REPOSITIONING BROKERAGE FIRMS IN THE EVOLVING MARKETPLACE

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Select findings from The World of Registered Representatives, a study conducted for ***Institutional Investor Magazine**** by:

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*** For a copy of the complete report, please contact Institutional Investor Magazine at www.iihighnetworth.com.**

BACKGROUND

We have undertaken a research-driven study on behalf of *Institutional Investor Newsletters* on the state of the brokerage industry and the critical challenges that will face brokerage and investment management firms as they endeavor to support their financial consultants. Conclusions are based on empirical research compiled through a comprehensive survey of more than 4,000 registered representatives drawn from wirehouses, regionals and independent brokerage firms.

To identify their demands, we asked brokers an extensive series of questions about their clients, competitors, products, and business relationships. Then, we recast the data, according to underlying producer characteristics, to highlight fundamental patterns that are of relevance to brokerage firms. The data indicates that more registered representatives are moving toward sophisticated, wealth management business models. These financial consultants are also seeking broker/ dealers that offer comprehensive platforms capable of supporting this type of a client servicing approach. From this research, it becomes clear that brokerage firms tailoring their operations to support specific wealth management activities such as advanced planning (e.g. estate/ trust, concentrated securities) and alternative investments will be better positioned to compete in the evolving marketplace.

PRACTICE PARAMETERS

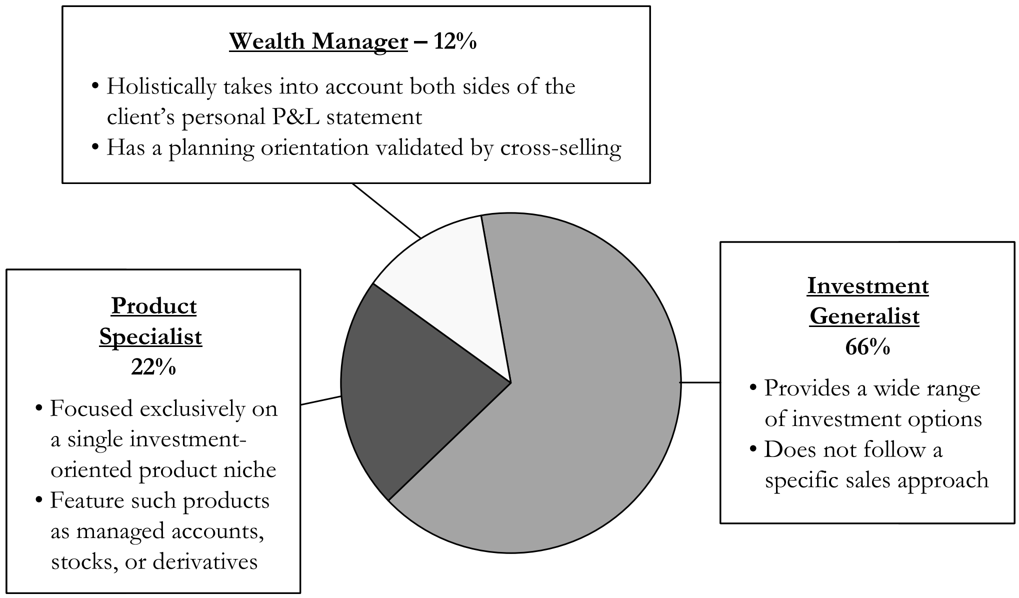
First, we analyzed survey respondents on two practice parameters that collectively characterize the relative success of a broker: 1) annual production and 2) number of clients. Meaningful statistical differences arose between those reps with less than $400,000 in annual production and those with $400,000 or more. In terms of the size of the broker's client base, the break point proved to be 150 clients.

The resulting four distinctive practice parameter quadrants define the challenges each broker is facing, which in turn highly influence what services and support they seek from their broker/ dealer:

Client Base	<$400,000	>$400,000
<150	**Q-I: 15%** *Novice and marginal brokers learning the business* Challenge: grow client base	**Q-IV: 10%** *Brokers with mature, efficient practices focused on high net worth clients* Challenge: maintain client relationships
>150	**Q-II: 35%** *Transitional reps building their practices through networking* Challenge: increase productivity through asset capture	**Q-III: 40%** *Established financial consultants struggling to move up-market* Challenge: improve quality of client base
	Production	

BUSINESS MODELS

Additionally, employing a cluster methodology, we identified three distinct business models that could be reviewed analytically, and are related to a broker's overall strategic approach to the business, as well as the producer's success in the marketplace. These business models are:



THE PROFITABILITY PARADIGM

There is a demonstrable relationship between a producer's practice parameters and the business model that the registered representative follows. Simply, the more specialized the registered representative (i.e. either a product specialist or wealth manager), the more profitable, and the more appealing to brokerage firms, they are.

