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For Immediate Release:

Study Finds Financial Institutions’ Focus on Profit Margins Might Limit the Profit Contribution of Their Investment Services Business

Chapel Hill, NC, September 20, 2023. Financial institutions tend to manage their investment services businesses the way they manage the core business of banking—controlling expenses to increase profit margins. But a new study from Kehrer Group finds that this approach might actually reduce the total profit contribution from investment services.

The study found that as a bank-based investment services firm moves from unprofitable to modestly profitable, total profit naturally increases. But widening profit margins beyond 30% actually results in a decline in total profits. “The bank would make more money from investment services with thinner profit margins,” commented Tim Kehrer, the author of the study.

“That is because the major expense that is being controlled is the cost of advisors,” Kehrer explained. “Adding a new advisor reduces profit margin at first because the new advisor typically has a higher transition payout at each level of production than established advisors, and there are other onboarding and recruiting expenses. Financial institutions understand this, which is why headcount is a frequent target of cost-cutting initiatives. The new advisor might actually be contributing profit, but less profit than after the advisor’s production has ramped up.”

Advisors are the largest expense of an investment services business, but they are also the drivers of revenue. No surprise, adding advisors increases revenue. But the surprise is that adding advisors increases revenue exponentially. “That means that each new advisor adds more revenue than their incremental production,” Kehrer explained.

The study found a similar relationship between advisor headcount and total profit contribution. Profit increases exponentially with the addition of advisors.

“As firms add advisors, they create efficiencies by enabling advisors to focus on smaller branch territories and fewer clients, so they actually become more productive,” he concluded.

The study—*Margin Mismatch: Why Financial Institutions Should Stop Managing their Investment Services Business on Profit Margin*—was sponsored by Cetera Financial Institutions, part of Cetera Investment Services. Kehrer Group analyzed the experience of 196 banks and credit unions from 2019 to 2022, and determined how their profit margins and advisor headcount impacted their total revenue, revenue growth, total profit contribution, and advisor productivity.

For nearly 40 years, Cetera Investment Services has empowered financial institutions to deepen client connections and expand their services with customized support that helps financial professionals meet their clients' full lifecycle needs. Learn more about Cetera's resources and support for financial institutions.

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