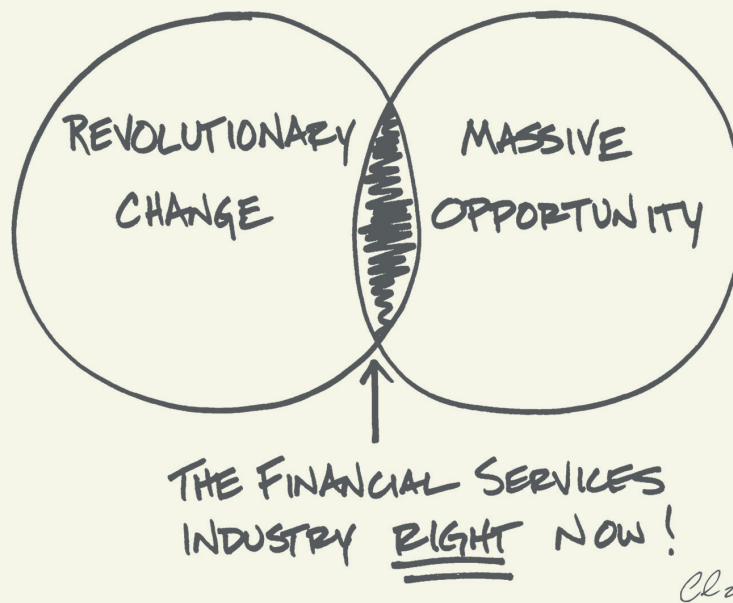


The Consumer Revolution

SURVIVING AND THRIVING
IN A TIME OF TECTONIC SHIFTS



Joseph J. Duran, CFA

Joseph A. Michelli, PhD

Robert W. Doede, PhD

The Consumer Revolution

SURVIVING AND THRIVING IN A TIME OF TECTONIC SHIFTS

Joseph J. Duran, CFA

Chief Executive Officer
United Capital Financial Advisers, LLC

Joseph A. Michelli, PhD

Best Selling Author of *The Starbucks Experience*, *The New Gold Standard*
& *When Fish Fly* and Internationally Recognized Speaker

Robert W. Doede, PhD

Chairman of the Board
United Capital Financial Partners, Inc.



HERE IS NO DOUBT that we are in the midst of the biggest paradigm shift for American and worldwide business since the Industrial Revolution. We are in the golden age of the consumer. **Never in the history of mankind has the consumer received so much of what they want, so quickly and in such a customized way.** Not only is every experience being uniquely created to each person's individual needs, but it is being done at a fraction of the price and with measurably higher convenience. In the meantime whole industry categories are being simply eviscerated, decades of history and improvement and market share gone in the flash of an instant. Consumers are proving to have the loyalty and memory of gnats because the new entrants in the market are not just improving upon what we have known, but completely changing the client experience and remaking the business models of entire industries seemingly overnight. Nowhere will the shift be more important than the financial services industry.

“There is no doubt that we are in the midst of the biggest paradigm shift for American and worldwide business since the Industrial Revolution. We are in the golden age of the consumer.”

Twenty years ago, when we organized a family trip, almost all of us worked with a travel agent. We would call them, get ideas, look at brochures of potential hotels and trust the agent’s recommendation. In almost every strip mall there would be a travel store plastered with pictures of wind-swept beaches or far flung exotic locations. Today many of those travel stores have closed. Most of us now go online to plan vacations aided by virtual hotel tours, GPS imagery of impending weather challenges and even the ability to consider what

we might order from the hotel’s room service menu. Is there any doubt that people are having more personalized travel experiences? The days of relying on a travel agent to create an experience that “fits us” are long gone.

Ten years ago music mega stores proliferated cities. Those stores were packed with thousands of CDs that we would sample at “listening stations” using unsanitized headphones to listen to selected tracks of the most popular albums. We would hope the CD we wanted would still be in stock, even though we only really liked a couple of songs on the album. Today, we sample music in the comfort of our homes, select only the tracks we desire and download them effortlessly for instant enjoyment. Has the music fan ever had it better?

Five years ago every town had the mom and pop video store replaced by big splashy movie rental firms. They’d have thousands of movies and dozens of copies of the biggest hits. We’d agonize over what to watch, ask for ideas and hope for the best. We’d get into fights about late fees and feel frustrated about the movie that always seemed to be out of stock. Today we can watch what we want when we want, check out the preview and never have to worry about those pesky late fees. Everything is available at any time, anywhere, for as long as you want it. We have never had entertainment so readily accessible.

