Advyzon Thought Leadership

What's fee-sible?

Data shows flat fees are more popular than many of us think, plus other exclusive insights on billing.

What's driving the flat-fee trend?

If you follow financial media, you know that flat fees are growing in popularity. An increasing number of advisors charge a flat dollar value versus percentage of AUM. (For example, $4,000 per year or $1,000 per quarter.)

But for some advisors, flat fees can be polarizing. Advocates swear by the fairness and transparency. Opponents say flat fees aren't sustainable: You need too many clients and end up working too much. These advisors say the more traditional AUM model is more sustainable.

"We get questions about just about every element of fees and billing. Advisors want to know what other firms are doing, whether it's billing in advance or arrears, quarterly or monthly, average daily balances, everything," said Charles Rowlan, Senior Vice President of Business Development at Advyzon. "Most of these questions come from breakaways, but existing firms ask questions, too, about how to do things better, whether that's using flat fees or building in average daily balancing."

2020: A perfect storm

Flat fees were growing in popularity prior to the COVID-19 pandemic, but the trend accelerated in 2020, according to industry experts. Why? Two converging factors demonstrated the potential downside to AUM fees.

First, a market crash meant shrinking assets, which translated to lower revenue for advisors who work strictly on an AUM basis. However, that same market crash led to concerned clients calling their advisors more. Advisors ended up doing more work for less revenue. Advisors were understandably frustrated by this.

RIA guru Michael Kitces told City Wire that he estimated AUM-based advisors lost 20% of their revenue in the first quarter of 2020 alone. And while markets have recovered, it can be hard to ignore the potential risk of a more prolonged downturn. After all, any advisor in this industry for the long haul is bound to experience one: 2000, 2008, 2020, and so on.

It’s not all or nothing

Some advisors are choosing a hybrid model, using AUM-based fees for investment management and flat fees for other services, like planning. Aite group told City Wire that about 9% of RIAs are charging for advice beyond their basic AUM fees. Others prefer a strictly flat fee.

We wanted to help advisors better understand some of these trends by answering questions around what other firms are doing. So we dug through our data to look at how popular flat fees really are. Here's what we learned from our users.

What does the data show?

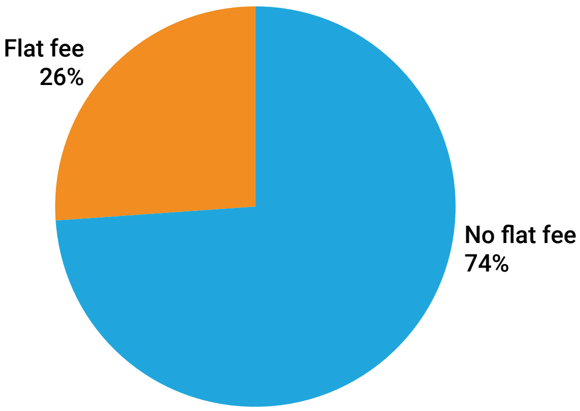
We knew flat fees were growing in popularity, but we were surprised by just how popular they were. More than a quarter of firms — 26% to be exact — are using flat fees. But that wasn’t the only area of billing we looked at. Here’s what data from our roughly 1,000 client firms told us.

How popular are flat fees?

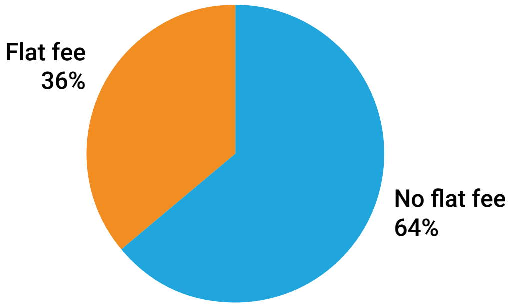
“It was higher than I expected,” said Rowlan, responding to the percentage of firms currently using a flat fee. “We don’t necessarily see advisors using a purely flat fee,” he said, meaning some firms might be using a flat fee in addition to AUM fees. But, he added: “The trend is definitely moving more toward incorporating some type of flat-fee element.”

