needs. Building this connection now through automated investing can help naturally migrate the children's accounts to an advisor's full-service offer when the time is right. Having an offer to serve clients' children may help drive referrals of ideal core clients to whom this service would appeal.

> "Today Boomers drive profits, but we'll need new choices for future clients. Millennials often prefer electronic interactions, and an automated platform might be valuable until their lives get more complex and they choose to transition to a more personal approach."
>
> —Robert Moser, Laird Norton Wealth Management

> "Business development can be frustrating for next-generation advisors because few people in their social circles meet our minimums. For these advisors, a technology-driven solution that enables us to take on clients with lower minimums—and make them profitable—could be an opportunity."
>
> —Roger Ward, TrueWealth Management

While an obvious new target is younger investors who may prefer an online experience to human interaction, the appeal of technology-powered investing is by no means limited to this demographic. Online access and self-service tools appeal increasingly to a broad swath of the population that is tech savvy and value conscious, regardless of age or asset level. The ubiquity of technology adoption—e.g., the cloud, social media, mobile platforms—among multiple generations is, in fact, reshaping consumer expectations and driving change across most industries. And while cost cannot be ignored in understanding the appeal of automated investing platforms, convenience, transparency, ease of access, and a satisfying client experience are also important.

Expanding referral opportunities

Advisors see growth potential in creating a segmented offer powered by an automated platform that helps get more of their staff and clients engaged in their referral strategy. Referrals are far and away the primary source of new business for advisory firms. In fact, our annual RIA Benchmarking Study reveals each year that referrals generate an average 70% of new clients and assets in a firm.[2]

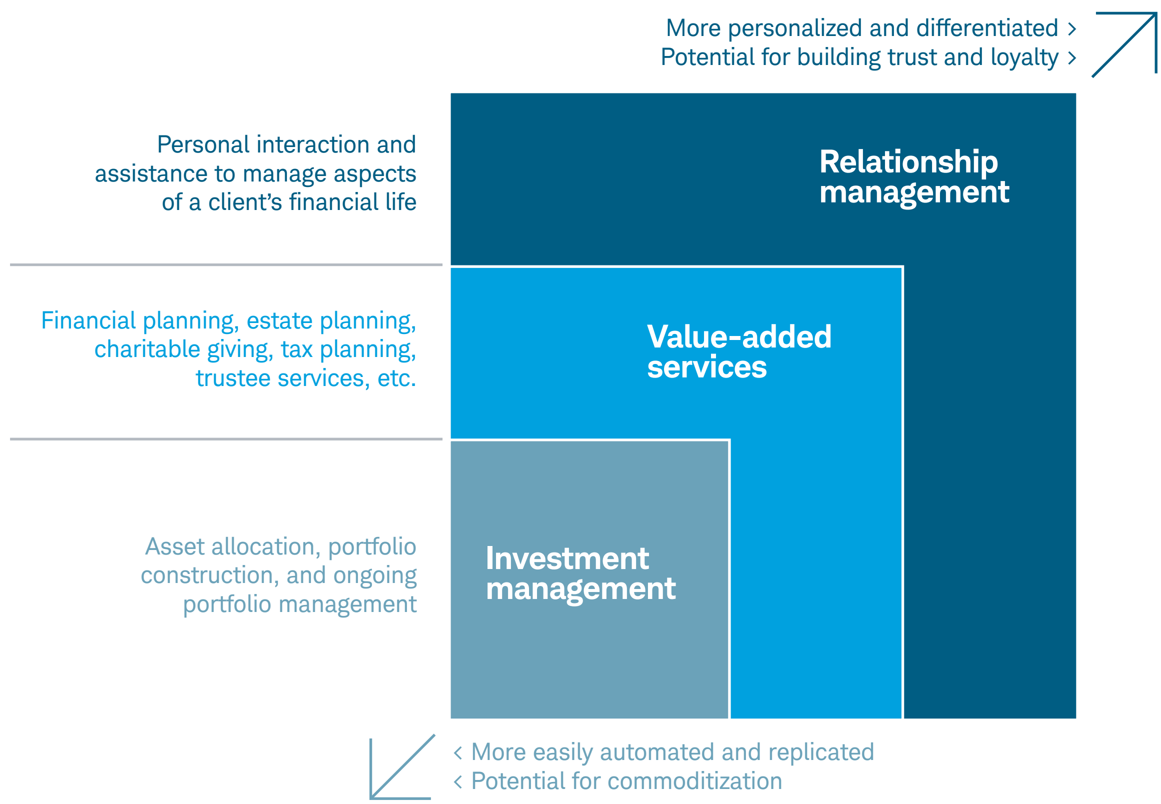
Those referrals often come through social interaction or community engagement. Younger team members may not come into frequent contact with established, high-net-worth individuals, but they more likely have connections among people like themselves—upwardly mobile professionals with growth potential who are starting to accumulate wealth. Defining an offer with a smaller account minimum may make junior staff more comfortable talking up the firm within their social circles. Loyal clients and centers of influence may also find it easier to make referrals if an offer exists that suits acquaintances with lower levels of assets. An automated offering gives them a story to tell and an opportunity to contribute to the firm's growth.

