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Fidelity Incorporated: Pricing the Fidelity Blue Chip Growth Fund (Abridged)

As the fund manager of Fidelity's Blue Chip Growth Fund (BCGF), John McDowell not only oversaw the investment decisions of the fund but had considerable input into its marketing plan as well. Senior management at Fidelity had asked McDowell to consider how to generate more profit from the fund. While the fund had grown significantly over the last few years, management believed that it was not charging customers enough for the services provided. Fidelity had recently spent a great deal of money updating and enhancing its online order-handling and customer-service capabilities and believed it was now appropriate to ask its customers to pay something for these increased services.

BCGF currently had fees that were significantly below the industry averages for actively managed domestic equity–mutual funds. Investors in this fund paid no front- or back-end load and annual expenses of 77 basis points (0.77%).[1] Total expenses attributed to the fund and expenses for fund management and marketing came to about 45 basis points. As of May 2003, BCGF held $17.9 billion in assets.

Most BCGF investors viewed management of their investments as a reasonably long-run decision. While the average holding time for an investment in the fund fluctuated with economic and market conditions, management believed the average holding time to be around seven years. In the previous year about 15% of the mutual fund shares held by investors at the beginning of the year were sold, and the money moved elsewhere. The fund also received new monies in the amount of approximately 20% of the fund's value. Both of these figures represent dollars-in-the-door and dollars-out-of-the-door based on customers' decisions and are not related to any investment gains or losses experienced by the fund. So the fund experienced a net cash inflow of 5% during the previous calendar year.

Edward Johnson, CEO of Fidelity Investments, in a memo to McDowell earlier in the week, had asked him to explore ways to increase fund profitability by 30%. McDowell didn't know whether he should try to generate the additional profit by introducing a front-end load to the fund or by increasing the annual fees. Back-end loads were probably not a feasible alternative given the history and pricing philosophy of Fidelity. And although any front-end load was technically possible, industry norms dictated that loads were set in increments of 50 basis points. So a load of 1.5% was fine in terms of industry norms, but a load of 0.75% was not.

McDowell was concerned that potential customers might view the higher fees as a deterrent to investing in BCGF, and worried that even current customers would leave the fund. He knew that he needed to find a

[1] A front-end load is a one-time charge, generally expressed as a percentage of the assets invested (i.e., 2%). A back-end load is analogous to a front-end load except the fee is paid when fund shares are redeemed. Annual expenses, also expressed as a percentage of assets under management, are deducted from the fund on an ongoing basis.

This case was prepared by Ronald T. Wilcox, Associate Professor of Business, Darden School of Business, University of Virginia.

way to generate the additional profit in a way that would lead to the least dissatisfaction among current and potential future investors.

McDowell's assistant, Maria Ramos, had pointed out a recently published study that might help McDowell make the new pricing decision. The study used the marketing research technique, conjoint analysis, to examine investors' preference for mutual fund stocks. This particular conjoint study had estimated the utilities or preferences of investors for different levels of front-end loads and annual expenses among other fund attributes. Ramos pointed out that the results of this study might shed light on how to increase profitability without seriously harming present or future investor satisfaction with the fund.

The Conjoint Study

A detailed description of the conjoint analysis of mutual fund choice was published in a technical academic journal.[2] Ramos distilled what she believed to be the important facts for the decision at hand and brought them to McDowell. These facts included the important features of the experimental design, given in **Table 1** and the results of the conjoint estimation, given in **Table 2**. The headings of the columns in **Table 1** indicate the name of the tested attribute, and the values below the heading are the levels of each of the tested attributes. **Table 2** provides the estimated part-worth for each level of each attribute.

Table 1. Experimental design.

Company	Front-End Load	Annual Fee	10-Year Past Return	Beta[3]
Fidelity	No Load	0%	5%	0.7
Vanguard	1%	0.5%	10%	0.9
T. Rowe Price	2%	1.0%	15%	1.1
Dreyfus	3%	1.5%	20%	1.3
Pecunia	4%	2.0%	25%	1.5
	5%	2.5%		

Data source: Created by author.

The study appeared to be conducted using a representative sample of mutual fund investors, but not necessarily customers of Fidelity's BCGF or any other Fidelity mutual fund. Ramos reported to McDowell that the data was collected using a specific type of conjoint analysis called "choice-based conjoint analysis," a type that seemed appropriate for this application.[4] Among the other results of the study, the author had also concluded that investors appeared not to take into account their investment time horizon when evaluating the fees of a given fund.

In addition to the question of price, McDowell also believed that Fidelity's brand name was very strong and, based on this brand name, he could probably charge his chief competitor, Vanguard, a premium. Vanguard had been aggressively marketing its PRIMECAP fund—a fund with a very similar asset base—to BCGF. PRIMECAP charged no front-end load and had an annual fee of 49 basis points. McDowell believed that Fidelity's superior customer service, investment in advertising, and enhanced web interface sufficiently increased investors' perception of the Fidelity brand to insulate BCGF from any serious price competition from Vanguard.

[2] Ronald T. Wilcox, "Bargain Hunting or Star Gazing? Investors' Preferences for Stock Mutual Funds," *Journal of Business,* 76 (2003).

[3] Beta is a measure of the covariance of the return of a fund relative to an index, in this case the S&P 500. It is often used as a measure of the volatility of a fund. For example, a beta of 1.3 indicates that the fund is 1.3 times more volatile than the S&P 500.

[4] Bryan K. Orme, "Which Conjoint Method Should I Use?," Sawtooth Software, Research Paper Series (2003).

The Pricing Decision

The stakes for this particular pricing decision were huge. McDowell, scribbling some quick calculations on a napkin, realized that every additional basis point he was able to capture in profit would increase fund profitability by almost $2 million. He struggled with how to use the information from the conjoint analysis to help his pricing decision. He wondered whether Ramos's study published in some academic journal he had never heard of, using a sample of investors who were not necessarily his customers, was useful at all in this situation. He was confident that the Fidelity brand would keep him from losing investors even in the face of the price increase. Ultimately, he decided that the increased profit target of 30% was not his call and that his job was to figure out how to get this done.

Table 2. Results of conjoint analysis.

		Utility Estimate	St. Dev. of Estimate
Company			
	Fidelity	0.08	0.09
	Vanguard	0.01	0.09
	T. Rowe Price	0.08	0.09
	Dreyfus	0.00	0.09
	Pecunia	−0.17	0.09
Load			
	No Load	0.88	0.10
	1%	0.48	0.10
	2%	0.05	0.11
	3%	−0.25	0.11
	4%	−0.49	0.13
	5%	−0.67	0.13
Annual expenses			
	0%	0.99	0.10
	0.5%	0.50	0.10
	1.0%	0.05	0.11
	1.5%	−0.07	0.11
	2.0%	−0.72	0.13
	2.5%	−0.74	0.13
10-year return			
	5%	−1.23	0.10
	10%	−0.70	0.10
	15%	−0.06	0.10
	20%	0.76	0.10
	25%	1.23	0.10
Beta			
	0.7	0.05	0.10
	0.9	0.06	0.10
	1.1	0.13	0.10
	1.3	−0.10	0.10
	1.5	−0.14	0.10