Overall, the number is 26%, but we also analyzed the data based on firm assets under management, to help you see what firms similar in size to yours are doing. More than a third of firms managing more than $100M in assets use a flat fee. For smaller firms with fewer than $100M in assets, that number is smaller but still high: One in four of these firms use a flat fee.

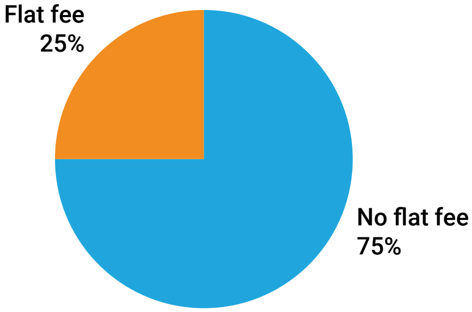
How popular are flat fees



All firms



Firms with more than $100M AUM



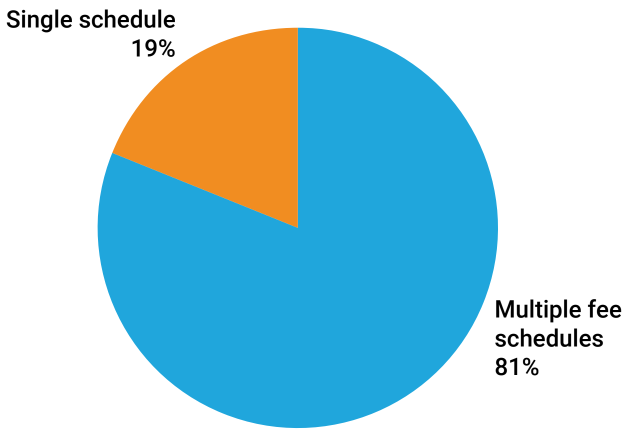
Firms with less than $100M AUM

Fee schedules

Of course, charging a flat fee doesn't mean charging flat fees exclusively. More than 80% of Advyzon advisors use multiple fee schedules. This may be one reason for the higher level of flat-fee usage — advisors are able to adapt flat fees as part of a broad fee structure, rather than switching to flat fees exclusively. Of course, some of the firms using multiple schedules are still using multiple percent AUM schedules as well.

Using multiple fee schedules is popular despite firm size, as well. Nearly nine in 10 firms with more than $100M AUM use multiple fee schedules. The number is slightly smaller for smaller firms — just under eight out of 10 firms (77%) use multiple fee schedules.

How many firms use multiple fee schedules?



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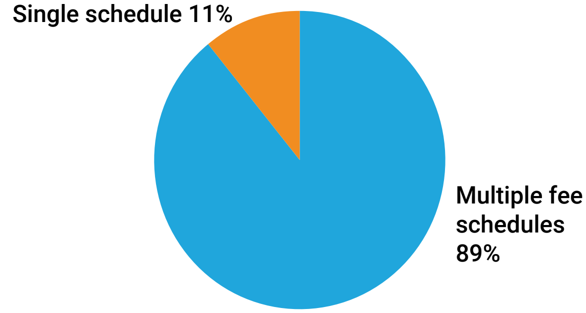
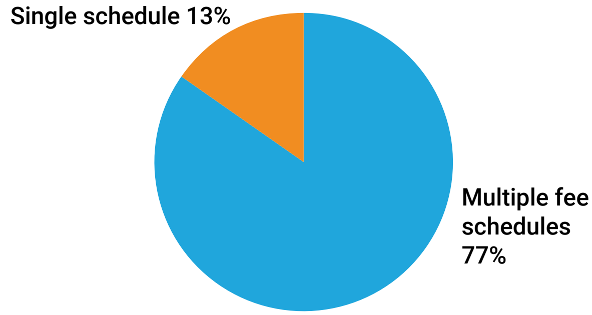


