Referrals in Regulated Financial Services: Myths, Misunderstandings & Misapprehensions

Introduction

It is the contention of this paper that the field of regulated financial services has been ill-served by marketing theory and that, as a consequence, the nature of marketing in this sector has been misunderstood, the key mechanism for generating new business in the field, namely referrals, has been the subject of serious misapprehension, and the guidance offered to practitioners has been negligible. The principal source of these misunderstandings and misapprehensions has been, as the conference organiser presage in their call for papers, an inadequate grasp of the complexity of this field of business. In particular, the role of the independent financial adviser (IFA) appears to have been conceptualised as a sales role, and the nature of the relationship between the IFA and the client has been addressed as though it were a straightforward buyer-seller relationship, with the IFA selling products to the client. It is unlikely that these conceptualisations were ever satisfactory and, following recent regulatory changes in the sector, they have become even less relevant. Most notably, since January 1st 2013 financial advisers have been prohibited from receiving commission for the sale of products on behalf of financial services companies, and so independent financial advice has become a fee-based service. Prior to this change, when financial advisers were permitted to work on a commission basis, it was perhaps reasonable to conceive of those who did as, in some sense, agents operating as sales-people on behalf of financial services companies. Subsequent to this change, however, personal financial advice for investment products in the UK has become an entirely fee-based service delivered by a qualified professional to a client, and regulated by the Financial Conduct Authority[1].

The paper commences with a brief introduction to the personal financial advice sector before moving on to consider the literature on the marketing of personal financial advice. Subsequently, focusing on referrals as the key mechanism for generating new business in this sector, the paper argues that referrals have been poorly conceptualised in prior work by both academics and practitioners/consultants. A new model of the *referral process* is presented. Given the constraints of length, this paper contains only a brief summary of the research methods and preliminary empirical results, which is followed by the conclusion.

The Personal Financial Advice Sector

According to the Association of Professional Financial Advisers (APFA): “40% of investment and protection products are sold through financial advisers, with annual revenue estimated at £3.8 billion (£2.2 billion from investment business, £1.2 billion from general insurance and £400 million from mortgages) … Over 50% of the population rank financial advisers as one of their top three most trusted sources of advice about money matters. As such, financial advisers represent a leading force in the maintenance of a competitive and dynamic retail financial services market” (APFA 2013). The regulation of financial services is a matter of great political, social and economic importance that has become even more

[1] Advisers may still be paid commission on certain non-investment products.

prominent in the wake of regulatory scandals such as the alleged mis-selling of payment protection insurance and personal pensions.

Financial advice makes a significant contribution to the UK economy; recent data suggests that over 160,000 active individuals participate in financial advice (Spectrum Data Management, 2013). It is estimated that the UK long-term savings and investment industry has assets of £2.7 trillion making it a mainstay of UK economic life. Surprisingly, even though IFAs account for 80% of sales in this sector, academic studies are rare (Tjandra et al, 2013). Financial advisors operate commercial enterprises largely comprising of three or fewer regulated individuals (FSA, 2010) and do not have the financial resources to embark upon the type of marketing campaigns available to larger institutions; instead they rely on referrals to obtain new business (Pickersgill, 2013). By and large advisory firms do not have advertising budgets or "the direct brand recognition to approach the retail public directly" (Sittampalam, 2013:5). Therefore it is crucial for advisors to build enduring client relationships, of satisfied clients, who in turn will refer prospective clients; research indicates that word of mouth (wom) influences behaviour more than other marketing methods (Buttle, 1998).

Marketing of Financial Advice

Since this field is relatively unexplored by academic researchers, and the research produced by consultant/practitioners is often mildly camouflaged self-promotional material, the selection of literature relevant to this study was not straightforward. For example, there are several relevant published works by (practitioner) financial planners who also hold academic positions, but they tend to cite research by fellow planners rather than fellow academics (Dubofsky & Sussman, 2010; Grubman & Jaffe, 2011,; Yeske, 2010). This relatively insular approach probably reflects the anecdotal and experiential nature of research reported by consultant/practitioners, their desire to build professional credibility, and the absence of an established body of knowledge concerning financial advice marketing (Geistfield, 2005).

Financial advice is considered to be a *credence good* (Darby & Karni, 1973:68), where the consumer has less knowledge than the service provider (Eraut, 1994). Financial service products are often difficult to understand (Gaskell & Ashton, 2008), and consumers may have insufficient knowledge to evaluate the service or product until many years after the purchase. Consequently, consumers have difficulty in determining whether they need advice and what type of advice is appropriate, while evaluating whether the advice was suitable has to be deferred until a future date (Clarke, 1999). It is understandable that consumers should be cautious when making decisions that could affect their long-term financial well-being. Additionally, the regulatory environment of personal financial services makes it difficult or impossible to use marketing communications tactics that would be regarded as perfectly normal in, for example, the marketing of packaged groceries. Providers are heavily constrained in terms of the ways in which they are allowed to describe their financial product offerings. Under these circumstances, where consumers often lack confidence in their own knowledge of the field and where conventional marketing approaches are heavily constrained, it is not surprising that relational aspects of marketing become important.