Exploring new directions

Some advisors are considering launching a separate-but-affiliated entity—complete with its own branding, staff, and points of entry. This new organization would be built on an automated investment management platform but could leverage the parent firm's infrastructure for rapid scale. Advisors at the parent firm would then have somewhere to refer prospects who don't meet their minimum but who could benefit from the firm's intellectual capital and investment strategy and still be served profitably. This could also be a viable option for advisors to present to price-sensitive, larger prospects who don't feel they need the level of service that comes with the core offer.

Essential components of a traditional offer

Most advisory firms' traditional offer for clients is made up of three essential components: investment management, value-added services, and relationship management. Of these, investment management is the most vulnerable to commoditization, price sensitivity, and competition—and it's the area that an automated platform is designed to support. By replacing hands-on management with automated management for a specific segment of their client base, advisors can serve those clients more effectively. This frees advisors to develop the other parts of their offer and focus on serving and growing their ideal client base.



By drawing lines between the two entities via separate staff, phone numbers, websites, and the like, the parent firm can create an offer by which it can potentially become its own best center of influence. This separate-but-affiliated entity could also serve as an incubator for the parent firm, both in terms of seeding clients who may "graduate" to the parent firm's offer as well as providing a testing ground for new technology that could prove viable in the core business.

Driving future growth using technology

Today, RIAs represent one of the fastest-growing channels in the financial services industry. In fact, more than one-third of the firms that participated in the 2015 RIA Benchmarking Study have doubled their assets under management, and nearly half doubled their revenues in the five-year period that followed 2009.[3] Perhaps just as remarkable is that this growth did not come at the cost of significantly increasing the number of professionals or support staff on hand, but rather through optimizing how firms serve their clients. Clearly, advisors have recognized that there is a role for technology to help drive further growth. Before diving in, however, there are a number of variables that merit consideration, starting with whether a more automated offer is consistent with a firm's value proposition.

What do your clients value?

Whether or not a firm ultimately decides to adopt some form of automated investing, having a documented, supportable, and differentiating client value proposition has long been regarded as a best practice for any firm. In the face of the automation trend, it is essential that everyone in the firm is aligned and can articulate what makes the firm stand out for the clients it serves. The goal of a client value proposition is to bring alive the key benefits clients realize by working with a specific firm—the benefits that set it apart in the eyes of current clients and the reasons future clients would choose to work with that firm.[4] Advisors who take time to define and document their client value proposition put themselves in a position to be far more effective in communicating it.

Defining value through clients' eyes

When the RIA industry was in its nascency, many advisors focused their articulation of value on their expertise in asset allocation, investment selection, and portfolio construction. As firms have evolved, investment management has come to represent just one piece of the overall value they provide to clients (see "Essential components of a traditional offer," page 5). Successful advisors, regardless of their value propositions, are those who are great at building trust and developing long-term relationships. Many investors seek advisors who will help them navigate the full spectrum of their financial lives and give them confidence in their decisions. Clients want a trusted resource to help with long-term holistic financial planning, to work with them to define their goals, to provide reassurance in uncertain economies, and to guide them through unexpected life circumstances.

Firms do best when they think about value from their clients' point of view. In order to review and refine a client value proposition, they ask:

- Where do clients derive the most value from working with our firm?
- What does our firm do to make our clients' lives easier?
- What problems do we solve for our clients?
- How do we help them in making decisions?