The Business Focus of Mature (*Q-IV*) Brokerage Practices

Practice Quadrant	Inv. Generalist	Product Specialist	Wealth Manager
Q-I	85%	10%	5%
Q-II	76%	14%	10%
Q-III	62%	23%	15%
Q-IV	12%	***68%***	***20%***

With the collapse of the Internet bubble and the slow decline in the financial markets worldwide, overall production per rep dropped by an annualized 35% since the beginning of the downturn. Not all brokers, however, have faced equal hardship.

Looking at practice parameters, the least successful reps – the Q-I segment – have suffered the most, with each loosing on average more than half (-54%) his or her production. Conversely, in spite of the economic environment and stock market performance over the last year, annualized production among Q-IVs actually improved, although only by 2%.

By business model, the wealth managers, by focusing on long-term relationships, fee-based revenues, and holistic planning, were the only producers able to continue growing their businesses. Product specialists, although only down 10% on average experienced extreme volatility (-90% to 72%) depending upon whether their products were "hot" or "cold" in the face of the market shift. Investment generalists, with their week client ties, struggled with business down by about half.

It is evident that the "best" brokerage field forces consist of Q-IV and Wealth Manager/ Product Specialist producers. The primary challenge confronting broker/ dealers is how to transition their current brokers up-market and retain existing high potential producers through the development of custom tailored platforms.

A DISTRIBUTION CHANNEL MANAGEMENT IMPERATIVE

Our findings suggest that there is likely to be significant movement of very profitable (and expensive to recruit and train) talent over the next two years. Most significant from a strategic point of view is the fact that the most productive reps (Q-IV) are the very ones who are most likely to leave their current broker/dealer. Nearly 40% expressed a likelihood of changing brokerages in the next two years. Equally significant is the fact that the least productive reps (Q-I) will stay (only 4% plan to move within two years). This leaves broker/ dealers two related problems:

1. How can top producers be retained and attracted?
2. How can less experienced brokers be most effectively transitioned toward better business models?

Due to the disparity of each group's interests, firms should segmenting their field forces and approach their producers with two distinct strategies. This division allows firms to concentrate appropriate resources toward the producers that need them, maximizing the impact of investments. Special wealth management platforms focused on enhancing customer relationships and providing access to specialized services may then be developed and focused on the needs of the elite reps with more sophisticated clientele and businesses. Furthermore, producers must be continually reeducated in their use so that they may keep up with industry advances and make full use of the tools the brokerage provides.

Concurrently, education, client acquisition support, and practice development resources may be oriented at the broader rep base that demands a degree of handholding outgrown by their more sophisticated brethren. Among the less successful brokers expressing a desire to switch firms, seeking better education and communication was expressed as a rationale by over half (65% for Q-I, 57% for Q-II, and 52% for Q-III).

ATTRACTING AND RETAINING HIGH POTENTIAL PRODUCERS

We have identified a number of factors on which brokerage firms must focus to satisfy top producers. In particular, firms must not neglect core functions such as operations and compliance as producers have little tolerance for breakdowns in basic service. While this may seem both obvious and a non-issue for credible firms, the extent of dissatisfaction with these functions among leading brokers is surprisingly extensive. Additionally, in working with a number of firms to reengineer their brokerage operations, it has become clear that these are frequently the most difficult issues for organizations to assess and resolve themselves.

Business Drivers Motivating Producers to Switch Broker/ Dealers

Motivations	*Q-IV*	*WM*
Better compliance function	68%	63%
Better business support services	64%	84%
Better back-office operations	40%	27%
Better access to new products (e.g., IPOs, alt. investments)	35%	9%
More sophisticated and comprehensive financial and advanced planning support (e.g., estate, restricted securities)	30%	67%
Better product options	29%	38%
Better reputation and image at the new brokerage firm	5%	5%
Better payout	2%	5%

Improving broker desktop capabilities is key to increasing satisfaction with operations and business support. The rapid pace of innovation requires firms to constantly review industry best practices, including portfolio management, investment analytics, research, client management, and CRM capabilities.

In particular, brokers have singled out financial planning and related functionality as a point of contention. Fewer than 2% of elite producers are pleased with current arrangements. Out of this, identifying enhanced planning solutions for implementation has become a major focus in our consulting practice in recent years.

Account consolidation technology is also generating significant interest, especially among wealth managers seeking to employ it as a tool to aggregate client assets. Over 90% of these individuals desire access to account consolidation capabilities. At the same time, many broker/ dealers' attempts at turnkey execution of existing vendor solutions have demonstrated limited benefits to the field.

Retaining quality brokers also requires a broad wealth management offering. Of basic importance are fee-based brokerage and managed accounts platforms. Only 60% of reps that make heavy use of managed accounts are satisfied with the programs being offered by their broker/ dealers. Specifically, less than half of elite producers are pleased with the profiling process, portfolio allocation flexibility, marketing support or completion portfolio capabilities.

