

# Financial Marketing ● FALL 2004

# Perspectives

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WE

SEND

OUR CLIENTS,

COLLEAGUES, AND

FRIENDS OUR VERY BEST

WISHES FOR A HAPPY HOLIDAY

SEASON.

*Gerri & Libby*

## One Year After Spitzer Mutual Fund Probe: Are Investors Better Off?

One year since revelations of wrongdoing were discovered at mutual fund companies, the SEC-mandated Rule 204 took effect, requiring all funds, fund Advisers and other Advisors registered with the SEC to appoint a chief compliance officer and adopt written policies and procedures governing their business practices. These moves were designed to protect shareholders and bolster investor confidence in mutual funds and markets.

There is no question that investor confidence was rattled by the allegations of wrongdoing among fund companies. But now that these new rules are enacted, are investors better off?

In an Op-Ed article we published in the *Baltimore Sun* last year, we wrote that a government overhaul of the mutual fund industry may end up hurting investors the most. Look no further than the SEC settlement that required firms to separate research and investment banking, we posited. In the process of routing out potential conflicts, regulation bought investors much less: few analysts, fewer companies and industries covered and a noticeable decline in written research reports.

Industry intelligence points to similar consequences for mutual fund industry reform.

Fund executives have yet to weigh in with precise estimates, but they agree that the cost of implementing Rule 204 has been very significant. The largest share of costs includes administrative and legal expenses, personnel costs and technology investments. In addition to unprecedented burdens on existing compliance and legal departments, fund companies report beefing up compliance staffs, investing in new systems to monitor trading, adding to training budgets, streamlining share class guidelines, creating new account types, taking on higher legal expenses and even creating dedicated staff units to meet the spirit and the letter of the rule.

Brokerage firms as well as mutual funds have had to examine their relationships. Brokerage firms, through which third-party mutual funds are distributed, have their own responsibilities to comply with fund policies. Brokerages that once granted hundreds of selling agreements and offered unlimited variety to their fund clients have severed relationships to focus on fewer fund groups and ensure that new, more stringent policies can be systematically followed. (For example, Fund A charges short-term investors who hold shares less than one year a punitive fee; for Fund B, short-term is 90 days. Compliance dictates that such distinctions must be programmed in brokerage sales programs.) As a consequence, investors will likely face fewer fund families with higher minimum thresholds and higher fees.



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# Getting Research Right

Wherever the market heads in the next four years, no one is anticipating the kind of growth or revenues that financial services firms enjoyed in the 1990s. Companies that expect to attract and retain clients will need to be on top of their game in all areas. While the financials are one measure of how companies are doing, how can they find out what it will take to win new business, what their clients are thinking, and what the competition is up to? We recommend research.

Where most large firms once had significant marketing research departments, over the past few years many firms have reduced their research budgets. This was attributable in part to cost and in part to the trend toward quarter-to-quarter planning. But running a business without the right information can be even costlier.

Research need not always be costly and time-consuming. It can include everything from a 6-month sophisticated conjoint study to help a firm determine optimal pricing to a hastily scheduled informal employee meeting to learn the kinds of questions customers are asking.

Here are the basics on research, and some real-life examples:

## Quantitative

Quantitative studies are used when firms want to know “how many” or “which one.” In the most common quantitative studies, researchers ask enough people the same questions for the answers to be statistically valid. This can be done in person, through the mail, over the telephone, or on the Internet. Generally, the more responses received the more valid the response and the greater the cost.

Quantitative studies can range from brand equity to usage studies, including those in which the researcher studies the participants’ behavior to understand activities or preferences.

*Example:* In the 1980s a large money center bank was concerned that selling proprietary mutual funds would cause disintermediation from more lucrative accounts. By studying the account activity of shareholders, the bank learned that most purchased funds with money from their savings or checking accounts but that within 6 months the balances in the other accounts had returned to their original levels.

## Qualitative

Qualitative studies are used when firms want to know “why.” The most popular form of qualitative research is the focus group, but researchers also conduct one-on-one interviews, dyads (two-person groups), and triads (three person groups). While a researcher might ask for a head count in a focus group, in qualitative research the results are always attitudinal.

Zora Neale Hurston,  
the novelist, once said  
“Research is poking and  
prying with a purpose.”  
If your purpose is to  
better serve your clients  
and your company,  
then research can be  
just the thing.