Expedia killed the travel agent, Apple demolished the music store, Netflix closed the video store. We have been told that the internet is causing a change in business worldwide, but the internet is simply the tool that allows the shift to occur, it is not by itself the cause of the change. The internet today is much like the machinery, mass production and interchangeable parts that allowed for the Industrial Revolution to occur a century ago, but the driving force then was mankind’s desire for scalable production. *Today the consumer revolution is as large and impactful to all businesses as the Industrial Revolution 200 years ago that shifted the way we produced and manufactured forever.*

SURVIVAL IN A TIME OF REVOLUTION

The **Industrial Revolution** was a period from the 18th to the 19th century where major changes in agriculture, manufacturing, mining, transport and technology had a profound effect on the socioeconomic and cultural conditions starting in the United Kingdom, then subsequently spreading throughout Europe, North America and eventually the world.

The Industrial Revolution marks a major turning point in human history; almost every aspect of daily life was eventually influenced in some way. ...“For the first time in history, the living standards of the masses of ordinary people have begun to undergo sustained growth. ... Nothing remotely like this economic behavior has happened before.” The effects spread throughout Western Europe and North America during the 19th century, eventually affecting most of the world, a process that continues as industrialization. The impact of this change on society was enormous. | Source: Wikipedia 11.2011

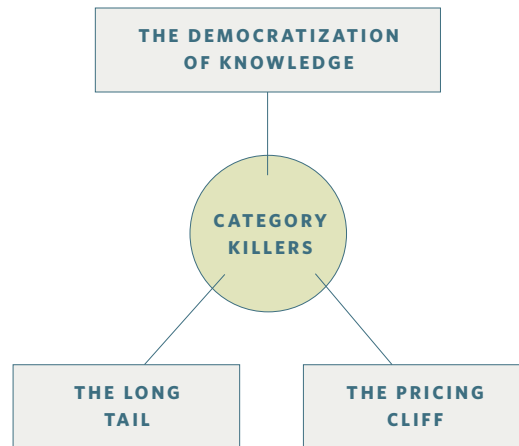
The simple truth is that almost every business in the world was affected by mechanization. The old ways of using animals to farm and intensive manual labor to manufacture gave way to a new way of thinking. **Every business needed to adapt to the fact that producing anything required a completely different approach if you were to remain competitive.** Many industries were wiped out as a consequence and could do nothing to survive (the buggy whip makers) and many new ones were born (car dealerships). The Industrial Revolution was production led, and the consumer benefited immensely from new products, better pricing and far more reliable products.

Unlike the Industrial Revolution, the consumer service and distribution industries are being affected even more than the manufacturing industry. In this revolution, the consumer is at the forefront and technology and worldwide production are being used to make it all happen. Then, as now, one survival rule reigns above all else: adapt or die.

THE RISE OF THE CATEGORY KILLERS

This generation's category killers are being created with alarming speed. Can there be any doubt that there is a tsunami rolling over every industry, wiping out long established businesses and creating massive shifts in how we consume and how we live? With this new era has come the birth of the category killer.

Category killer is a term used in marketing and strategic management to describe a product, service, brand or company that has such a distinct sustainable competitive advantage that competing firms find it almost impossible to operate profitably in that industry. The existence of a category killer eliminates almost all market entities,



whether real or virtual. Many existing firms leave the industry, thereby increasing the industry's concentration ratio. | Source: *Category Killer: The Retail Revolution and Impact on Consumer Culture* by Robert Spector 11.2004

What are the common traits aligning all of these category killers like Amazon, Apple or eBay? While they are supposedly all in different industries, all these firms at their core understand that they are in the consumer services business, and they are all using the same three core principles to destroy their competition:

- *The Long Tail* **A term coined to describe the ability to supply very unique and specific units profitably.** For example, at iTunes every single song is in supply and available. At Zappos, the largest online shoe retailer, thousands of shoes are available in every size. They are almost never out of stock and can deliver each unique product profitably. How in the world can a traditional storefront compete?
- *The Democratization of Knowledge* Consumers today know more, research more and have more information readily available to them than they have ever had. But, most importantly, they share their experiences like never before. **Information sharing will continue to grow exponentially over the next decade.** At Yelp, reviews are written by clients of local firms and available online, anytime. Every bad experience is magnified and has the potential to become massively expensive. You cannot survive by relying on people's ignorance or lack of knowledge, and just as important, every bad (or exceptional) client experience can have serious implication on your reputation. **The category killer understands the power of viral networks and the rapid flow of information and knows that by creating a major shift in the client experience they can change the landscape of the industry at breathtaking speed.**

■ *The Pricing Cliff* The category killer doesn't just create incremental drops in price, **it creates abrupt and extreme discounting.** Online travel agents charge almost nothing. Skype lets you video call for free. Music can be purchased by song instead of by album. Consumer pricing didn't just drop, so much as collapse for the traditional competitors.