Although it's important for firms to define their services, such as financial planning and facilitating generational wealth transfers, clients won't typically latch onto the specific attributes of an offer. Clients identify more with the value they derive from those attributes and the benefits that they receive—in other words, with how the services make them *feel*.

Sharing an authentic message

Once a firm has clearly articulated its client value proposition, it's critical that everyone in the firm buys into it and can clearly communicate it. Reviewing the value proposition with staff to ensure it resonates and feels authentic is helpful. Many firms coach team members on the messaging to ensure they can succinctly and consistently talk about the service offerings and the value provided to clients.

Understanding and being able to consistently articulate value is a best practice that will help advisors differentiate themselves in a competitive and changing landscape. Additionally, having a clear client value proposition can help in responding to questions about pricing. If clients feel that a firm has helped make their lives easier, they will be less likely to focus on fees.

Clarifying a firm's value proposition is a key factor in the decision to integrate an automated offer. Other factors include the firm's approach to client segmentation, its overall technology presence and strategy, and its cultural readiness for change—issues explored further in this paper.

Automation and segmentation: Complementary strategies

Before deciding how a firm might complement its core model with an automated offer, a thoughtful and deliberate evaluation of its approach to client segmentation is valuable. The decision to add an automated component is, in effect, a segmentation decision informed by the firm's strategic goals. If a firm intends to offer different service models for different types of clients, it's beneficial to decide in advance for which clients and prospects an automated offer makes sense, and which clients are the right fit for the traditional offer. This depends on a number of factors; chief among them are clients' needs as well as their potential profitability and cost of service.

Defining levels of service sets clear expectations

Segmentation—the practice of defining standardized service models for specific client groups—serves a variety of purposes:

- It puts well-defined expectations at the heart of every relationship, for both clients and staff.
- It can increase the perceived value of an offer because it is more focused and targeted.
- It gives the firm a structured approach to service delivery that is effective and consistent.
- It can help improve the margin on smaller client relationships.
- It helps ensure clients receive the appropriate level of service commensurate with their needs.

Done well, segmentation can help firms manage assets profitably for a broader array of clients, serve smaller clients more efficiently, free up time to grow the ideal client base, and develop a framework for building out a new offering.

Automated platform integration scenario

With $400 million in assets under management and 250 client relationships, Valley Wealth Management* was strongly positioned in the market. While the firm had been operating for the past several years under a well-developed client segmentation model to support its service strategy, leadership was looking to further free up advisors' time to focus on serving and growing the firm's ideal client base.

Under their current segmentation model, they had identified and coded into their CRM three types of clients, taking profitability, attitude, and firm advocacy into account. "A" clients were the most profitable and loyal, and working with them was rewarding. "B" clients were generally a good fit for the firm or showed promise of becoming larger. "C" clients were largely made up of accommodation accounts, often belonging to children of A or B clients. The firm tended to serve C accounts at a loss, depending on how far below the $1 million account minimum they fell.

Firm leadership realized that by revising their segmentation model, and adding an automated investment platform, they could solve some of the profitability issues associated with smaller accounts and reduce the demands those accounts placed on advisors' time. They added a new "D" segment, served in part by a digital investing platform, and have already transitioned more than 50 C clients over. It's been a positive change for everyone: The firm is more profitable in each of its segments, and clients are gaining services better matched to their needs. What's more, the firm found that the addition of a digital offer opened up an unexpected growth opportunity in serving smaller accounts, enabling them to profitably work with clients they might have previously declined.

