Mostly Commissions to Mostly Fees: Making the Switch Work for You

If you’re thinking about trying to build the fee-based side of your business, you’re not alone. The number of fee-based financial advisors is expected to grow from just over 16,000 to over 19,000 by 2012, according to a recent estimate from Tiburon Strategic Advisors, a consulting firm in San Francisco. But switching to a mostly fee or fee-only model takes a lot of planning, and proper implementation is crucial to success. Read on for some how-to advice on making this transition.

Determine your approach

Before you make any changes, you have to decide how you’re going to build the fee-based side of your business. Are you going to divest all your transaction business at once and manage only fee-based accounts going forward? Are you going to phase out the commission business gradually? Or would you prefer to keep a small percentage of transaction business while making fee-based business your new focus?

There’s no right answer—it’s more a matter of preference—but you do need to decide what works for you. “This business is an art, not a science,” said Jim Pritchard, general manager of Kelleher Family Wealth Management, a New York-based wealth management firm.

Doing it all at once is a big gamble, of course, and some advisors may choose to take things slower, phasing out the commission business over time. That’s what Hunter William Bailey, a financial advisor with Securities America Inc. in Citrus Heights, Calif., is working toward.

For the past several years Bailey has been in the process of transitioning his business to fee-only, which he hopes will be complete within three years. Instead of dropping his commission-based clients outright, he began transitioning those who were willing to portfolios made up of C-shares and no-load funds. This gradual approach has given him confidence to do more fee-based work in the future. It’s also allowed him to continue to work with certain clients who want to remain transactional. “At the end of the day every advisor would love to be fee-based…but there are a lot of people out there who simply want to buy a product,” he said.

Indeed, taking a flexible approach—trying to transition things to fee-based on a going-forward basis—but keeping existing clients transactional if that’s what they want, might be a viable solution for many advisors who are fearful about giving up the security of commissions. This approach allows you to limit your commission business to “what you need to do to put food on the table,” said Morgan Smith, an advisor with Burns Advisory Group, a fee-only RIA in San Diego, Calif.

Be able to communicate your value proposition to clients

How you talk to clients about the changes you are planning can make all the difference when it comes to retaining their business.

One tactic that has proven successful is to tell clients you are thinking about changing your business to an advice model, talk to them about your approach, and ask them how they feel about it. The client feels like part of the process as opposed to being sold a new idea, and it offers the client a chance to say no without feeling pressured, said John Moninger, senior vice president of advisory and brokerage consulting services at LPL Financial in San Diego.
Another approach that works well is to be more assertive in telling clients that you are changing your business, this is the approach you are taking, and that you really hope they’ll join you in your new endeavor, said Moninger, who works with advisors who are trying to switch to a fee-based model.

Whatever approach they choose, advisors need to be confident and explain to clients precisely how you add value to them and how they will benefit from the change. Show them, for example, how much they spend each year on commissions, verses what they would pay in a fee-based model.

Moninger also suggests advisors role play with friends and family to gain confidence in the delivery of their message to clients. You might want to start with smaller clients first, he said, so by the time you get to the best clients, you’ll be more polished. Other advisors who have gone through the process and your firm may also be valuable resources for you.

That said you should expect some resistance. Clients who have been in a transactional account for so long may be wary and wonder what the catch is, or why they haven’t been told about it before, said Smith of Burns Advisory Group. “It’s really important to educate them, and you can’t just expect clients to jump on over and say ‘yeah, I trust you.'”

Deliver on your value proposition
Here’s where most people drop the ball, according to Walsh of TRW Investments. They have a value proposition, but don’t deliver on it. If your value proposition is to review the managers in your clients’ accounts, make sure you do it. You also need to make sure the client knows you are doing it. “If the client doesn’t know it’s happening, it’s as if it’s not happening,” he said.

Make sure you stay in touch frequently, at least every three months, Walsh suggests. Staying in touch aggressively and servicing clients incredibly well is particularly important when the market’s down, because clients will expect you to live up to your earlier promises, he said.

Be prepared for a revenue hit
If you do your job well, it’ll likely be temporary, but advisors still need to ask themselves whether they are financially prepared for the potential revenue hit. Not only do you risk initially losing clients when you switch to a fee-based model, but you’ll no longer have the immediate payouts that come along with transactional business.

“You can make some pretty good paychecks in a transactional business. When you’re building a fee-only business you tend to be pretty skinny from a revenue perspective early on. But as time goes on, you’ll find that the revenue base will grow to a healthy revenue base with a more consistent cash flow stream,” said Smith of Burns Advisory Group.

Indeed, converting existing clients to a new model can be “very difficult,” said Pritchard of Kelleher Family Wealth Management. “Change is seldom a welcome visitor.”