



segmenting your services

June 2010

Recent research carried out by NMG provides evidence of financial advice firms segmenting their client base into distinct categories. The research and subsequent analysis throws light on what is driving this change, how advisers are differentiating between clients and the implications this has for the future.

NMG's research reveals that around a third of advisers* have segmented their client base. Here, **David Burns** reports on findings from further in-depth research carried out with 14 of these businesses to understand the approaches taken.



Our research evidence illustrates that client segmentation goes hand-in-hand with readiness for RDR. While over 40% of 'enthusiastic advocate' firms (those who are fully equipped for RDR) have segmented their client base this falls to fewer than 20% of 'steadfast rejector' firms (those who reject RDR terms the most).

The drivers for segmentation, however, have proved to be much more than merely responding to regulatory requirements. As segmentation has become embedded the economic benefits are coming to the fore. In looking to the future these firms are not only seeking to give their clients clear expectations of exactly what they will receive in return for their adviser charge, but have identified models which enable them

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Segmentation helps to make sure we spend the time with the client we need to... if you are agreeing a fee structure with someone you have to meet their needs and requirements and make sure what you are agreeing to, you are then delivering.

IFA, NMG segmentation research

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to service clients profitably. Increasingly, advisers have come to understand that a deluxe service can no longer be provided for budget level clients.

We have identified three main types of segmentation being used:

- **Separating the wheat from the chaff.** At its simplest level, segmentation involves distinguishing between the clients advisers believe they can afford to service in the future and those which are uneconomic (including those where no ongoing relationship has been established). Whereas some clients are actively 'resigned', others are going into a legacy pile. While for many this is the natural starting point to segmentation there is a possibility that if it goes no further these firms could be storing up TCF problems for the future.
- **Wealth-based tiers.** Typically 2-3 tiers. These usually involve a 'top tier' of wealthier clients with more complex financial needs, a second advisory tier of less wealthy clients and a third for transactional business.
- **Service-level tiers.** Typically 3-4 tiers based on the service level offering from the adviser. Clients can choose from a range of service propositions with associated costs. Various service levels are on offer differentiated by the frequency of reviews and reports, and the level of open access to advisers for 'ad hoc' advice. In some cases it seems clear that the highest and most costly tier serves mainly as 'window dressing' – the equivalent of an

aspirational premium bottle of wine alongside the mainstream supermarket range where the majority of sales will take place.

Fund-based commissions will normally automatically differentiate the earnings between segments but minimum levels are often applied here, topped up by fees and offset commissions where minimums are not achieved. Higher-level tiers are expected to produce at least £1,000 per annum (and much higher for some firms) whereas second tier earnings are typically expected to generate at least £500 per annum.

It continues to be important for firms to accommodate a fully transactional offer within the segmentation approach. This gives businesses the flexibility to help clients with simpler specific needs (eg for mortgages and straightforward protection) but with no need or desire for an adviser 'relationship'. It also leaves the door open for future contact when these (typically younger) clients begin to acquire wealth.

is it working?

Our research suggests that those who have segmented their client base are dealing with fewer clients per adviser than those who haven't. Segmenting the client base also appears to have a number of associated benefits:

- **A greater focus on what it costs to service clients.** Advisers who have gone through this process believe they are now acting more commercially, thinking in terms of profitability and not just sales.



- **More emphasis on what the business offers the client.** Creating a service proposition with specific charges focuses the mind on just what the adviser business does offer to its clients and what their clients value.
- **Smoother back office processes.** Setting clear delivery objectives for groups of clients has resulted in more organised back office processes with clearer time and delivery expectations for each client.
- **And for some a much enhanced work life balance has resulted.** In identifying which clients and which activities support their business model, advisers have been able to concentrate on the tasks that matter most rather than chasing every lead.

For many advisers though, segmentation is still in its infancy. The research illustrates that segmentation has just been a starting point for some firms to work out which clients they can afford to service post-RDR.

These are exciting times and segmentation could offer an opportunity for a more targeted business approach for different types of client. One clear area of opportunity appears to be in investment portfolios (see panel, right).

Such differentiation could be by default, the wealthier clients simply tending to lean towards specific investments. But taking this further, client segmentation could be linked to more specific and differentiated investment propositions. It could also impact on staffing with distinct teams working within particular areas.

For larger firms, post-RDR, this could include a restricted advice segment for clients where it is uneconomic to provide a full advice service.

Another potential development is in the charging area. An adviser's time is spread over a number of different functions, some of which could offer more 'added value' to clients than others. The research shows that there are inevitably major differences in the distribution of time for new and ongoing business. Adviser firms are often not taking this into account in the construction of their charging structures and much guesswork and gut feel is involved in setting charges. But a greater depth of understanding of the activity of all members of the adviser team could help firms to differentiate between what is profitable client business and what is less so – and to create a real cost model of servicing particular clients and tiers. This in turn could lead firms to reconsider their investment proposition, eg where the revenue generated from a client is insufficient to justify the level of work required to monitor a bespoke portfolio.

Although the majority of adviser firms have yet to segment their client banks, it does appear to bring advantages – even if only in helping to focus the mind on the cost efficiency of servicing different types of client – or in freeing up time to spend with the family. ●

David Burns is Director of NMG. NMG is an independent specialist financial services consulting firm.

*Based on NMG's monthly IFA Census of around 300 advisers.

segmented investment solutions

The highest tiers of client segments tend to be associated with more **bespoke offerings**, to fit with the generally more complex requirements of wealthier clients. Breadth of fund choice and access to a wide range of assets is important here and at the higher end of the scale there is evidence of increasing use of discretionary investment management services.

In 'tier 2' we see less evidence of bespoke investment advice and increasing use of **pre-defined or asset allocated portfolios**. Model portfolios, risk-rated funds, multi-manager and multi-asset solutions fit into this area together with wider support from platforms in additional screening and monitoring to identify the most suitable funds in each sector.

For clients with limited funds and those who are only starting out in building a portfolio, hands-on investment advice could look very expensive. There is a need for a slick and 'self monitoring' investment solution, leading to growing interest in '**packaged portfolio solutions**' such as risk-rated funds.

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