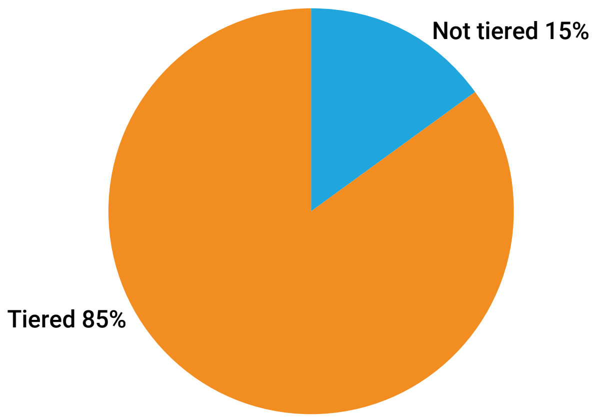
Firms with more than $100M AUM



Firms with less than $100M AUM

For the advisors using percent AUM, nearly all prefer a tiered basis, charging lower rates for assets above a certain threshold. Overall, 85% of Advyzon firms prefer a tiered fee structure. Broken down by firm size, 90% of firms with more than $100M in AUM use a tiered structure and 82% of firms with less than $100M in AUM do.

Tiered fee structure: Still the favorite



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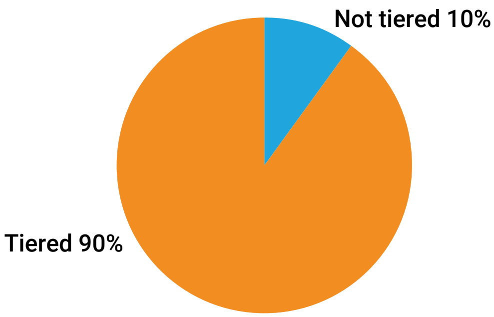
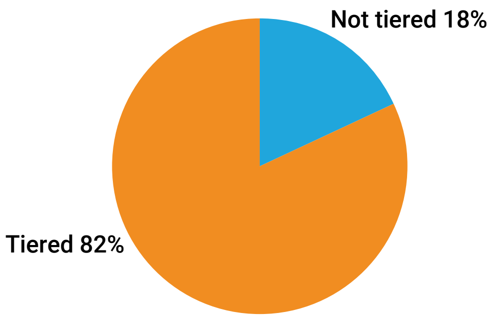


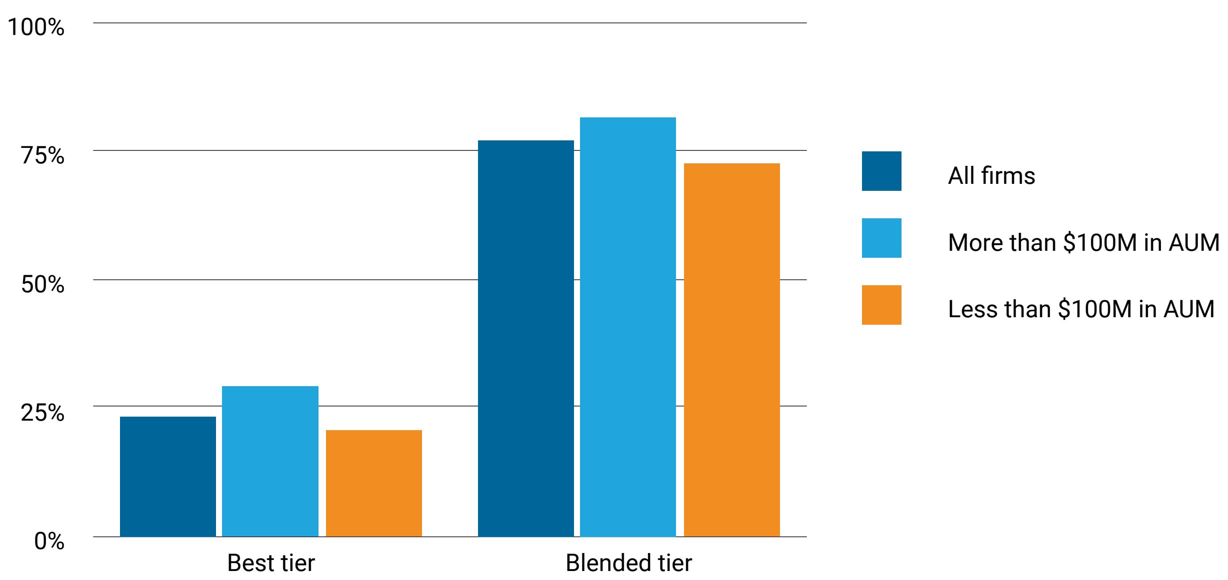
Firms with more than $100M AUM



Firms with less than $100M AUM

This preference for tiered fees also showed up in recent research from Cerulli Associates, highlighted by the Wall Street Journal: The average investor with $750,000 paid 1.04% of invested assets in fees in 2020. (That's an increase from 2015 when the rate was 1.02%.) For investors with $10 million in assets, the fee netted out to .62% of invested assets, up from .54% in 2015.