Little academic work has specifically addressed how advisor/client relationships can be developed that will lead to client referrals (Boles et al, 1997). The published work that is available in this field is often authored by consultants and practitioners; in some cases academic researchers have collaborated in these studies (Dubofsky & Sussman, 2010; Grubman & Jaffe, 2011; Yeske, 2010; Weatherill, 2010; Trusted Advisor, 2012; Bowen et al, 2008). The impression is that this body of literature promotes largely experienced-based, unsupported, anecdotal approaches and is characterised by an absence of methodological rigour, academic referencing and peer review. Quantitative reporting methods are often used as illustrated by Weatherill (2010:22) who asserts that empathy is the key ingredient in building trust supported by both numerical proof and a "proven methodology". The validity of these findings has been challenged by other authors (Dawson et al, 1992; McBane, 1995) who find the relationship between empathy and behaviour to be unproven although Weitz et al (1986) provide limited support when suggesting empathic advisors may be more successful.

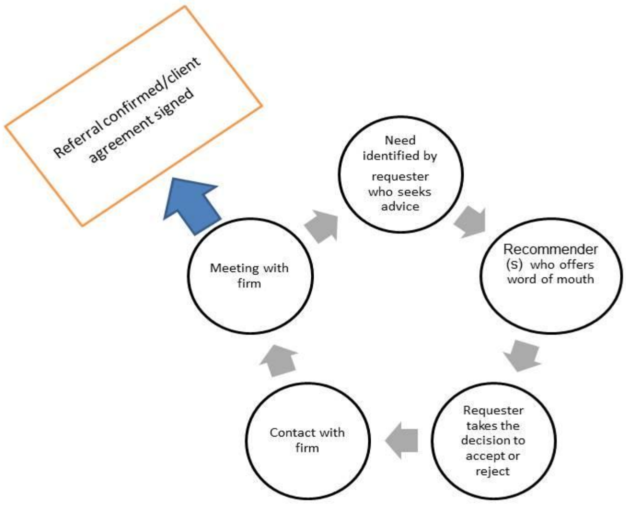
Defining Referrals

For practitioners of financial advice a 'referral' means the opportunity to present a service proposition to a new prospective client resulting from a recommendation by an existing client. Despite the vital importance of referrals it is claimed that researchers have devoted "little attention" to relationships that generate referrals (Boles et al, 1997:254). Authors have sought to quantify the value of referrals in monetary terms so as to evaluate the contribution they make to the success of a firm (Helm, 2003). However Helm (2003) does not explain what methods are known to be successful. The limited number of authors exploring referrals in other contexts emphasises the limitations of academic research in this field; a view that is reinforced by Ryu & Feick (2007:84) who note that despite a wide search they found "almost no empirical work". For our present study, searches for "referrals" and related terms in the *Journal of Services Marketing* produced no results; 17 results were found for the words "financial advice". Searches were also implemented for the terms "referrals" and "financial advice" in the *Journal of Personal Selling and Sales Management*, the *Journal of Marketing* and the *Journal of Marketing Management*, and the research papers identified were added to this literature review.

The scope for confusion of terminology in relation to referrals is considerable. "Referral" is often confused with "word of mouth". Helm (2003), Kumar et al (2010), and Ryu & Feick (2007) are examples of studies in which word of mouth is considered a proxy or a synonym for referrals; yet, it is quite clear that positive word of mouth need not result in a referral. Therefore this study argues that a referral is more complex and of greater business significance than positive word of mouth. Furthermore, the contention of this paper is that referral is better conceptualised as a *process* than as an *act.* Related terms such as "recommendation" and "word of mouth" may play a part in the overall process, but the referral process is only completed once a new client contract has been signed. Both positive word of mouth and a client recommendation may occur in the early stages of the referral process, but additional steps must take place before a referral is finalised.

Broadly following the definition advocated by Kumar et al (2010), for the purposes of this study, a referral is defined as occurring when an existing *client* (not a professional connection) motivates a prospective client to visit the advisor who acts for the introducer. However unlike certain other authors (Kumar et al, 2010; Ryu & Feick , 2007), this study does not consider the completion of a transaction to be the defining element of a referral. The completion of a transaction is dependent upon a prospective client accepting the service proposition offered by a financial advisor, after which the referral can be regarded as a client of the advisor firm. Cutting the link between a referral and a transaction in the way that is suggested here makes particular sense in the context of the UK financial advice sector after January 1st 2013, since independent financial advisers are now remunerated only through fees and are not permitted to receive commission on the sale of financial investment products.

