

Asset allocation is the core

For a client-centric, sustainable business, advisers should focus on portfolio building

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There was a time when the mutual fund industry went overboard trying to introduce new products. Today, the industry leaders seem to agree that simple, generic products work the best. In the wealth management business, bankers and brokers assumed that their HNI clients always seek something new. Today, many of them tell me that the simplest products are the most sought after even by the super-rich.

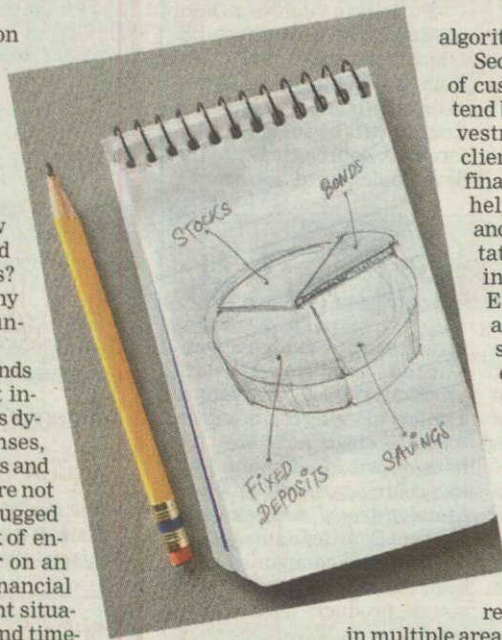
However, the financial planning and advisory business continues on the path of new products, unique solutions and customisation. I believe that this segment should return to the basics in its own interest.

Today, financial planners go to great lengths to tell their customers that the solutions they offer are customised. Several business models tend to rely on the ability of planners to bring together customer data and suggest unique solutions. However, this approach is prone to higher risks than the unsuccessful attempts by mutual funds, banks and brokerages to work on exotic products. The primary reason for the advisory business to have chosen this route is the need for differentiation. They do not want to be clubbed with 'product pushers' or distributors, who sell a financial product for a commission. Several of them also have business models that require the client to pay a fee for the financial

plan. Some of them take on the responsibility of executing the plan, while others label themselves as 'fee only' advisers, earning from writing the financial plan for the investor.

Why do I hold a dim view of this seemingly noble and good way to do business? There are three reasons why this business model is unlikely to be sustainable.

First, plan writing demands a large quantum of client information, much of which is dynamic. The income, expenses, goals, saving patterns, assets and liabilities of a household are not stock figures that can be plugged into an algorithm. The task of engaging with the customer on an ongoing basis to keep a financial plan relevant to the current situation is onerous, intimate and time-consuming. Boutique financial planners working with a few customers can do it; business models that seek large-scale generation of financial plans may not be able to replicate it, even with the most sophisticated software or



algorithm.

Second, the financial life of customers is likely to extend beyond a clutch of investment products. The clients who seek holistic financial advice will need help with loans, insurance, investments and estate planning, depending on their life cycle. Each segment of this advisory business is specialised. It may be extremely expensive for a financial planning firm to afford expert manpower in each of these areas to sustain a holistic financial planning practice. For an individual planner, the task is tougher;

requiring specialisation in multiple areas. The customers will engage multiple specialists to get their jobs done, and financial planners may risk oversimplifying this problem if they define their business as 'holistic, customised solutions for the family'.

Third, the sustainability of business models

depends on how well they align with the economic incentives and competitive structure of the industry that they operate in. When it comes to financial services, the incentives are still skewed in favour of the seller of products. A financial planning model has to dovetail execution in terms of product sale to sustain its revenues. The competitive space is dynamically altering with fixed costs for plan writing falling drastically, and with technology-based solutions modifying execution costs. The advisory firms need variable asset-based fees to survive.

The entrepreneurs with the vision to build customer-centric financial advisory businesses may get bogged down by this popular orientation towards 'customised holistic financial planning solutions'. What can they do instead?

At the core of a sustainable, customer-centric, competitive financial advisory business is asset allocation. It is the construction of a performing portfolio that defines what a financial adviser can do for the client. Just as a fund manager can select securities based on the core skills in constructing a portfolio that beats a benchmark, the advisory business should focus on showcasing its ability to create portfolios across assets that serve the investor interest.

This approach focuses on the ability of the adviser to choose the performing products from a given range and bundle them for the customer in the form of standard solutions that deliver a

pre-specified risk-return combination. For instance, if advisers are able to offer portfolios that are managed to deliver a 10-12% compounded return over a 10-15 year time frame, with a maximum 15% downside risk, the customers will choose these for their retirement or their children's education. The adviser need not know the age of the child, the estimated cost of education, or needle the customer for the profession the child is likely to take. The risk preference of the customer is the only variable to tackle, and several simple models enable factoring this input seamlessly in portfolio construction.

Importantly, the performing, standardised portfolios can be showcased. The adviser can build clientele based on the demonstrated asset allocation expertise. This leads the way to asset-based fee that sustains and grows the business. Add automation and technology to the execution of the portfolio, and the adviser has a scalable solution. The advisory business then competes on cost, performance, reach and execution services, which fosters a better business landscape. Importantly, it enables the customers to choose advisers objectively. If client interest drives these businesses, they should choose simple over complex.

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