When we combine the idea that many firms have multiple fee schedules and tiered pricing, the natural next question is how many advisors are using a best tier rate and how many are using a blended tier rate. Here's how those numbers break down among Advyzon clients:

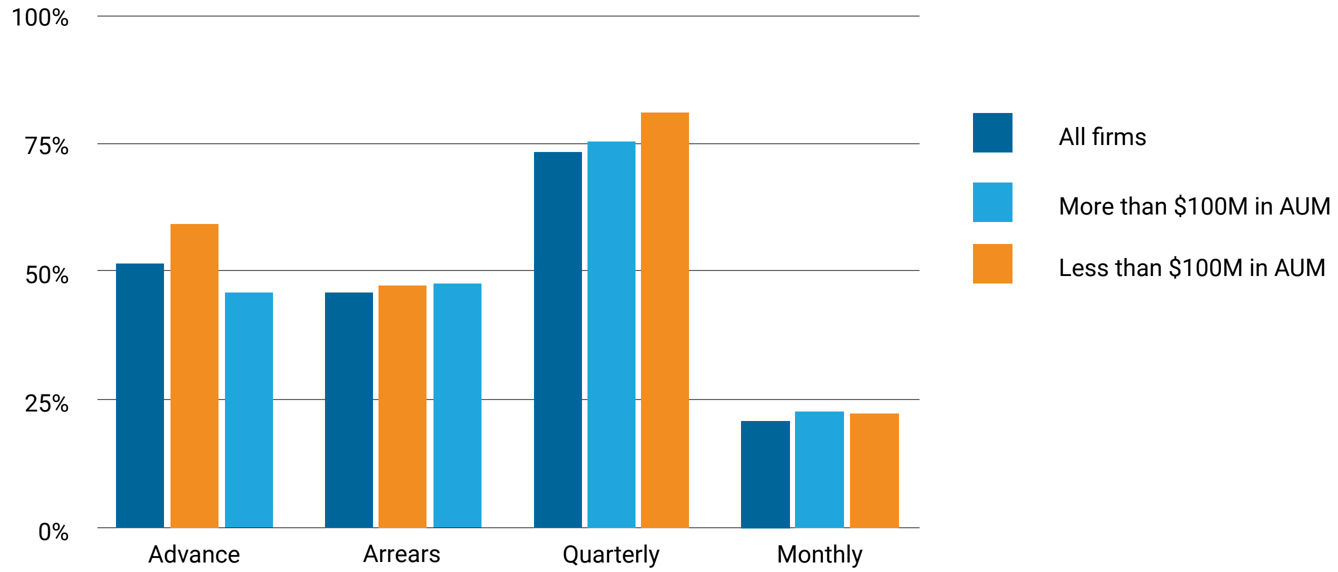


Overall, 24% of Advyzon firms use a best tier rate, while 76% use blended tier. Broken down by size, about 28% of firms with more than $100M in AUM use a best tier schedule, while 82% of those firms use blended tier. For firms with less than $100M in AUM, 21% use a best tier rate and 73% use blended tier. Remember, the vast majority of firms use multiple fee schedules, so some firms might be using both best and blended tier depending on the client and advisor.

Billing matters

Finally, the fees you charge are only part of the equation. Billing is a central part of both cash flow and profitability.

In fact, our most asked questions, both to our sales team and our internal relationship managers, tend to center around billing. We'll dive deeper into billing considerations later in this paper, but for now, let's look at how Advyzon advisors are handling billing.

