

The graphic features a dark blue background with diagonal lines and abstract shapes in purple, yellow, and blue with dotted patterns. The text is centered and reads:

BISA **2024** **ANNUAL**
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The Case for Zero Margin: Why Financial Institutions Should Stop Managing the Investment Services Business on Profit Margin

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The Case for Zero Margin: Why Financial Institutions Should Stop Managing the Investment Services Business on Profit Margin

Tim Kehrer, Kehrer Group

The Great Profit Margin Debate

Financial institutions want to manage their investment units on profit margin, believing that cost control is key to squeezing increased profitability out of the business.

But many in the financial institution **investment and insurance community** think that approach constrains growth and is a barrier to achieving deeper penetration.

Which is the better approach?

About Today's Session

- Objective: Explore how managing the investment services business inside a financial institution on profit margin impacts revenue growth and profit contribution, and compare that approach to one that prioritizes reinvestment in the business over margin.
- Sources of Data:
 - Margin Mismatch: Why Financial Institutions Should Stop Managing the Investment Services Business on Profit Margin
 - *Kehrer surveys of 196 banks and credit unions*
 - **Sponsored by Cetera Financial Institutions (2023)**
 - Smart Investment: Evaluating the Total Return on Investment Services to the Banking Enterprise
 - *Macromonitor – biennial survey of consumer financial behavior (4,000+ US households)*
 - **Sponsored by BISA (2020)**
- Live Calculator Demonstration: How would managing to growth rather than margin impact your firm's contribution to your institution?

Benchmarking Profit Margin

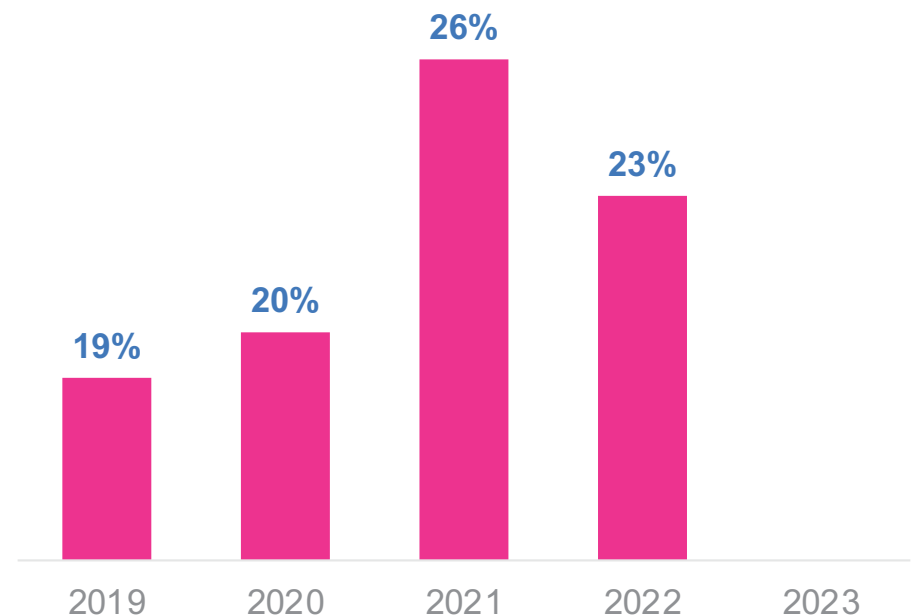
Kehrer Group surveys hundreds of financial institutions on the performance of their investment services units every year, including the net income contribution margin of the business.

We define profit margin as pre-tax operating expenses as a share of total gross revenue (GDC). This is sometimes called net income contribution margin.

To gain an accurate view into the impact of widening profit margin on the success of the investment services business, we drew on data from the past three runs of our annual survey, effectively normalizing variations in margin that may have otherwise distorted the analysis.

The Margin Mismatch study encompasses data on 196 financial institutions collected between 2020 and 2022.