*Example:* In the 1990s the institutional sales force at an investment bank told management it had to cut the pricing on its money market funds because competitors had introduced funds at half the cost. Before matching the lower pricing, the firm conducted 50 one-on-one interviews with a wide range of customers. The company learned its customer base was divided in two, and only half were price sensitive. Rather than cutting prices across the board, a lower cost second family of money market funds was introduced for the price-sensitive segment.

## Competitive

Although classic research types would stop at the first two, we consider competitive research the third type. It includes competitive analysis of products and services as well as shopping your own firm and that of your competitors. Understanding the client experience has become especially important in recent years, because the product has become increasingly generic.

*Example:* In the late 1990’s a large wirehouse invested heavily in a special IRA promotion. Despite the advertising, the numbers were unimpressive. Then a researcher shopped the branches and called the service center. Half the time the Advisors and customer service representatives were unfamiliar with the promotion. The firm improved its numbers just by improving internal communications.

## Doing it Right

We’ve seen a lot of research projects fail because firms did not think them through before proceeding. We suggest:

**Focus on the fundamentals.** If you want to know how to motivate high-net-worth customers to consolidate their assets with your firm, don’t stand next to the ATM to conduct a poll. Be sure to ask the right participants, the right questions, the right way.

**Don’t assume.** It’s easy to unconsciously steer research if you think you know the answer. When money market funds were first introduced at banks, it was assumed that investors would use them as a cash management tool, so advertising stressed how easily money could be transferred between accounts. In focus groups, most shareholders reported using the funds as savings accounts, and they did not want to think about how easily the money could be moved.

**Be creative.** Combining techniques can be effective. To research positioning for a firm the researcher first interviewed the sales force and senior management to identify key issues, then surveyed a large sampling of clients online to understand their likes and dislikes, and finally conducted one-to-one phone interviews to learn the “why.” The result was a robust picture of where the firm stood in the eyes of its employees and clients, obtained at a reasonably low cost.

**Know your sources.** Sometimes it seems we’re flooded with research so there should be little need for more. Look again. A lot of the generic information available is produced to serve a specific constituency. While adding it to your bank of knowledge is fine, firms need to know what’s true for them.

## A Second Chance for Wall Street?

The reelection of President Bush may well offer Wall Street a second chance. Among the president's key initiatives is the reform of social security, including plans to partially privatize the program and permit younger people to invest in the stock market. Many executives at wirehouses and fund complexes have begun calculating the billions that could free up for investment.

But it seems to us there is more at stake. How financial services firms handle this opportunity may also determine whether the scandals and lawsuits of the past two years permanently characterize the business, or become a moment of indiscretion for an otherwise respected industry. In other words, given a chance to do things differently, will they?

One firm that has taken dramatic steps to change, at least in the compliance department, is Morgan Stanley Asset Management. At a recent Financial Women's Association Distinguished Speakers event, its president, Mitchell Merin, talked about how the firm's regulatory paradigm has shifted. Previously, he explained, it operated in a "rule-based" world where the standard was to comply with the letter of the law, and if something wasn't prohibited it was

okay. If mistakes were made, he said, they were handled quietly, with the situation remedied but rarely punished.

Today, he continued, the company operates in a "principle-based" world where firms need to comply with both the letter and the spirit of the law. The only acceptable practice is putting clients' interests first and assuming everything is public. He told the audience this was not part of the cycle we've seen before of boom, wealth generation, excess and corruption, bust, scandal, and regulation—but a real change in the way business is done.

It's a promising beginning. The question is whether it will extend to the rest of the way the firm's business is done. For example, will Morgan Stanley and other firms:

- **Start to train and compensate their Advisors** so that it will be in the Advisors' best interest to put clients' interests first?
- **Get serious about investor education?** Firms are building new compliance departments to meet the new regulations, but marketing departments remain lean, and client communication at most firms remains focused on compliance and sales.

- **Make pricing transparent and understandable?** Even the customer service departments at most firms can't explain their firms' pricing policies. (We know, we've asked.)

We're not sure, of course, how soon this new legislation could come to pass, even with a president known to move quickly when he wants to. But it's not a minute too soon to be thinking about the changes your firm needs to put into place. Listening to clients and designing policies and programs to better assist them is among the services we provide. If you're ready to make the most of your firm's second chance, let us know how we can help you.