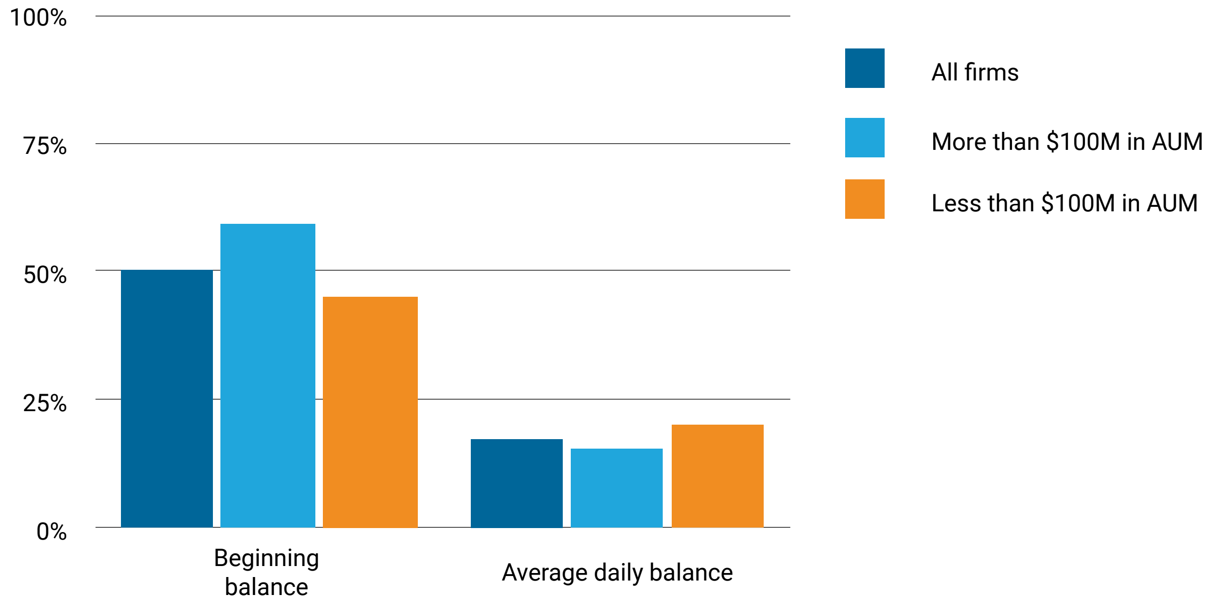


Overall, Advyzon firms favor advance billing: 52% of firms prefer to bill ahead while 46% bill in arrears. Looking at the subsets, the preference for advance billing is slightly more prominent in firms with more than $100M in AUM — 60% use advance billing, while 47% bill in arrears. For firms with less than $100M in AUM, the numbers break down equally, 47% bill in advance versus 47% in arrears.

When it comes to quarterly versus monthly, quarterly is still the industry favorite. 74% of the firms working with Advyzon use a quarterly model, while 21% use monthly billing. Quarterly billing is slightly more popular with larger firms: 81% of firms with more than $100M in AUM bill quarterly compared to 70% of firms with less than $100M in AUM. For monthly, those numbers are 22% for firms with more than $100M in AUM and 21% for firms with less than $100M in AUM.

Of course, one of the big questions firms need to answer when deciding whether to bill quarterly or monthly is: “How will we calculate our clients’ balances?” Beginning balances are still more popular than ending balances, but since those numbers are essentially the same (as far as snapshots and methodology go), we’re only focusing on beginning balances here. Overall, exactly half of Advyzon firms use a beginning balance model — 58% of firms with more than $100M in AUM and 44% of firms with less than $100M in AUM.

What’s more notable, however, is the increased use of average daily balance, where firms take a client’s balance every single day and average those together, then bill on that number — the average daily balance.



“In the past, firms just couldn’t do this by hand, you need a FinTech provider like an Advyzon to make it possible to do this at scale,” explained Rowlan. “It’s also a bit more complicated to explain the numbers to clients. Intuitively, clients understand the concept and like it, but you’ll have to do more to show how you got your totals. But again, that’s something Advyzon can help with.”

Right now, 16% of Advyzon firms use average daily balances in their billing. That breaks down to 14% of firms with more than $100M in AUM and 18% of firms with less than $100M in AUM.

Average daily balances tend to be more popular with firms who bill quarterly. “If you’re only taking four snapshots a year, market volatility could have a huge impact on your revenue if there’s a selloff at the beginning or end of a quarter,” explained Rowlan. Using an average daily balance smooths out that volatility. He added: “It’s a very fair way to bill, from the client side. And on the advisor side, it smooths out the cash-flow fluctuations that otherwise come with market volatility.”

