Embracing The Small Client
By Raymond Fazzi

The trend is to seek out big accounts, but many investment managers and planners continue to value relationships with small clients.

For financial advisory firms looking to grow, the prevalent theme nowadays is that firms need to move up the wealth ladder and shed themselves of client accounts that sit on the lower rungs.

James Hallett finds such talk amusing. In fact, he's heard colleagues boast so much about high-net-worth clients and their Rolex watches that he has a prepared comeback. "It's always fun for me to say we work with low-net-worth people who wear Timex watches," he says.

Hallett, president of Hallett & Associates in Port Angeles, Wash., goes against the flow when it comes to moving upstream in search of the big fish. His firm has no official minimum account requirement and deals with clients who have an average account size of about $250,000. Some clients fall much below that.

Yet even with a clientele that falls below what industry consultants consider the "sweet spot" of profitability—a recent study suggests the most profitable clients have liquid assets between $500,000 and $5 million—Hallett says his firm has robust growth.

The firm has about 330 clients and in the last six years has seen its assets under management go from $10 million to $80 million. The growth, he says, is due to the firm's open door policy for both large and small clients. It's a policy partially derived from the fact that Hallett & Associates sits in a former thriving logging community that is now grappling with 10% unemployment. But it also is a policy grounded in what he calls "holistic planning."

"I can understand it from a business standpoint that every relationship should generate x-dollars to the bottom line, and I truly understand it and have looked at it," he says. "However, our philosophy and my firm's philosophy is such that I don't think the bottom line is the true definition of a healthy practice."

Hallett is among a number of firms that, for various reasons, have bucked recent trends and adopted a policy that either includes or focuses entirely on serving Middle America. They are doing so at a time when many management consultants preach just the opposite. A recent survey by Rydex Advisor Benchmarking, for example, found that RIA firms requiring a minimum account size increased the requirement by an average of 18% in 2005, to $408,000 from $345,000 a year earlier.

The approaches firms use to serve smaller accounts do vary. Some firms serve small accounts as a niche business and only in the area of financial planning. Other firms, meanwhile, have managed to fit small accounts into a business model that includes both financial planning and investment management.

In either case, no one is suggesting such a strategy is easy. Advisors who serve small accounts say that the work requires careful time management and a relatively high number of clients to be operationally successful. Some firms have been unable to make the model work.

KLB Financial in Edina, Minn., recently raised its minimum account requirement to $500,000 and, in the process, transferred 200 clients to an independent RIA who used to work for the firm. The firm opened its doors in 1990 with no minimum account requirement. "It took us three years to embrace the fact that we had to give them away," co-owner Dana Brewer says of the 200 transferred clients. "It took a lot of soul searching, and we just couldn't come up with a way to keep them."

The problem, she says, is that the firm has stuck to a comprehensive service model as its client rolls grew over the course of the last 16 years. It got to the point, Brewer said, where the fees from larger accounts were subsidizing the smaller ones.

The firm instituted its first minimum requirement of $250,000 a few years ago but even that wasn't high enough, she says. "It was crazy and busy here and we knew that we would rather be busy with the profitable clients," Brewer says.

Mallard Advisors LLC of Newark, Del., found itself dealing with the same issue last year. After launching with an open-door policy, the firm gradually realized it had outgrown many of its smaller accounts. What the firm decided to do in this case was adopt a new tier of service, a "gold" level of investment management that requires a minimum $1,000 annual fee—equating to an account size of about $135,000.

The firm's higher "platinum" level of service requires at least $3,000 in fees a year, equal to about $400,000 in assets. "We didn't like the idea of shutting the door to smaller accounts," said Paul Baumbach, the firm's senior wealth manager. "Also, many of them eventually grow into larger accounts."

Before the adoption of the tiered service, the firm had a straight $300,000 minimum, but continues to service smaller accounts that were leftover from the years before it had a minimum requirement. Those grandfathered accounts have now been moved into the gold tier, which Baumbach described as a more streamlined and less costly level of service. Gold tier clients, for example, get their quarterly reports two months later than other clients. "That helps us dramatically with work flow," he says.

Another reason for the lower tier: It is a convenient place to put client referrals with smaller accounts. "Usually the people who come to us with less are family friends and word-of-mouth folks, and those people you especially don't want to show the door," Baumbach says.

Some advisors who started out as accountants say they felt an obligation to serve small accounts when transitioning to investment management. "I think it was getting back to being an advocate or protector of clients," says James Warring, managing member of R&M Wealth Management Services in Bethesda, Md. "It's ingrained in your DNA to help clients and put yourself in their shoes."

R&M Wealth Management has an $80,000 account minimum, but Warring says the firm will try to work out arrangement with any client. "We don't turn clients away necessarily," he says. "Our belief is that a small client becomes a big client, and also that there is a need out there for good advice and good service."

Traphagen Investment Advisors LLC in Oradell, N.J., has had a $10,000 account minimum since it was launched by a group of accountants in 1997. "Working with accounting and tax clients we saw there was a need to help these people," says V. Peter Traphagen Jr., a partner at the firm. Traphagen's father founded the accounting firm 30 years ago.

Traphagen says keeping small accounts is also a good way to build relationships. He notes that the firm, while it makes on average about $30 to $40 a year on a typical $10,000 account, often sees those accounts grow. He gives as one example the holder of a $2,000 Roth IRA who later brought in $2 million from an inheritance. "Another way to look at it is it's almost like a marketing expense," he says.