Additionally, brokerages must enhance trust, family limited partnership, concentrated/ restricted stock and advanced planning solutions to support the wealth managers' relationship-based approach. Delivery of hedge fund, private equity, and equity derivative products, along with IPO's, syndicated lending, and other sophisticated investment opportunities are also critical, particularly to high-producing product specialists.

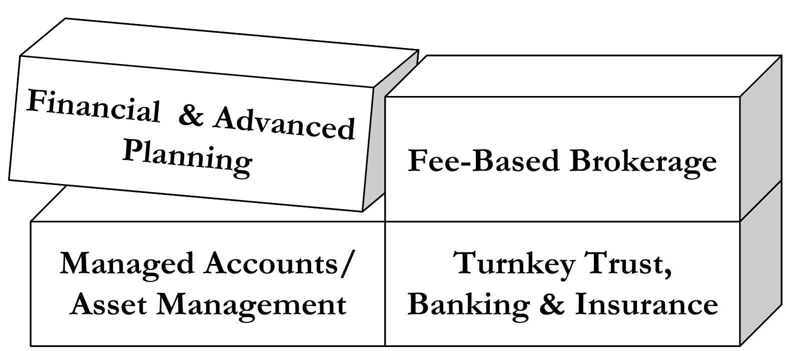
Concerns over payout and reputation & image, while highly emphasized in many firms' recruiting efforts, were of marginal importance to brokers. Management often pays undue attention to these topics at the expense of improving service levels and the advisory infrastructure.

TRANSITIONING EXISTING BROKERS UP-MARKET

To improve profitability and insulate operations from market shifts, brokerages need to work with less established brokers to reposition them in the marketplace, transitioning from a transaction orientation toward an asset gathering approach. We have learned that encouraging asset aggregation activities must go beyond training producers to use specific sales tools, but rather to initiating a sea change in broker behavior, allowing them to grow their business by attracting higher potential clients and gaining a greater share of customer wallet.

At their heart, these sales and marketing initiatives should be grounded in familiarizing producers with the components of the broker/ dealer platform and how brokers may utilize them in the adoption of a relationship-based sales process. Brokers attention must be focused on the value-added dissemination of advice related to, among other things:

The Wealth Management Model



Education programs must impart extensive knowledge of the high net worth and family office markets, providing tailored sales and servicing approaches for these markets and explicitly training reps on methods to increase the number and quality of their clients. Novice brokers are consistently demanding such assistance, including development of advisor referral and joint venture programs (76% of Q-I producers), turnkey prospecting seminars (70%), market-tailored sales and marketing materials (73%), direct mail prospecting and cross-selling programs (62%) and direct sales support assistance (63%).

Additionally, programs should guide brokers in the usage of optimal technology to support their businesses, including elements such as financial planning tools, account consolidation, broker desktop functionality and CRM/ datamining, in the context of facilitating a relationship-based, financial planning-driven business orientation.

CONCLUSIONS

It is evident from this research that brokerages must focus on a number of activities to maximize their potential in the current market environment, including:

- ❖ **Sales Force Quality Enhancement** – development of a recruiting and retention strategy in line with the firm's desired current character, market positioning, and platform capabilities
- ❖ **Channel Segmentation** – creation of a bifurcated support structure offering advanced services to elite reps and fundamental training to the general brokers
- ❖ **Product Expansion** – benchmarking of leading wealth managers to evaluate optimal delivery strategies for a comprehensive suite of services (e.g. brokerage, managed accounts, trusts, insurance, banking, alternative investments)
- ❖ **Integration of Wealth Management** – development of an overall strategic approach for the delivery of financial and advanced planning to producers, including the coordination of advisory services with fee-based offerings
    - Design of appropriate service delivery flows governing roles & responsibilities and hand-offs between the field and central specialists
- ❖ **Education and Training** – familiarizing producers with the firm's wealth management platform and adopting best practices to move brokers up-market:
    - Market education
    - Prospecting campaigns
    - Sales scripts
    - Cross-sell prospect identification
    - Practice evaluation metrics
- ❖ **Distribution Organization and Compensation** – supporting team-based approaches to customer servicing by wealth managers and product specialists through tailored compensation arrangements and other methodologies
- ❖ **Technology** – identification and implementation of enhanced producer technology to facilitate a relationship-based, planning-driven orientation:
    - Financial planning tools
    - Account consolidation
    - Portfolio management systems
    - Advisor desktop functionality
    - CRM/ datamining

The preceding was prepared by Patpatia & Associates, Inc., a strategic and execution management consulting firm specializing in servicing the financial services industry. We assist in the development and repositioning of investment services businesses in both the domestic and international markets. Our clients include brokerage firms, insurance companies, banks and investment management companies, and represent some of the largest players in the industry.

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