Takeaways for advisors

While advisors often ask what other firms are doing, it's important to remember that your goal is to create a workable cash flow for your business, while also conveying value to clients. We'll talk about both of those things in the next section, but to wrap up this summary of what Advyzon users are doing, keep this in mind, from Rowlan: "There are a lot of misconceptions about how difficult different types of billing are. Whether it's average daily balancing, or monthly versus quarterly, people want to know how to be more efficient."

Sometimes, finding that efficiency is obvious. Monthly billing is always going to take more time than quarterly, since it's 12 times a year versus four. That's one reason why quarterly billing is so popular. However, neither will take as long as quarterly billing by hand used to take, when reports had to be collated manually.

"A lot of breakaway firms stick with whatever they were doing at their previous firm. And the industry is still on a quarterly model," said Rowlan. "But those same advisors are often used to getting paid monthly. So now you've got cash flow to consider. What we try to do when we talk to firms is get them to look at the 'why' behind why they want to bill a certain way or use a certain fee. That helps them start looking at what will work best for their specific needs."

How to think about pricing

There are two main things to think about when it comes to pricing:

1. **Are you generating enough cash flow to sustain and grow your business?**
2. **Are you pricing your services well for your clients?**

Both of these considerations are important, and they're connected. For instance, if you're targeting working-class or younger clients with smaller investment accounts, you'll need to think about what they can reasonably afford. Based on that, you'll need to figure out how many clients you need to have in rotation to meet your expenses and make a living.

Often, we hear new RIAs discuss burnout. The wrong pricing formula leads to round-the-clock work to make ends meet. That kind of work isn't sustainable, and it can be harder to raise prices once you've set them. To help you get ahead of these decisions, we'll dive into both areas in this section.

Cash flow

Advisors often discuss cash flow with their clients — money in and money out. But if you've never run your own firm before, you may not have applied this type of thinking to a business. The good news is, it works pretty much the same.

Like with personal cash flow, it boils down to money coming in and money going out. And like with personal cash flow, money doesn't always come in or go out at the same intervals. Some expenses are monthly just as some income is quarterly.

As you know, improper cash-flow planning can create big financial problems, so it's helpful to create a 12-month cash-flow forecast. Map out any expenses you anticipate and when they're due. Note how many expenses are monthly versus quarterly, and where your larger payments are. With quarterly payments, note if they are due at the start of the quarter or at various points throughout.

This can help you determine two things: The amount of revenue you need to generate from clients and the ideal timing of those payments. Knowing these things makes it easier to evaluate which fee and billing structure makes the most sense. You might land on percent AUM with staggered, quarterly payments or a flat fee you bill monthly.

Once you have a sense of your fees and billing, create income estimates to come up with a more complete cash-flow picture.

To create a full cash-flow forecast, you can keep track of your estimates in Excel, or use one of the many apps that offer cash-flow templates for business owners. (If you're an existing RIA, start with a cash-flow statement recapping the past year before getting into any forecasting.)

If you're just starting out, use this forecast to create revenue targets, which can help you test and refine your fee schedules.

In addition to the obvious (revenue and expenses), look at the timing of the payments. Timing is a good opportunity to think outside the box. For instance, if you prefer quarterly billing but are running into cash squeezes mid-quarter, see if your clients are OK with being billed at different intervals. Depending on the client, this may be a non-issue, and it could do quite a bit to improve your cash flow without you needing to change your fees.

For instance, Advyzon user Schaefer Financial Management charges a third of their clients at the start of the quarter, a third one month in, and a third the final month. This system helps improve cash flow, while keeping their clients on the quarterly billing schedule they were used to.

If you're a new advisor starting out, remember that you don't need to use a quarterly model. In the past, the lengthy amount of time required to create reports and bill meant quarterly was the only feasible option. Now, it's much quicker. At Advyzon, we estimate 30 to 60 minutes per cycle, per firm. While monthly cycles are still going to add up to more time than quarterly, most firms find an hour each month to be manageable, so don't feel like quarterly is the only way to go just because it's the most popular.

