Communication Dynamics

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I used to have three cats, all named after Nobel prize-winning economists. When my cats passed on to that Big Economic Summit in the sky, I replaced them with two adorable Labradoodles with mundanely suitable names like Ginger and Cinnamon.

My cats flat out refused any kind of training, but I decided to get an expert trainer in positive reinforcement for the dogs. The first day we met, the trainer sat down with me and explained how this was going to work. "I don't train dogs," she said emphatically. "I train the owners. You need behavior modification more than they do."

Earlier this year, I had a lively discussion with a group of institutional portfolio managers at the CFA Institute Annual Conference in Seattle. It was pretty clear to them that the world of institutional management has changed; people need management more than their portfolio does. We are increasingly beginning to realize that the soft skills of building client relationships and managing client behavior are more important than the technical skills of plan design and portfolio management. Over a decade ago, Meir Statman, professor at Santa Clara University, well known for his work in behavioral finance, wrote that 93.6% of the financial planning process is the behavioral management of the clients.

This really addresses the basis of what we do; we must know our clients. We learn to communicate with them on their terms, building a plan and an investment portfolio that recognizes their automatic decision-making biases. In his book Thinking, Fast and Slow, Daniel Kahneman refers to this as "Level 1 behavior," in other words, their instinctive behavior. There is very little we can do about it without very intentional management. In practical terms, the Level 1 behavior will take over when the advisor and client are under pressure. Pressure is present anytime clients have to make major life and financial decisions.

Most advisors will admit they can't tell how their clients will react under pressure, although many of us spend time, energy and effort trying. We somehow believe that we can learn enough about our clients by simply observing and listening to them over time. However, the more I learn about behavioral finance, the more I realize that humans, because they are human, naturally have blind spots that can get in the way of good decisions. The problem for most advisors is how vulnerable and exposed they feel in dealing with the human issues at a deeper level. Sticking to the numbers is easier.

Over the last 10 years, I have been following the work of Hugh Massie at DNA Behavior International. Hugh believes that the financial planning life cycle is about relationship management through the behavioral management of the client, or what he refers to as "understanding people before numbers."

Traditionally, advisors have used a risk tolerance questionnaire or some kind of risk assessment to better know their clients. We even developed our own at our firm. The problem is that many of the risk tolerance tests can produce unreliable results because the questions may be subjective, often difficult to understand and generally biased by current perceptions of the market. Even if a risk tolerance questionnaire is a good one, it still will not tell you how to communicate with the clients or help you understand what their broader predispositions are for spending, saving and goal-setting.

It's entirely possible that two people with a similar amount of money to invest and the same risk tolerance could have different financial personalities.

Or they could have similar financial habits but very different risk tolerance. Understanding how to guide clients through these key decisions under pressure and uncertainty is the reality advisors face every day. The core of this, and frankly all our dealings with clients, is effective communication.

This summer, the FPA Research and Practice Institute released its survey, "Trends in Client Communication 2014. The study examines communications with clients—the frequency of reviews, the length of response times to e-mails and phone calls, etc. It then discusses advisor tracking of these standards of service and reports on advisors' perception of their effectiveness.

While the findings are not startling, I find it sobering that fewer than half of the advisors in the study have a formal client feedback process. It's concerning that 56% of advisors have communication service standards but only 30% actually review and reinforce them with clients. It's fascinating how frequently practitioners talk about communication but how little they spend on it.

Finally, it's amazing that a majority of advisors (more than 77%) believe they have a client communication process that is fairly effective. Their perception is apparently confirmed by the findings from the study "Rules of Engagement 2014," by Advisor Impact and AssetMark. Ninety-one percent of clients in the study indicated they were very satisfied with their advisory relationships. But this begs the question: Are advisors really doing a good job of communicating or is it that when markets are positive, clients don't care? The risk, of course, is that the clients may start to care a great deal in a bear market, and if our communications are poor, our business may be at risk.

My favorite book is Selling the Invisible by Harry Beckwith. First published in the '90s, it makes a valuable point that has always stayed with me. What we do in the service business—any service business—is sell something that a client cannot touch, see or feel. Many times, he can only judge, years later, how effective or valuable our service has been. And because our work is intangible, our relationship is fragile unless we successfully make this "invisible work" visible. It doesn't break down until it breaks down, and when it does, it becomes something very personal. For example, when the client's air conditioner acts up, he blames the unit; when his portfolio is volatile, he blames you. So while we are patting ourselves on the back for the good job we are doing, we aren't working on improving our communication processes or making them more effective and less invisible.

As part of our communication classes at Texas Tech, we use the DNA Behavior software developed by Massie. It has carefully crafted questions that pinpoint behavioral style, particularly what Kahneman refers to as Level 1 or automatic behavior. First, we use the assessment with students to help them understand their own financial hardwiring. Then we help them evaluate their clients' financial hardwiring in order to design an appropriate portfolio (instead of using risk tolerance alone).

People who take the assessment will fall into one of four behavioral styles defined by DNA Behavior. There is the person focused on goal-setting, who is looking at opportunities. Second is the person who is focused on his lifestyle (meeting people and having fun). Third is the person who seeks safety and stability. And fourth is the person who's more focused on getting information—an analytical type.

There are optimal ways for advisors to engage each of these types. For the goal-setter, an advisor will want to provide discussion and opportunities. For the lifestyle-focused person, an advisor will want to offer fun and openness (and graphics). The person seeking stability will need to hear more about security and feelings and will require more instruction, whereas the information-oriented person will require analysis, research and details.

You and your team also take the assessment so that you can generate a behavioral management report specifically designed to help you lead your client through the financial planning process. In essence, the report compares your style with your client's and tells you how to modify your own behavior.

Let's take a client, "Annie," who's primarily focused on her lifestyle but is also a goal-setter. Your own style is to focus on information—the analysis, research, facts and planning. But to talk with Annie, you will have to refrain from jumping right into facts, figures and details. Annie will respond best to open discussions, charts, graphs and seeing the big picture.

While there are many more aspects to the software, one of the most powerful is that it connects the client's unique style to behavioral biases so you can understand how she might make decisions or react to decisions under pressure. Annie, for example, might score higher for certain traits: She may be more likely to sell winners and hang onto losers for too long. She may tend to be impatient for results and may sell at the wrong time. This means that as Annie's advisor you will want to have a clear, understandable, long-term-view investment policy that she agrees to follow, even in volatile markets.

Though I find this software practical and useful, no one piece of software can make a difference in your effectiveness or profitability unless you commit to developing services and processes around it that focus on communication with the client.

Talk of better client communication seems to be in vogue this year, but I personally believe we need to spend less time talking about it and more time, money and effort in doing something about it. Try putting your communication plan into effect this year, then plan to track its effectiveness throughout 2015.

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