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## Serving Wealthier Clients Raises the Bar on Advisor Competence

Grooming Financial Advisors to serve million-dollar relationships is a challenge at many firms. What are the clues to wealthy investors that the Advisor is serious, skilled and capable of handling financial issues without taking a sales approach?

In a marketing panel with colleagues from Smith Barney, Legg Mason and Raymond James at the SIA Sales & Marketing Conference, Gerri Leder drew from the practice-building devices of Registered Investment Advisors' (RIAs). Registered Investment Advisors (RIAs) are gaining ground in the war of asset gathering and enjoying increasing market share of million-plus accounts, according to various industry research.

There are five ways RIAs light the way for Financial Advisors to serve wealthy clients more effectively: professional credentials, specialization, study groups, branding and relationship with customer.

### Professional Credentials

The CFP and CIMA are two of the most significant credentials that separate specialists from generalist Advisors in our business. RIAs in the same firm often hold CFP, ChFC, or have accounting or law degrees. In the brave new world of high net worth, credentials connote competence in the client's eyes.

### Specialization

As they gain more knowledge, RIAs often gravitate toward practice specialties. They become grounded in the knowledge, training and language of the specialty. Competence drives practice specialties (e.g., retirement plan business) while opportunism drives sales-based specialties (e.g., retirement plan asset gathering). When Advisors choose a specialty, they know that clients will fairly assume a high level of subject expertise.

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## Study Groups

Study groups keep RIAs current and connected, and build their professional knowledge and networks too. Alliances formed through the FPA (Financial Planning Association) and NAPFA (National Association of Personal Financial Advisors) lead to study groups, where complex live cases are addressed by peer advisors with varied expertise. Study groups deepen the relationships with intermediaries and build knowledge.

## Branding and Public Relations

Some RIAs have proven very effective at branding, without having global firms behind them and public relations help. Third-party commendations are incredibly powerful in endorsing Advisor competence. They have discovered the various publications that regularly select "Top Financial Advisors": *Robb Report Worth* list Top 250

Advisors in America, *Bloomberg* ranks Top Wealth Managers, *Medical Economics* selects the Best Financial Advisors for Physicians, and *Barrons* recently named its Top 100. Nominations are accepted and selection criteria vary from one publication to the next.

Another tool in the branding arsenal is the Advisor web site. Do your top Advisors have sites for their practices? It's no secret that more affluent Americans are using the Web to undertake research, gain information and make buying decisions. Firms like Raymond James offer Advisors breakeven pricing to design, launch and host web sites—so committed is that firm to the tool. Advisors can stake their claims to a distinct practice identity with an effective online presence.

## Choice of Custodian

In a way, RIAs gain great benefits from their custodians because they are client to custodi-

ans like Fidelity, Schwab Institutional and Waterhouse Institutional. These firms, recognizing that they must offer practice-building tools to keep RIAs on their platforms, are continuing to expand the suite of available services and vendors, including development and practice-building, marketing and transition-planning services—on a pay-as-you-go basis to RIAs. This spirit of continuous improvement of their platforms drives the resources RIAs access to compete effectively. Have you reviewed your practice-building pallet lately?

As marketing executives and Advisors think outside the box and examine ways to present a compelling offer to high net worth investors, look no further than the RIAs. If independent shops with 10 or fewer professionals can do it, so can your firm.

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While these burdens have changed the face of the entire industry, the brunt of burden is especially felt at small funds. Prior to 2004, the level of self-sufficiency in the fund industry was estimated at \$75-100 million. It will inevitably rise due to implementation costs. Several funds have conceded defeat and have announced plans to sell or close their doors.

Fund families have been a force of product innovation for decades, and fund investors have benefited. New product introductions have fallen off while fund organizations dig out from the investigation. The number of US mutual funds, which grew

from just 564 in 1980 and reached 8,235 at the end of 2002, fell slightly to 8,101 by the third quarter of 2004.

Investor protection has clearly improved and investor confidence in mutual funds is strong, evidenced by a tracking study by the Investment Company Institute. These facts and new reforms point to a more level playing field for investors and greater transparency in fund costs. And, while the new playing field is not without higher costs and sacrifices to all participants, investors and mutual fund companies alike will adjust to the new realities in time.

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