As you think through your fees and billing, remember that Advyzon can help you set up a variety of billing and fee schedules. You can set different rates and schedules for each client, though this could get hard to keep track of if you aren't strategic.

Figure out fees

In addition to cash flow, it's also important to create fee schedules that resonate with your clients. And to do that, it's helpful to think about behavioral economics. As an advisor, you probably consider behavioral economics all the time regarding risk and portfolio management. The same research can also teach us a lot about how people respond to price and think about value.

Since behavioral finance is rooted in psychology, creating a profile of your ideal client is a good place to start. This helps you understand your client's mindset in terms of what they value the most: quality, price, value, or something else entirely. You may already be aware of these things, but creating a profile of your typical client can help you get more specific about the details, which can help you improve your pricing.

If you've already looked at your (target) cash flow and profiled your (potential) clients, you likely have a good handle on how much your clients can afford, how much you need to make, and how many clients you (and your team if you have one) can reasonably take on.

Start with what your ideal client can afford, and how they think about value. What's more important to them, a financial plan or investment returns? On top of that, what can they reasonably afford per year? These questions can help you figure out whether flat fees or percentage AUM makes more sense. It may even be a combination of the two.

Next, add any considerations around cash flow. Do you need monthly revenue and think your clients will respond best to a flat rate? You might consider a monthly flat fee. Use your client profile and cash-flow needs to determine your ideal fee schedule(s). (As you saw earlier, the vast majority of firms have multiple fee schedules.)

Figuring out these details is, in many ways, the bread and butter of keeping your practice profitable. But you also need to make sure your clients feel good about the fees you're charging, and that's where behavioral finance can kick in to help.

For instance, have you ever noticed that in fancy restaurants, where quality is emphasized over cost, the prices are often in a smaller font with no dollar sign or decimals? That's because not including the dollar sign disassociates the number from money. Keeping the decimals off makes the number seem smaller, as does a smaller font size. These subliminal cues keep the focus on the food while sending a signal that the prices are secondary to the food. There are similar cues you might be able to send on your pricing sheets to emphasize service over cost.

On the other hand, for value-focused brands, you'll notice prices ending in nines: $3.99 instead of $4. That's because our brains read from left to right and the number at left makes the first impression. We associate the first price with $3, even though it's closer in value to $4. If you have clients who are conscientious of value, you may be able to send cues that they're getting a good deal, which could make them more receptive to your rates.

Here are a few behavioral finance observations that may be able to help you when it comes to discussing price, value, and fees with clients.

CHARM PRICING. This sums up the earlier example. If you're courting value-conscious clients, consider fees that end in nine, like 0.99% of AUM. Clients are more likely to read that as "less than 1%" which could be a big win in exchange for a single basis point. If you charge a flat fee, it might mean charging $3,996 per year, since that breaks down to less than $1,000 per quarter, in addition to less than $4,000 per year.

If your clients are more focused on service, you might deemphasize pricing altogether and remove markers associated with money — write out percent instead of using a numeral or list "4,000 per year" in smaller font below a description of your flat-rate service.

ANCHOR PRICING. Our brains tend to anchor to what we see, even when we have a broader frame of reference. Case in point: Have you ever noticed someone in a movie theater is more likely to buy a large soda if it's just $1 more than the medium, even if both sizes are priced far higher than market value? In this scenario, the large soda seems like a good deal.

You can create this type of anchor within your pricing plans. Consider pricing packages where one package serves as the anchor. Over time, you may start to learn how your clients respond to the different tiers, which could give you additional insights.

Anchor prices can be incredibly powerful even when arbitrary numbers are used, consider this study of a group of environmentally conscious visitors to an aquarium. They were asked how much they would donate to help sea birds affected by oil spills. When no anchor price was offered, the participants said $64. With an anchor price of $5, they offered to donate $20 on average. When $400 was used as an anchor, the participants said they'd be willing to donate $143.

Mentioning high numbers to clients could help you highlight your own value, since you may have created an involuntary anchor. You could do this by saying something as simple as "some firms charge [insert number] for this service" before sharing your rates.