		Traditional offer			Digital offer
		A	B	C	D
Basic information by segment	Firm's objective for segment	Grow the segment; deliver comprehensive service	Keep an eye on cost to serve; tier services offered based on needs	Transition to segment D; try to not add any new C clients	Inherit clients from segment C; add new smaller clients
	Percentage of total number of clients	15%–20%	30%–35%	10%–15%	35%–40% of client base
	Fee structure	Tiered billing based on AUM, starting at 100bps on the first $2 million of assets, subject to a stated minimum fee of $8,000			60bps on AUM, subject to a $4,000 minimum fee
	Percentage of revenue	58%	30%	5%	7%
	Segment profitability	Highly profitable	Profitable	Break-even or loss	Profitable
Investment management	Investment selection and asset allocation	Appropriate blend of proprietary in-house model portfolios that are monitored by the investment committee and rebalanced periodically			Firm-specified model portfolios automatically rebalanced by the digital platform
	Quarterly reports	Delivered on web portal or paper if requested	Delivered on web portal	Case-by-case decision	NA–custodial reports and digital access suffice
	Annual summary			Delivered on web portal	
Value-added services	Comprehensive financial planning	Yes	Yes	No–provided as an accommodation as needed	NA–must transition to traditional offer for access to these services
	Tax planning and strategy		Yes		
	Estate planning		No		
	Assistance with lending, insurance, etc.		As needed		
	Charitable planning		As needed		
Relationship management	In-person meetings	3–4x/year	1–3x/year	1x/year	NA
	Virtual meetings	As requested–cost is lower than in-person; firm accommodates request if clients in the traditional offer prefer virtual meetings			2x/year
	Loyalty event invitations	Yes	Case-by-case decision	No	No
	Holiday/birthday gifts	Yes	Case-by-case decision	No	No
	Family education	As needed	Case-by-case decision	No	No

*Example described is for illustrative purposes only. It does not represent a guarantee of future performance or success and may not be representative of your experience.

"Planning issues come up as clients get larger. We could show clients that their wealth has grown and that they could benefit from more personalized planning, and then transition them to our full-service offer."

–James Knight, Vista Wealth Management

Getting comfortable articulating what is specifically included at different levels of service enables firms to be transparent to their clients about what they are receiving for the fees they are charged. Many advisors contemplating an automated offer anticipate that they will layer some degree of financial planning, relationship management, or other value-added services on top of it to provide a more customized experience. The exhibit "Automated platform integration scenario" shows an example of how one hypothetical firm structured its automated offer in comparison with its other offers (see page 7). This firm chose to introduce a digital segment "D" as an offer that would be powered by an automated investment platform and would include fewer touchpoints than those in other client segments. This model includes a scaled-back relationship management component delivered through more cost-effective and scalable channels.

Developing a strategy to drive scalability and efficiency

Depending on a firm's business model, objectives, and client profile, the approach to segmentation will vary. While it should always be compatible with a firm's core mission, value proposition, and business philosophy, a segmentation strategy can be implemented formally or informally, and it can be done in stages or applied only to certain parts of the client relationship. Additionally, a segmentation plan should have sufficient flexibility to allow for fluctuations in time allocation and service delivery as clients' needs evolve.

Becoming comfortable with technology-based interaction

If advisors are used to frequent, in-person interaction, would they be comfortable interacting less often and using electronic correspondence or video calls with clients in an automated offer? In a segmented offering, modes of client communication should be fairly prescribed and consistent. And with an automated offer, a subset of staff—ideally a clearly defined subset—would need to be open to more technology-based interaction. Some firms have established task forces composed of associates who are more comfortable and proficient in digital communication channels to help develop the path forward.

A thoughtful, well-planned segmentation strategy often enhances a firm's financial and operating performance by bringing greater scalability for increased efficiency, productivity, and profitability. From a management perspective, segmentation allows a firm to build an organization around well-defined, high-quality client experiences and apply the right staff, skill sets, and resources to optimize delivery.

Whether or not a firm decides to implement a full, formal segmentation strategy, mapping and thoughtfully planning the client experience in itself can unlock value. Taking a fresh look at segmentation will help firms identify how they can deliver a client experience that matches expectations across all targeted segments.

How ready is your firm?

Before undertaking any new initiative, a firm may want to assess its readiness to absorb and capitalize on the change. The introduction of an automated investment management offer will likely have a significant impact on the way a firm does business. It has implications not only from technological and operational perspectives, but also from a cultural perspective—employees will be asked to promote and deliver the new service.

"The question is: Can we take our smart thinking and ideas and create something with technology that allows people to serve themselves and tap into what we offer?"

–Barry Glassman, Glassman Wealth Services

Reexamining your technology strategy

More and more, traditional advisory firms are responding to the changing landscape by embracing the new technology available to them. Many advisors are looking to modernize the experience they deliver by standardizing service models, automating and streamlining internal processes, and deploying technology to offer clients multichannel interaction options. Indeed, shifting expectations and the wider use of online and mobile tools across all generations are making the adoption of new technology a priority at many firms.