By using these three legs of the stool, the new titans are changing the landscape and in their wake leaving whole industries and businesses behind, and we are all willing participants in this creative destruction occurring every day.

THE SEA CHANGE IN THE FINANCIAL SERVICES INDUSTRY

Here in the US, which is predominantly a service led economy, we are having a renaissance that will change the way most of us work and the way all of us live. We will all be affected by these shifts; business leaders can either bury their heads in the sand and hope for the best, like the travel agents who hoped you'd keep calling, or realize that change is certain and we might need to reinvent how we work and what we do to support our clients.

The financial services industry in particular has always benefited from a fairly consistent landscape; while we have had steady improvements in products and service standards, the changes have been evolutionary rather than revolutionary in nature. **The industry is accustomed to change on its own terms.** The retail financial services industry went from buying and selling individual securities for individuals to shifting to mutual funds and managed money and the shift took decades. The industry went from being a transaction led industry to gradually becoming a fee-based business over the course of decades.

Because the typical retail client knows and understands so little about investing, we have been allowed to selectively and gradually introduce new investment ideas and products at a pace that let us to stay profitable and in business. **That is now changing; the shifts in the financial services, as in every service business, will be more abrupt, disruptive and transformational.** The landscape for the financial services industry will be forever shifted in the next decade.

A CURRENT EXAMPLE IN THE FINANCIAL SERVICES INDUSTRY

Think about the impact of the exchange traded fund (ETF). Today, even the least sophisticated investor has heard of ETFs. The first ETFs were launched in the U.S. in 1993, the QQQ saw its debut in 1999, and Barclays introduced iShares in early 2000. By September of 2010 there were already 916 ETFs with almost a trillion dollars in assets. But the real

explosion in popularity only happened in the past 10 years, in the midst of a secular bear market. In 2008, the SEC approved the first actively managed ETFs. We are only in the third inning of the ETF game. This simple investment idea has proven to be a catalyst to a rapidly changing landscape.

"In the financial services industry, ETFs will rapidly replace craftsmen that have spent their lives building unique portfolios."

Mutual funds have fees ranging from 1 percent to 3 percent and can be purchased once a day. Many have trading restrictions. Meanwhile, ETF costs typically range from 0.1 to 0.5 percent and are traded with the liquidity of a common stock. The client wins, but there are some serious economic ramifications to the industry. **The ETF is wiping out billions of dollars of reliable revenue streams for custodians and wirehouses and brokers.** Where in

the past large custodians could count on a steady stream of income from Administrative Service Fees (ASFs) as high as 45bps from many mutual funds, they now offer free trading on ETFs with razor thin pricing to support the structure and distribution. All of those revenue streams are gone forever, and the base of mutual fund assets will either shift or pricing will be compressed in order to compete. The custodians will need to grow or shift their business model to survive. Their pricing to their clients will also need to change. The ramifications will be vast, extreme and affect everyone in the industry.

But the ETF is simply one example of how our industry is not immune to the consumer revolution. So how do you compete and thrive in a time of enormous shifts, and more importantly, how should you adapt your service business to the realities of the new consumer?

DEATH OF THE CRAFTSMAN

For most of Abraham Lincoln's life, he could travel no faster than Julius Caesar: the speed of horse or about 20 miles a day. By the later part of his life he was travelling at 20 miles an hour. For 2000 the world stayed at the same relative size, and in the span of a few decades the world became effectively one-twentieth the size. Centuries of evolution gave way to decades of revolution that extended throughout the business world.

The real power in the Industrial Revolution came with the creation of machinery and interchangeable parts. Seemingly overnight tools and goods were being mass-produced and people as well as machinery became interchangeable in the manufacturing world.

All of the craftsmen who had spent generations learning to make custom products became obsolete.

In the financial services industry, ETFs will rapidly replace craftsmen that have spent their lives building unique portfolios. It used to be next to impossible to invest in emerging markets outside a mutual or hedge fund, but now if you want an investment in emerging market infrastructure or Brazilian agriculture companies there is an ETF readily available.

Access is no longer a privilege, and many investments can be replaced with another far more flexible solution at a fraction of the price. Many of today's financial craftsmen will need to change the way they work and the services they offer.