PRIMING YOUR PRICE. Anchors aren't the only way to create context for your pricing. Consider this psychological study: Participants were asked about the average temperature in Germany. Researchers asked one group if they thought the average temperature was higher or lower than 41 degrees. They asked the second group if they thought the average was higher or lower than 68 degrees. Afterwards, both groups were shown a word puzzle. The first group was more likely to identify words related to winter: snow, shovel, and so on. The mere mention of 41 degrees, a wintertime temperature, primed their brain to look for words related to winter. Similarly, the group who were prompted by 68 degrees picked out words related to summer. Temperatures in Germany have nothing to do with a word puzzle, but the brain is still ready to recognize related words.

You can use this psychology to your advantage when you discuss pricing with clients by including information that could make your clients more receptive. You might mention that people who work with financial advisors are more than twice as likely to feel financially secure (or, put another way, if you have a financial advisor, you're 100% more likely to feel financially secure) That statistic doesn't relate to cost, and being 100% more likely to feel financially secure is ***very different*** than saying 100% of people who work with an advisor ARE financially secure, or that advisors have a 100% success rate. But, the human brain has a tendency to skim and oversimplify. Your potential clients may walk away from a statistic like that with a positive impression of financial advisors and financial security that makes them more receptive to your prices.

BEWARE OF CHOICE OVERLOAD. As you saw earlier, many advisors offer multiple fee schedules, and creating this choice can help you better serve your clients. Flexible pricing allows you to tailor your fee to you clients' needs. And as we saw earlier in this section, having more than one pricing plan can help you anchor your price and convey value. However, it's important not to take this too far. Creating too many options in your pricing can lead to choice overload.

You've likely read about this effect on retirement planning: Investors who are presented with too many fund options within their 401(k) often make no choice at all as they are overwhelmed by the choices. If you provide different pricing options to clients, make sure the choices are both justified and easy to understand.

In addition to overall price, there's also a behavioral element to billing.

We mentioned earlier that people tend to focus on what's in front of them. That means clients are more likely to focus on the cost of your services if you bill them in a way that requires them to actively pay you.

This tends to affect advisors who charge a flat fee if they bill that flat fee separate from a client's investments. Deducting a fee from clients' investment accounts may feel more palatable, since the client doesn't need to take any action.

It's worth noting that you can also bill flat fees to be paid from a client's investment accounts, and in fact this is more common. "A huge majority of our advisors —more than 90% — choose to deduct flat fees from a client's investment accounts versus billing them separately," said Rowlan.

Deducting your fee from an investment account, though, could be risky in the long run, since fees can compound and eat away at overall returns. Fiduciaries often discuss this with clients when discussing different funds or helping clients choose investments in a 401(k) plan. Think about how you'll discuss the relationship between your fees and returns with your clients. You might consider taking a strategic approach to which investment accounts you subtract your fees from, and then walk through your approach with clients.

Another way to achieve the "out of sight, out of mind" effect without influencing returns is to set up automatic billing via a client's bank account or credit card. There are challenges to this method as well, however, including potential processing fees that can eat into your returns.

Conclusion

Everyone is attempting to figure out fees, from advisors to clients, industry publications, and mainstream media, like the Wall Street Journal. Ultimately, you must decide what makes the most sense for your business and your clients. However, we know it can be helpful to see what others in the industry are doing (after all, the industry trend is the true “anchor” when it comes to pricing). While we knew flat fees were gaining in popularity, our data shows flat-fee use to be even more popular than some experts estimated.

Part of this might be down to tactics: Some advisors charge flat fees for planning services and a percent of assets for investment management. This type of varied fee schedule puts a new twist on the tiered pricing that still reigns supreme. It also allows advisors to potentially lower the percent of AUM charged for investment management, which could create a competitive advantage.

Whatever pricing you decide on, make sure you’re presenting it in a way that highlights the value you’re offering your clients. Start with what your clients find most important. Then, consider how behavioral finance and psychology can help you tee things up, too. You might even revisit the behavioral economics reports you use to help with investing and money management, but with pricing in mind.

We hope this white paper was helpful in providing insight into what your peers are doing, while also exploring ideas to help you evaluate your own pricing tactics. Once you land on a pricing strategy that works for you, Advyzon can help you quickly set up customized fee schedules and billing systems that you can run quickly and conveniently. Pricing and cash flow may be the most important parts of a profitable business, but they shouldn’t be the most important part of your day.