

## Costs and Benefits:

### *Evaluating Financial Products and Services Not A Easy Matter*

*(Author's Note: I recently came across some old notes and writings regarding evaluating services. I thought I would combine them into a new look at the subject.)*

After almost two decades in the financial services business, I am still amazed at the mythology in which many consumers and even professionals continue to believe. Many mistakes are made due to erroneous assumptions about costs, perceptions regarding objectivity and biases about how people get paid. Two of the biggest myths regard fees and commissions.

#### **Myth #1: Paying somebody a fee means she will be more objective.**

##### **Reality:**

Nobody is completely objective. We all have our experiences, training and "gut feelings" that color our views. Objectivity is a relative condition, and it depends mostly on the discipline and personal integrity of the person.

Certainly, a person compensated by commission has biases according to how he gets paid. He might favor a higher-paying product over a better one that pays less. He might receive perks from one provider and not another. These are important issues.

But a fee provider may have as many biases and axes to grind as any commission salesman. The compensation of someone charging an hourly fee is "billable hours". Therefore, it stands to reason that it is in that person's best interest to create dependence and process. Her interest is less in closure than it is in continuing work.

Someone working for a "flat fee" might be motivated to cut corners to maximize profits. And any consultant can be either incompetent or disingenuous about his biases or relationships.

I have known fee consultants to denigrate commission salespeople who had done excellent jobs. Sometimes the purpose was to cut out or diminish the influence of others that might have the client's ear. Other times it was because they had a bad experience resulting in a set bias against insurance agents or stockbrokers or retail sales people. And I have known commission salespeople who put down accountants and attorneys or other consultants.

When there is competition among providers, things can get confusing and sometimes unpleasant. I will never forget one of my early training classes where I was taught to "disturb" the prospect. The idea was that the way to get them to listen was to point out something real or not about which they should be worried. If they had advisors already, the goal was to subtly question what they had done or recommended. If you could cause doubts in the prospect's mind, you stood a better chance of replacing their other advisors. It was this kind of "modus operandi" that made me question whether I really wanted to be in this business.

Now this is not to say that you shouldn't point out problems that really exist. Nor should you refrain from positively selling your services if you think you can improve a person's situation. There are issues over which people *should* be disturbed. But it is too easy to use such techniques in manipulative and less than honorable ways.

Fortunately, I have found a majority of practitioners refrain as much as possible from "negative selling". But it still happens regularly, so buyers beware.

## **Myth #2: Going direct and cutting out the "middleman" gets you more for your money.**

### **Reality:**

As many recently found out with low-cost Internet trading of stocks, going direct can be hazardous. Sometimes, an honest and competent middleman can be worth his weight in platinum if he just keeps you from making a big mistake or two. Whether the consultant is fee-based, commission-based or a combination of the two is almost irrelevant if they do a good job.

I have experienced situations where I have saved people large sums of money by finding them less expensive solutions or recommending against a course of action which would have cost them dearly. Unfortunately, some clients did not fully understand what I had accomplished, and I found out only later about their ignorance and misperception about my work when they did business elsewhere.

## **How to Evaluate Products and Services as Objectively as Possible:**

1. Start with clearly defined and realistic objectives.
2. Concentrate on facts and make sure your impressions and perceptions are as accurate as possible.
3. Define how success is to be measured.
4. Evaluate performance, benefits, services and costs as a total package.
5. Treat everyone involved as you yourself would like to be treated.

### **Start with clearly defined and realistic objectives.**

Objectives can be simple or complex. In either case, clear definitions are critical. And they need to be realistic.

A couple years ago, a man I will call "Jim" called me after getting my name out of the phone book. He said he was looking for an investment advisor. I asked him what he thought he wanted from an advisor. One of the first things he said was "I want to get a 10% or better annual return, but I don't want to take much risk."

I could have said, "No problem. I have many clients who made over 15% per year over the last five years, and in none of those years did they lose any money." Now that would have been a true statement, but it would also have been terribly misleading. That five-year period just happened to be among the best in history for stocks and bonds.

In fact, in today's environment, it would be impossible to achieve a 10% return without taking risks. It was clear

that if Jim were to become a client, we would have to spend a lot of time discussing his objectives realistically.

If you want too much, you are setting you and your advisor/provider up to fail. I can't think of many, if any, accounts that have not had problems from time to time. Not every stock or mutual fund I have recommended has performed as we hoped. Not every insurance claim is hassle-free. Administrative problems occur. Nobody and no organization can be perfect.

A clearly defined and realistic objective might look like this:

- Goal: 10% average annual return over ten years (7% above inflation)
- 3% inflation rate assumed
- Risk of losing as much as one third of your account value in a worst-case scenario over a one-year period
- Low risk of losing any money over a ten-year period.
- Up-side potential of over 20% annualized return.