Figure 1: The Financial Advice Referral Process (source: original)



What seems clear is that a potential referral cannot be manifest until a prospective client meets with a firm. Everything before a meeting is considered as word of mouth exchanges which may or may not lead to a referral, since the firm may never know of these preliminary exchanges. Therefore a referral is defined to have occurred once a meeting takes place between a prospective client, recommended by an existing client, who in turn contacts and arranges a meeting with a financial advisor. A referred, prospective client may then become a new actual client. Rather than conceiving of a referral as an *act* that takes place when one party (the client/introducer) mentions the financial adviser favourably to another party (the prospective client), *referral* is better conceived to be a *process*. This is illustrated in Figure 1.

Research methods and preliminary results

The goals of the empirical study were, first, to explore the meaning of referrals among financial advisors and their clients with a view to testing empirically the definition outlined above; second, to investigate how referrals come about in client/advisor relationships; and, third, to determine how important financial advisors believe referrals to be as a tool of new business development. The research methods are outlined in appendix 1: predominantly qualitative methods were preferred owing to the exploratory and interpretivist nature of the research goals, while a small quantitative study was employed to evaluate the perceived importance to advisors of referrals as a business development tool. Research was conducted among financial advisors, clients of advisors, and individuals who manage their own personal financial portfolio (that is, could be clients but decide not to be). Clients of advisors were sub-divided into clients of known advisors found through contact with the advisor ("fettered clients"), and clients of unknown advisors found through other means.

Owing to constraints of space it is possible only to provide a brief summary of some of the key results. From the empirical study it is clear that the financial advisors believe referrals to be easily the most important mechanism available for generating new business. Most of the advisers reported that a majority of their new clients come through referrals; furthermore, advisors reported that where a referral was received, the likelihood that the person referred to them would become a client was very high. However, caution is required in the interpretation of these findings, since the answers to follow-up questions suggested that advisors have very poor systems for monitoring referrals (sample comment: "don't know … sad, but I don't know"). Indeed, it seems that the claims made by advisors about the frequency and importance of referrals were estimates, or even guesses, based on negligible data. Thus, a paradox arises, since advisors believe that referrals are of crucial importance for new business development, yet have little or no management data about referrals. Furthermore, advisors reported that asking clients for referrals during client meetings was something rarely done, and was considered to be an ineffective method of acquiring new clients. The client interviews tended to support this perception: clients reported that their financial advisors rarely asked them to provide a referral, and that they would be very reluctant to respond positively if they were asked. Taken at face value, these results suggest that financial advisors believe referrals to be critically important and something over which they have a degree of managerial control, yet advisors acknowledge that they have negligible management data about referrals, and clients report that they are very seldom asked for referrals by advisors.

Conclusion

This paper has outlined an area of great professional concern within the practitioner world of independent financial advice, namely, how new business can be generated through referrals from existing clients. Research investigating this topic has been sought in the practitioner literature and the academic literature. While consultant/practitioners have written about the subject, this work tends to be anecdotal or based on research of dubious provenance, and is often suspect since it appears to have a primarily self-promotional purpose. Academic researchers have not squarely addressed the subject of referrals in the financial advice sector. An important gap exists. There is little convincing research evidence about how important referrals, in fact, are, despite frequent claims by consultant/practitioners that they are easily the most important source of new business in this sector. Additionally, the extent to which referrals can be actively managed is unclear. Arguably, a strong mythology has grown up around the subject of referrals within the financial advice industry; a mythology that this study seeks to explore.

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Appendix 1: Outline of the empirical research approach

Phase 1 – Initial exploratory interviews with the stakeholder groups

Who	Number	Purpose-understand more of current thinking
Advisors	4	Importance of referrals, interpretation, experiences in this field
Consumers of advice	4	Share experience in sourcing an advisor, have they referred and if so under what circumstances
Personal clients	4	Why did they refer, what did the requester ask, what did they say, what would make them terminate relationship
Consumers who DIY	4	Why they elect to DIY, understanding of advice, what methods they use to investment

Phase 2 - Pilot questionnaires

Who	Number	Purpose
Advisors	4	Test layout, questions, ease of completion, responsiveness, willingness to cooperate, free writing participation
Consumers of advice	4	Test layout, question understanding, ease of completion, time to complete, nature and language of data responses
Personal Clients	4	Explanations of the circumstances leading to a referral, did the advisor influence the referral, who made contact with the advisor, timing and language used
Academic colleagues	2	Test layout, ease of completion, wording, structure, mix of open and closed questions

Phase 3 – Semi-structured interviews and final questionnaires

Data source	Number of participants	Purpose
Financial Advisors APFA (13) Advisors (7)	20	To obtain quantitative and qualitative data
Unfettered respondents (clients of advisors)	20	To obtain quantitative and qualitative data
Unfettered respondents	10	To obtain quantitative data
Consumers who DIY (manager their own portfolio)	15	To obtain quantitative and qualitative data Explore the reasons for not utilising advice, contrast the approach to service selection, if previous advisor why terminated