If a firm offers more digital options, either for a single segment or for all clients, the experience should be consistent with its brand. Advisors considering an automated offer for only a subset of clients may want to address the potential disparity in experience between the different models. For example, if a firm has a static brochure-like website, adding a third-party automated offer with a very different, more high-tech interface is likely to appear strange to clients and prospects. Some firms are evaluating potential upgrades to their web presence, either in tandem with or before launching a new automated service, to ensure brand consistency regardless of the channel of interaction.

Many advisors are looking at their current technology infrastructure to determine if it is sufficiently robust to be complemented by an automated platform. Essentially, the more automation that exists in a firm's operations, the more seamless a client-facing digital offer will feel. Many firms have invested substantially in infrastructure over the past five-plus years to gain scale, reduce costs, enhance their client experience, and prepare for future growth.

Regardless of whether a firm is ready to introduce an automated offer, there are any number of steps it can take to modernize the experience delivered to clients. Examples include building out a client portal that automatically displays dynamic portfolio views, adding mobile capabilities, or giving clients the ability to sign documents electronically. Competitive forces also make it imperative for firms to constantly evaluate how they can use technology to strengthen client relationships—for example, by leveraging nontraditional modes of communication or by curating content that will appeal to more tech-savvy clients.

Automation is not an all-or-nothing proposition. Technological advancements give advisors the flexibility to create the modern client experience in a model appropriate to their business.

Gauging cultural readiness for lower-touch service models

Integrating an automated platform from a technological standpoint may actually be the easy part compared with the sizable cultural shift it may entail. It is ultimately people who will determine the success of a new offer, regardless of the power of the technology behind it. How will such an offer be received by those who will be asked to use or deliver it? Key success factors include how well staff adhere to service-level segmentation and how open they are to new technology.

> "We set up a digital task force to determine our approach to an automated investment management offering. We'll likely employ a phased approach and different levels of service, but need to reconcile our philosophy with how digital platforms handle client onboarding and investment selection."
>
> —Peggy Ruhlin, Budros, Ruhlin & Roe

As discussed earlier, many firms are considering implementing automated investment management for a certain segment of their client base to free up staff time to focus on larger, more complex clients. To be successful, it is crucial that everyone at the firm understands and is comfortable adhering to the agreed-upon service levels. For example, if clients get an annual checkup, but not a quarterly review, as part of the automated offer, will staff be comfortable supporting such a model? Will they be able to promote the value of this offer?

Prospecting and onboarding using technology

Many firms are taking steps to integrate additional automation into ongoing client account management, or have already done so. A bigger shift may be embracing self-guided or technology-driven approaches with new clients from the start of the relationship. For example, a digital platform may rely on an automated questionnaire to gain insight into a prospective client's risk tolerance and preferences, which then drives investment decisions with very little, if any, personal interaction. While some platforms may allow a degree of customization, a general tenet of digital offers is that the investment approach is standardized for clients with comparable profiles. Much of the scale is derived from not allowing portfolios to be adjusted for exceptions.

Some firms may already be leveraging online marketing tools to promote their capabilities, answer prospect questions, qualify leads, and drive inquiries from qualified prospects—which in the past might have led to an in-person conversation. With new technology options, clients may no longer need to meet in person and may be comfortable going right into an automated investing platform to open and set up an account. A firm may need to adjust its new client onboarding process to fit with the automated investment system while remaining true to the distinct value it delivers.

This applies to core clients as well. Despite increasing availability of online tools and digital signatures, some firms still engage in time-consuming, paper-based, high-touch processes to guide new clients in their traditional offer through the onboarding process. Often common "exception" processes prevent firms from fully automating client onboarding. Could more of the process be automated in the interest of consistency and efficiency?

Some firms may consider a personally assisted onboarding experience a value driver for clients. In that case, there may be a way to integrate the infrastructure of a third-party automated solution for investment management, but supplement the onboarding process with a higher-touch approach to establish the relationship and set expectations.

Strategies for modernizing the client experience

Implementing an automated investment management platform is just one way advisors can deliver a modern client experience. Firms can also address their online presence, key client touchpoints, and back-end operations and workflows. Enhancing these elements can improve client satisfaction and a firm's efficiency, and increase the scalability of its offers. The chart below illustrates the continuum of development opportunities. Advisors may want to consider where they are on this continuum and where they would eventually like to be.