Such an objective could be supported with historical market data and would put the overall plan in perspective.

### **Concentrate on facts and make sure your impressions and perceptions are as accurate as possible.**

A few years ago a woman I will call "Alice" came to me because she thought her stockbroker had been doing a poor job. After listening to her, I ascertained that her perception was based on a magazine article and some general suspicions she had difficulty articulating. Also, an insurance salesman had been telling her that fixed rate annuities and life insurance would be better for her and criticized stockbrokers. In fact, she had signed some insurance contracts and was going to liquidate her brokerage account.

Alice came to me for a third opinion because a friend suggested she talk to me. We discussed her objectives, her overall financial situation and how she felt about various investments and risks. I asked her to give me her statements and reports for the last few years and promised her I would evaluate her portfolio and report back to her.

I discovered, when looking at the facts, that her broker had actually done a reasonably good job. Yes, there were some recommendations that didn't do well, but overall he had done his job honestly and adequately. His recommendations and performance were very acceptable given her objectives and situation. His commissions were reasonable. On the other hand, the insurance agent's recommendations were not very favorable. The contracts were very restrictive and not as competitive as other insurance products.

Alice had a poor understanding of the facts. She also allowed herself to form opinions and perceptions based on biased third parties. Such a combination of false impressions without factual understanding can be deadly. The rest of her story will follow later.

### **Define how success is to be measured.**

This can be difficult, especially where multiple objectives and personalities are involved. For instance, some

objectives can compete against each other. On one hand you may want it to be simple and no hassle. On the other you may want lots of options and flexibility. You may want low risk but high returns.

If you have clearly defined and realistic objectives, evaluate results in relationship to them. Don't compare your performance to someone else's or to indexes in the paper. While those have their place, the most important thing is whether you are achieving what you set out to do.

You and your advisors should have regular review meetings to discuss progress and reevaluate objectives. Open discussion and critique is valuable to all.

### **Evaluate performance, benefits, services and costs as a total package.**

It's the total package and end result that matters. Don't get hung up on particular pieces because of a bias or misconception.

Some people think a person getting paid commissions will increase the cost of a product or service. Actually, commissions are often built into the product and the cost would be the same whether you paid your consultant a fee or used the commission structure. In this case, it is actually to your benefit to use a consultant who receives a commission. Fees can actually result in greater costs with no greater benefits.

On the other hand, higher costs may be justified if the end results are better. There are some mutual funds that assess sales charges up front, but have lower annual expenses than many "no-load" funds. Some funds that have high expense ratios actually have performed better than funds with low expense ratios.

If your advisor saves you \$50,000 on group insurance costs or saves you from making a big investment mistake or provides knowledge and advice which avoid a law suit or saves your estate a quarter of a million dollars, what is that worth?

Obviously, you want to get the best results for the lowest cost. The key is in the balancing of the two for the best overall package.

### **Treat everyone involved as you yourself would like to be treated.**

If you have done business with someone and they have generally done a good job, treat them well. If you are talking to competitors let your current provider know all the facts and your reasoning up front. Don't blind-side him. Remember that no one is perfect and the new person may have an unfair advantage if you reveal any past problems. Hindsight can be perfect, and you won't have that advantage with the new competitor; it is unlikely they will display their clay feet, whereas you will see the current provider's deficiencies all too easily. Remember the adage, "The grass is always greener..."

If there have been problems, have you contributed to or caused any of them? Don't make a current provider the fall guy for your own bad decisions or failure to work with that provider effectively. If you have not provided all the information, resources and attention needed for your advisor to do a good job don't blame him for what he couldn't control.

Discuss any problems or issues openly and give the current provider a fair chance to solve them using steps 1-4. Remember that your decisions can profoundly affect other people's well being.

Alice was confused. She was suspicious of her broker. Once she became disturbed, she went to others before asking her broker about her concerns. The mistake the broker made was in not paying attention to his client's perceptions. In his busyness and daily stress he had failed to communicate as effectively or as often as this woman wanted. He probably wasn't even aware he had a problem. He thought he was doing a good job, and was probably surprised and hurt to learn he was not appreciated. It was a failing I recognize all too well, for I am often guilty of it myself. It's a tough business.

At our next meeting, I explained this to her. Had I wanted, I was in a position to use the broker's minor failings and the disingenuousness of the insurance salesman to attract the business to myself. Instead, I suggested she initiate a face-to-face meeting with her broker to reestablish the relationship. The best client-advisor relationships are where both parties take responsibility to communicate with each other openly and without hidden agendas.

I can tell you this. Nothing hurts worse than knowing you have served someone well only to be blind-sided later and lose a client because of a misperception, inaccurate and unfair criticism and/or manipulative maneuvering by other advisors behind the scenes.

It's a simple but often neglected principle: "Do unto others..."

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