THE RISE OF THE SOPHISTICATED CONSUMER

We know the new consumer shares some common expectations with their vendors, whether buying shoes, planning a trip, getting medical help or receiving investment ideas from their adviser:

They want a unique, self-designed experience

Just as people no longer need to place trust in travel agents to secure a vacation that is perfect for them, the current role of financial advisers is at risk. Our industry grew up in an era of trust, a time when most investors delegated big decisions to people they had confidence in. The people with money over the past 30 years (the Great Generation) were accustomed to trusting advice relationships with their accountants, lawyers, doctors and financial professionals. **However the ensuing generations, led by the Baby Boomers, are far more guarded and much more activist in their approach and expectations.**

Given the level of control they now apply to every aspect of their consumer experience, from web browsers (a customized home page) to TV viewing (DVRs allow you to never have to watch a commercial), **consumers expect to take an active part in designing their financial lives too.** The medical profession has had to adapt to the fact that many patients are self-diagnosing and expect to be a part of the decision making process when seeking treatment.

The old days of telling clients what to do and expecting them to accept our recommendations without explanation are rapidly disappearing in the financial world too.

They want value for every dollar they spend

Our industry has thrived by having fees disguised in various complex forms, from fees being taken out from the NAV so that the client never sees what they are paying in their mutual funds, to having extensive holding periods, locking in their assets (and their fee payment) for long periods of time, like in variable annuities. But change is in the air. New



retirement plan regulation requires a full disclosure of plan costs to all participants, and now costs of every fund and investment vehicle are readily available for all, along with extensive research and insights on any public investment vehicle for any investor caring to look. Transparency is the new world order. Today the consumer knows more, expects more and plans to pay less.

They want judgment, simplicity and objectivity from their advisers

At the end of the day, the consumer cares about achieving the best possible outcome, and they expect their adviser to understand that they are responsible for helping the consumer achieve that. Whether it's the doctor, the lawyer or the financial professional, the new sophisticated consumer wants every adviser to be free from conflict and to have transparent, simple answers to questions. They would not accept doctors making money from prescriptions, lawyers making money from referrals or any other conflict. They want their financial adviser to guide and advise objectively, they want their advisers to help them accomplish their best possible outcomes. They expect their financial professional to be responsible for his recommendations.

THE NEXT WAVE OF FINANCIAL SERVICE FIRMS

If we look at the three core aspects of the category killer and combine them with the shifting expectations of the sophisticated consumer we can determine the traits of firms that will thrive in the new era. The new client-centric firm will share some very explicit values:

A Customized, Original, Scalable and Networked client experience

The next wave of firms will not simply replicate what has been done in the past but will completely shift how the client receives financial advice and investments. They will have created a client experience that is:

“The next wave of firms will not simply replicate what has been done in the past but will completely shift how the client receives financial advice and investments.”

- **1. Customized** The evolving financial services client wants to be a part of designing their experience and making it their own. The delegator/DIY model that has been dominant in our industry will blur and most clients will become hybrids. In the future it would be

better to think of clients as wanting to be pilots, co-pilots or passengers. The former delegators will not be satisfied simply being passengers on the plane, they will want to be co-pilots of the plane. The new era firm will expose more, explain more and bring knowledge and judgment to the client experience. They will educate and encourage participation to design a truly interactive and personal solution for their clients. The new financial adviser will view their role as arbiters of truth and honest guides. They will co-opt their clients and help them to make good decisions. They will think of their responsibility as identifying impending turbulence and helping their clients navigate through adverse conditions.

■ **2. Original** The industry has thrived in building up the complexity of products and services, but the new wave of firm will grow by creating a client experience that is far more understandable, meaningful, measurable and tangible. The focus will be on simplification and innovation. Expect a new kind of dialogue and better ways to help individuals understand what is happening to them and **how to make better financial decisions when giving advice.**

Expect the next wave of investment firms to create and provide pioneering investment solutions to help their clients to thrive in different market environments, focused exclusively on attaining the best possible outcomes for clients.

■ **3. Scalable** The new era firm will use technology and systems to scale their practice management operations to revolve entirely around elevating and servicing their clients. They will understand the true revenue and cost by each client and appropriately tier servicing and pricing to ensure their profitability and survivability. **They will use their size to drive down costs in every area and manage their staff in a model that allows for each individual to focus on their core competency and on very explicit specialized roles. They will deliver unique client experiences profitably.**

■ **4. Network Connected** The world is getting smaller, and in order to grow, the next generation of firms will create a strong client community, linked together by utilizing technology and customized client events to unify their client set. They will form unions with appropriate affinity groups and have a sustainable sales strategy and customized outreach programs. They will also grow wholesale by having a clear recruiting strategy for culturally aligned professionals.