Online public presence				MODERN CLIENT EXPERIENCE >>
Public website	Does not offer public website	Offers general information; not updated frequently	Includes information about services and value proposition; updated twice per year	Is a powerful tool that differentiates the firm; fresh content is updated regularly
Social media	Is not interested in using social media	Wants to explore options, client needs, and resources required	Posts to one or two key social networks regularly	Follows a social media plan; consistently posts on multiple sites and tracks responses
Client interaction and access				MODERN CLIENT EXPERIENCE >>
Web portal	Does not offer web portal	Offers PDF copies of quarterly reports; some clients use web portal	Offers functionality such as two-way document sharing; many clients use web portal	Offers comprehensive tool with dynamic portfolio views; most clients use integrated portal
Mobile access	Does not offer a mobile solution	Offers mobile-optimized public website	Offers view-only web portal capabilities on mobile devices	Offers an integrated mobile experience with custom content and full account information
Electronic approvals	Does not offer electronic signature and electronic authorization	Offers electronic signature and/or authorization outside normal workflows; low usage	Offers electronic signature and authorization in normal workflows; average adoption	Offers electronic signature and authorization; high adoption; custom firm forms are enabled
Communication	Uses in-person meetings and phone communications	Leverages technology to increase in-person meeting productivity; video calls offered ad hoc	Offers clients electronic communications, e.g., video calls and web meetings	Uses CRM to track how clients want to communicate; initiates outreach based on their preferences
Business operations				MODERN CLIENT EXPERIENCE >>
Client workflows	Performs minimal workflow standardization as each relationship is unique	Automates certain aspects of account setup and maintenance	Employs well-documented processes; not fully systematized	Automates process flows fully; uses assigned owners and triggers
Investment management	Builds custom portfolios for each client due to firm's unique approach	Assigns many clients to model portfolios; rebalancing is standardized but time-consuming; exceptions are manually tracked	Assigns most clients to a specified set of model portfolios with automated rebalancing that must be initiated and validated	Assigns almost all clients to uniform model portfolios that are automatically rebalanced; exceptions are digitally tracked
Performance reporting	Has limited report options; data entered manually; dedicated staff generates and validates reports	Makes a range of report options available; minimal data entry; costly to add reports and customize	Enables trained staff to develop new reports quickly and post PDF versions to the client portal	Leverages dynamic tool to access other systems; staff/clients can create and share new reports on the fly
Cost-to-serve analysis	Has a general sense of the cost to serve various segments, but no formal tracking	Tracks touchpoints with existing clients; could likely calculate a cost to serve	Analyzes client profitability regularly; staff who overserve clients are coached not to	Tracks cost to serve from initial contact, using CRM; data is shared regularly with entire staff
Business intelligence	Does not use client information to customize communications or services	Collects and analyzes basic data about prospects and clients	Contacts clients proactively based on behavior changes, such as portal usage	Uses client information to improve and customize communications and services

Shifting to a lower-touch model is understandably challenging for advisors and staff who are conditioned to pull out all the stops for any client who calls. Many advisory firms are hardwired to "delight" clients, often resulting in overservicing without regard to the human capital expense or opportunity cost. When management teams and all levels of staff take segmentation strategy seriously and implement it with rigor, firms find the discipline to offer only the services intended for each segment. If firms find they are making quite a few exceptions, it is likely that they need to reexamine how they train and coach staff on delivering a segmented client experience. For some firms, it may make sense to hire new staff to support an automated offer if the economics justify it.

Assessing a firm's cultural and technological readiness will help ensure that a move to digital investment management is successful for the staff and clients. Many advisors may choose to make a gradual transition to automation. Combining some level of automation with personal service might be more consistent with a firm's culture and be more easily embraced.

Pricing considerations for an automated offer

Advisors will need to think very strategically about how to price an automated offer. The decision will be based on a number of important considerations, such as how a firm prices smaller accounts today, what additional services will be included, and whether the goal is to generate business by attracting a new segment of investors that the firm does not currently serve.

Once the services included with the digital offer have been defined, including the amount of time required to deliver those services and manage each client relationship, firms will be better able to arrive at a pricing structure and strategy that is fair, competitive, and profitable. An ideal strategy should be logical within the context of the firm's overall offerings, and staff should be well trained on how to communicate the value proposition, scope of service, and pricing for both the traditional and digital offers.