Middle America As A Specialty

Two powerful trends—the aging of the baby boomers and the growing realization that Americans aren't doing enough to prepare for retirement—are leading to a growth in the number of advisors who focus on middle-income clients, according to advisors involved in the specialty.

Sheryl Garrett started the Garrett Planning Network six years ago to help advisors set up and operate practices focused on delivering affordable financial advisory services that are billed by the hour. Two years after the network started, the network drew 115 advisors. It now has about 260.

She notes that the trend is working two ways. More advisors are gravitating to clients that have traditionally been ignored by professionals, while more middle-income families are waking up to the fact they need professional planning advice.

"The guys on the factory line are talking about the stock their company is putting in the (retirement) plan," she says. "There's a lot more

interest and recognition by the average Joe that we have to be more involved in our personal finances."

Garrett says the most difficult transition for advisors going into this market is time management. Most advisors, she says, are not used to billing by the hour or setting a time allotment for specific projects.

That may be one reason that only 30% of the advisors in her network provide investment management in addition to financial planning services. "As-needed investment advice is a very different animal than portfolio management," she says. "We don't see that happening with an individual practice very often.

At Cambridge Advisors, a network of advisors geared toward serving those with annual salaries of between $40,000 and $100,000, advisors include investment management with the help of planning tools provided by Cambridge, network founder Bert Whitehead says.

Among the approaches used by Cambridge Advisors is to include a client's home when managing assets, and striving for tax efficiencies, he says.

Cambridge advisors are all certified tax specialists who typically do their clients' taxes each year, he says. "I don't know how you would serve Middle America without doing their taxes," Whitehead says.

Roger Kruse, who with his brother Ron has been providing fee-only financial planning and investment management to middle-class clients with less than $1 million in assets since 1997, says many of his clients came to him after working with commissioned agents and brokers. The sales-oriented nature of those relationships is what usually gets them to seek out a fee-only advisor, he says. "They have low confidence that their current person can meet their retirement needs," he says.

Rebecca Pace, owner and founder of Pace Advisors LLC in Cincinnati, has chosen to focus her practice strictly on providing financial planning to those who need it. In many cases, it's people who have no more than a 401(k) account to work with. "I think there is a huge need for the service in the middle market," she says.

Most of her clients fall into the $300,000 to $1.5 million range of assets, and typically are do-it-yourselfers looking for a second opinion on their retirement accounts and portfolios. "I define middle market as anyone who does not have estate-tax issues," she says.

Pace would be fully capable of expanding the breadth of her business. She is both a CPA and an RIA, and has previous experience in the life insurance industry and as a financial planner dealing specifically with Fortune 500 senior executives. Now, however, she is a strong advocate of the "hourly-as-needed" model of financial planning, which in her practice amounts to a $400 fee for a two-hour consultation and $2,500 to $3,000 for a comprehensive financial plan.

Her typical engagement consists of a meeting with clients near retirement, with accounts they've been running themselves for a number of years. When it comes to baby boomers getting ready for retirement, Pace is on the front lines. "Most of them, knowing they are retiring, are getting nervous and so they want some reassurance they are on the right track," she says.

Pace provides either validation, new strategies or both for most of her clients. She recommends annual checkups and rebalancing, and will send out e-mails and newsletters as reminders, but doesn't push the issue beyond that. It's a business model, she admits, that doesn't maximize the potential for repeat business. "From a business perspective, it is scary," she says. "It means I have to be continually out in the public and continually marketing and making my message fresh."

She has largely been depending on RIAs sending her clients who don't meet their minimums, as well as referrals from CPAs and existing clients. The other source of business has been people finding her name on the Internet—mainly through planner search tools on the Web sites of the Financial Planning Association and the CFP Board of Standards. "One thing working in my favor is that every day someone has a birthday and is getting ready to retire," Pace says.

For Diane Maloney, owner and founder of Beacon Financial Planning Services Ltd. In Plainfield, Ill., the focus on serving middle- to upper-middle-class clients evolved as she set up her practice. Maloney decided to become a financial advisor in 1988 after spending 20 years as a high school teacher—the latter years as an instructor of financial planning. Soon after making the switch, the state board of education asked her to participate in a two-day seminar for teachers who were approaching retirement. "They told me they had a terrible time finding planners who understood the teacher retirement system," she says.

Maloney agreed to participate in the seminar and, at the suggestion of board officials, left her business card and promised a free hour consultation for any attendees who wanted to meet with her. That one event, it turned out, became the foundation for her firm. "I got 50 full-time planning clients in a matter of months," she said.

Building her firm mainly through client referrals, Maloney now serves 275 families in 15 states across the country and in Europe and has $50 million under management. She considers her ideal client to have between $300,000 and $1.5 million in liquid assets, but with no minimum account requirement she has many clients with less.

The firm gets the majority of its income from investment accounts, but Maloney considers the financial planning end of her business crucial to the relationship she has with clients. She has, for example, accompanied clients to inspect assisted living communities to provide an objection voice in their decision-making.

While some firms at similar stages of growth are firing clients, Maloney continues to embrace client relationships that bring little or no return to the bottom line. "We are just client focused here. I just like to know them and what their needs are," says Maloney, who has brought in two staff assistants and another CFP practitioner since starting the firm. "For some of them, I've held their hand through some of the saddest tragedies in the world."

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