Over the next several months we will be discussing the three key traits of the financial services firm of the new era. In the next four updates we will be providing an in depth analysis of how each of these keys to success should be applied in the next generation firm, this will include:

- *A landscape review of what is currently being done by the industry*
- *An understanding of industry pricing*
- *A best practices example*
- *A field tested case study*
- *Specific application how-to guides*

We hope you have found this initial paper helpful and welcome any and all feedback at **jason.delcol@unitedcp.com**. If you would like to contribute any ideas or share thoughts we look forward to hearing from you.

This is an amazingly exciting time for our industry and our goal is to provide a blueprint for our industry to survive and thrive in a time of continuous paradigm shifts.

ABOUT UNITED CAPITAL

United Capital Financial Advisers, LLC (United Capital) is one of the nation's fastest growing Registered Investment Advisors (RIAs). United Capital offers clients objective advice and an open architecture investment platform that enables a wide array of investment management solutions tailored specifically to their needs.

United Capital is a well-capitalized, fast growing national partnership of exceptional financial advisers. We provide centralized back office operations, customized professional advice and objective, expertly applied investment management in a highly client-centered service model. The firms that join us are in the top 1 percent of their field. Their principals choose to join United Capital and continue to run their practices as a means to: centralize operations, access exceptional investment solutions, grow their business and share in wealth creation. Our unique business model typically means our partners grow their assets and revenues immediately, and as fellow shareholders of the parent company, all of our firms enjoy the benefit of large company valuations as we grow.

ABOUT THE AUTHORS

Joseph J. Duran, CFA®, is the chief executive officer and founding partner of United Capital Financial Partners, Inc., the parent of United Capital Financial Advisers, LLC (United Capital), and is a recognized expert in the field of entrepreneurship. United Capital is one of the fastest growing financial advisory firms in the country. Prior to starting United Capital, Mr. Duran was president of GE Private Asset Management, formerly Centurion Capital Management. He holds the Chartered Financial Analyst designation and received MBA degrees from Columbia University in New York and the University of California at Berkeley.

Mr. Duran is the author of two nationally published books: *Start It, Sell It and Make a Mint: 20 Wealth Creating Secrets for Business Owners* (Wiley and Sons, 2004) and *The First Time Investors Workbook* (McGraw Hill, 2001). Mr. Duran has appeared on a wide variety of media outlets and is a regular contributor on CNBC and other broadcast channels and print publications. He was featured on the cover of *Financial Advisor Magazine* and regularly appears in *Registered Rep.*, *InvestmentNews*, *Financial Planning* and *Investment Advisor* magazines.

Joseph A. Michelli, PhD, is an internationally sought-after speaker, author and organizational consultant who transfers his knowledge of exceptional business practices in ways that develop joyful and productive workplaces with a focus on the total customer experience. His insights encourage leaders and frontline workers to grow and invest passionately in all aspects of their life.

Dr. Michelli recently was recognized by *Focus* as “one of the top five customer service influencers to track in 2011.”

Dr. Michelli’s book, *The Starbucks Experience: 5 Principles for Turning Ordinary into Extraordinary*, published by McGraw-Hill, regularly achieved bestseller status on *The Wall Street Journal*, *Bloomberg BusinessWeek Magazine* and *USA Today* lists. Dr. Michelli’s other books include *The New Gold Standard* about service excellence at The Ritz-Carlton Hotel Company and *When Fish Fly: Lessons for Creating a Vital and Energized Workplace* that was co-authored with the owner of the “World Famous” Pike Place Fish Market in Seattle. He is currently working on two new books to be released in 2011 – one about UCLA Health System and one about Zappos.

Dr. Michelli believes his greatest accomplishment is his ability to learn from the laughter and humor of his children, Andrew and Fiona.

Robert W. Doede, PhD, is retired and a private investor. He also currently serves as chairman of the board for United Capital Financial Partners, Inc.

Mr. Doede is a past member of the Board of Trustees of the Bishop's School, La Jolla, Calif., having served as chairman of their finance committee. He is also a past member of the Board of Directors/Trustees of California Western School of Law, San Diego, Calif., University of California San Diego Cancer Center, San Diego Symphony and the La Jolla Chamber Music Society.

Mr. Doede co-founded Catallactics Corporation, a specialty service firm for trust departments at major banks. He served as the chairman of the board of Catco, Inc., parent company of Catallactics. He also ran his own investment fund and served on the boards of directors of Concentric Network Corporation, Glenwood Trust company, Quantum, Inc. and Jefferies & Company.

Mr. Doede holds a PhD and MA, both in Economics, from the University of Chicago and a BA from Yale University, with a major in Economics. Mr. Doede also taught economics at the University of Pennsylvania Wharton School.