Pricing alternatives

As highlighted in "Essential components of a traditional offer," the core advisory offer typically includes three essential components: investment management, value-added services, and relationship management (see page 5). Most advisors bundle these components together and charge clients based on their level of assets, often with a minimum fee that serves as a proxy for the minimum account size they wish to attract. For accounts under $1 million, 100 basis points is a typical fee.[5]

Across the industry, however, there is a widespread prevalence of discounting, or serving clients under the published minimum, often at a loss to the firm. Currently, on average 51% of client relationships that advisors serve are under $1 million, and 32% of those relationships are less than $500,000. Increasing profitability in this segment represents a significant opportunity for firms.[6]

As advisors begin to think about how they might price an automated offer, most plan to continue to charge an asset-based fee. Three prominent pricing strategies have emerged:

- **Maintaining the firm's current fee, but lowering the required minimum.** This is particularly attractive for firms that simply want to serve existing smaller accounts more efficiently and allow the number of these smaller accounts to grow with a new generation of investors, particularly the children of their core clients.
- **Lowering the asset-based fee and minimum and offering a lower-touch service model.** This structure may appeal to advisors who want to create a digital offer with fewer touchpoints for their smaller clients and may include more self-service tools.
- **Implementing an aggressively low asset-based fee and minimum to compete with other online automated offers.** Firms pursuing this model would include little to no value-added service or relationship management in the offer to keep pricing competitive. This scenario is very uncommon, since most advisory firms don't intend to compete with national automated offers.

The arrival of automated investment management has ignited discussion about whether alternative fee structures, such as a flat fee for value-added services or a subscription-based fee, might emerge, as they have in the retirement segment. These pricing alternatives may be interesting to explore, but they tend to be less attractive to advisors. Most would likely prefer to implement a pricing structure that is complementary to their traditional offer.

Relationship management and cost to serve

Thinking about pricing necessarily involves thinking about a firm's cost to serve, relative to the revenue generated by clients in each of its segments. Firms strive to earn appropriate compensation for value delivered and meet reasonable profitability targets.

By estimating the time senior advisors, junior advisors, and client service staff will spend delivering a particular offer, it's easier to evaluate the cost to deliver that offer on a per-client basis. This gives management a sense of staff capacity and how many clients each individual can service in a given segment. Again, having a well-thought-out segmentation strategy and implementing it with discipline are key. The goal is to match time and staffing to each segment's level of need and revenue.

One of the most important cost considerations will be the level of relationship management an advisor will provide to clients in the digital segment, either intentionally or unintentionally, due to a cultural bias to meet and exceed client expectations. A key question to answer is, "Just how automated will this offer really be?"

The trust that well-trained professionals build with clients as they deliver unbiased advice is highly valued and has helped drive the success of the independent advisory model. This strong relationship between clients and advisors is the hardest thing for competitors to commoditize. Compensating these professionals, however, represents the single biggest driver of cost for a firm—49% on average—because profitability is directly related to the ratio of clients to professionals.[7] As advisors determine the appropriate pricing for a new offer, they will want to balance the value that relationship management brings to the client experience with the cost to provide it.

Because of the high correlation between relationship management and cost to serve, advisors are encouraged to perform an in-depth and realistic analysis of how they will structure their services prior to setting their final price point for the offer. Careful consideration should be given to pricing, given the added complexity a second model will introduce to the firm, and how difficult it can be to raise prices later if limiting the level or number of services proves unrealistic.

Communicating the pricing model and value delivered

Regardless of whether advisors choose to integrate an automated offer into their business, the changing competitive landscape requires them to be more prepared than ever before to talk about their pricing with clients. The ability to explain specifically what clients receive for the fees they pay helps set appropriate expectations both internally and externally. This is especially important if the automated offer's pricing differs from the traditional offer.

Alternative fee structures for an automated offer

While most advisors plan on maintaining an AUM-based fee structure for the foreseeable future, several alternative, though largely untested, pricing models that warrant mention have been proposed by industry observers and the media. Advisors may choose to charge a basis-point fee for the automated investment management component of their offer, and they may charge for relationship management or value-added services according to one of the alternative models below.

- **Hourly fee pricing:** Clients pay an hourly fee for services desired on an ad hoc basis.
- **Subscription-based pricing:** Clients pay a monthly fee for access to an advisor and typically have the ability to renew or cancel services every month.
- **Flat-fee pricing:** Clients pay an annual fee that includes a very specific set of services with clearly delineated outcomes.
- **Annual retainer:** Clients pay an annual fee for access to an advisor, with no clear delineation of services; these retainers can be renegotiated annually depending on how much the client used the advisor's services over the past year.

These alternative models represent just a few ideas advisors are considering, and there may be other models they choose to explore. It may be helpful to discuss ideas for alternative pricing models with a few trusted and loyal clients, or with a client advisory board, to get their reactions and input before locking down a plan and firming up the fee structure for a firm's automated offer.

As firms consider the introduction of a new automated offer, they may want to have proactive discussions about their pricing with select clients to head off any potential confusion. This is particularly true if the children of core clients will be served by the firm's automated offer due to their asset size, lower level of complexity, or some other reason. Given the likely familial, social, or professional connections among clients in a firm's automated segment and in its other segments, staff must be able to clearly articulate why the pricing is different and how it is justified by the services that will be provided.

Finally, it's essential to communicate and train staff on the level of service associated with the automated offer and why it's different from the core offer to help them avoid overservicing. Limiting service can be a challenge to firms accustomed to exceeding client expectations, but because staff time represents such a significant cost within the business, it also represents the biggest risk to achieving the desired profitability of a digital segment. Advisors with a structured and well-documented client experience map for each client segment will find it easier to align everyone on service expectations and monitor what's being delivered.

Conclusion

Advisors are no strangers to change. The independent investment advisory industry began—and continues to grow—fueled by a desire to break from an established way of doing business and to forge a new path in serving investors. The entrepreneurial spirit shared by advisors leads them to constantly look for innovative, creative opportunities to better serve their clients, evolve their firms, and grow their businesses. Automated investing may present such an opportunity.

For many firms, leveraging this new digital technology will help create scale and efficiency around investment management. To advisors, the key benefit of automated investing is time—time to focus on the value-added aspects of their offer and build client relationships, trust, and loyalty. Having an automated solution for those clients with simpler financial needs can enable advisors to spend more time providing wealth management expertise to those with more complex needs. This increased attention may lead to greater satisfaction among a firm's ideal clients, helping to turn them into strong advocates for the firm.

As with any change, planning and preparation can lead to a greater chance of success and alignment with objectives. Firms that take the opportunity to sharpen their value propositions, clarify their client segments, and assess their technological and cultural readiness will be better equipped to make informed choices and map the path forward. Schwab Advisor Services™ has developed resources that can help with these efforts exclusively for independent advisors.

To learn more about automated investing, including the Institutional Intelligent Portfolios® platform developed for advisors who custody with Schwab, please contact your Schwab Relationship Manager.

12

Consulting programs and resources for advisors

Advisors who custody with Schwab can work with our business management and technology and operations consultants to address key, business-critical issues and help drive efficiency and growth. Schwab Advisor Services™ offers consulting programs including:

- **Strategic planning:** This consulting engagement helps advisors articulate their value and purpose as well as set a vision for the firm's future. A step-by-step framework to develop strategies that can aid firms in achieving their goals is provided.
- **Client segmentation:** This program helps advisors develop a segmentation strategy that can enable them to serve a diverse client base while building a profitable and scalable business.
- **Referral growth strategy:** This engagement helps advisors create a culture of growth in which employees and clients become advocates for the firm. As part of this program, advisors build a client referral strategy that involves each person within the firm.
- **Technology optimization:** This consulting engagement helps advisors transform and modernize the experience they deliver to clients by leveraging tools on Schwab's platform to drive greater efficiency.

Schwab Advisor Services also offers a variety of resources to help advisors manage and grow their businesses including:

- **Schwab Market Knowledge Tools® white papers** that complement our consulting programs and are designed to share insights, best practices, and analysis on practice management and technology topics
- **Technology solutions** such as electronic approval capabilities and a mobile application that can help provide a modern client experience
- **An online Client Learning Center** that can assist advisors in explaining resources available to their clients through the Schwab Alliance website

1. The 2015 RIA Benchmarking Study from Charles Schwab.
2. Ibid.
3. Ibid.
4. *Maximizing Firm Growth,* part of the Schwab Market Knowledge Tools® series, explores best practices for defining a firm's client value proposition and referral strategy.
5. The 2015 RIA Benchmarking Study from Charles Schwab.
6. Ibid.
7. Ibid.

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