Net Income Contribution Margin



Profit Margin Varies By Broker Dealer Model

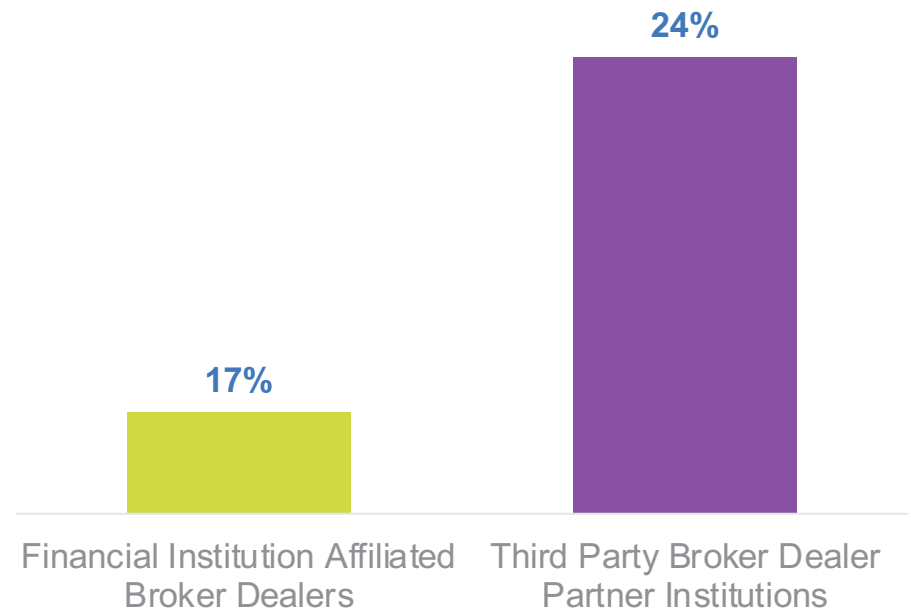
Profit margin varies by whether the institution insources or outsources its broker dealer functions.

The investment services unit in the typical bank or credit union contributes between 17% and 24% of revenue to the institution after operating expenses.

Net income contribution margin tends to be lower in broker dealers owned by financial institutions.

In situations where the institution has outsourced the functions of the broker dealer to a third party, margin tends to be wider because of the elimination of middle and back-office staffing expenses.

Net Income Contribution Margin

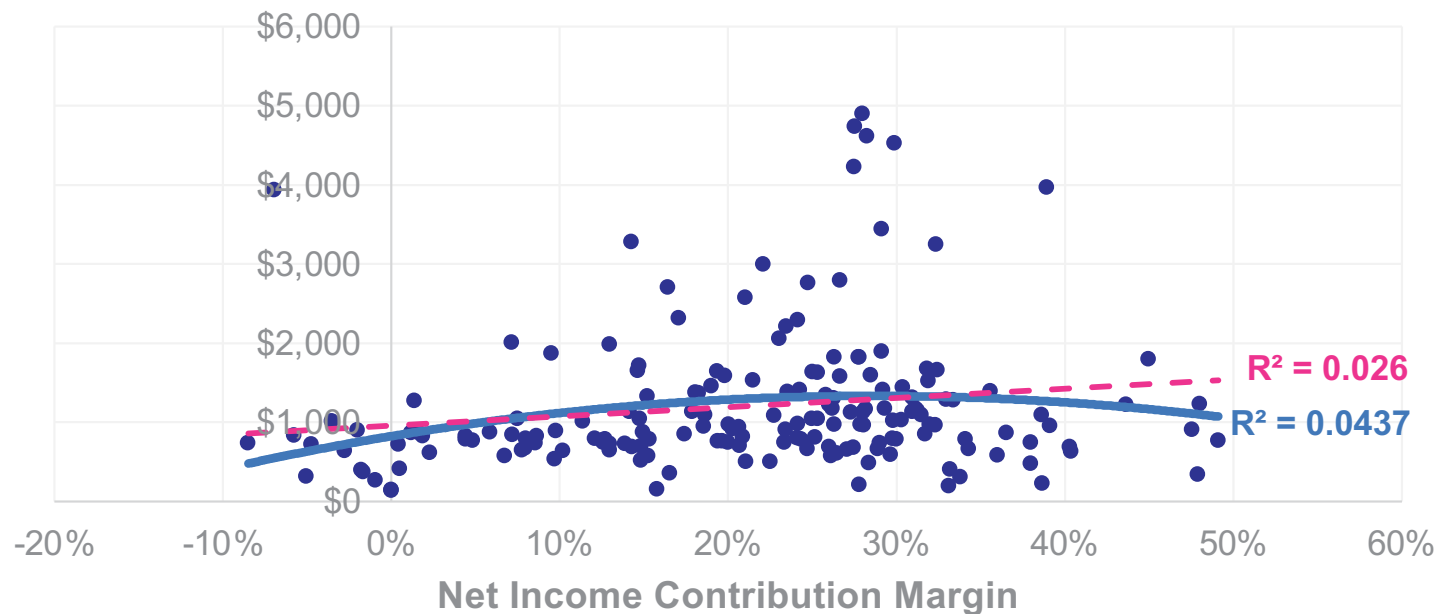


What is the impact of widening profit margin on revenue and profit contribution?

Margin v Revenue

Firms with top quartile margin (30% and above) have below average deposit revenue penetration, suggesting that wider margins hurt the institution's ability to capture a meaningful share of its opportunity.

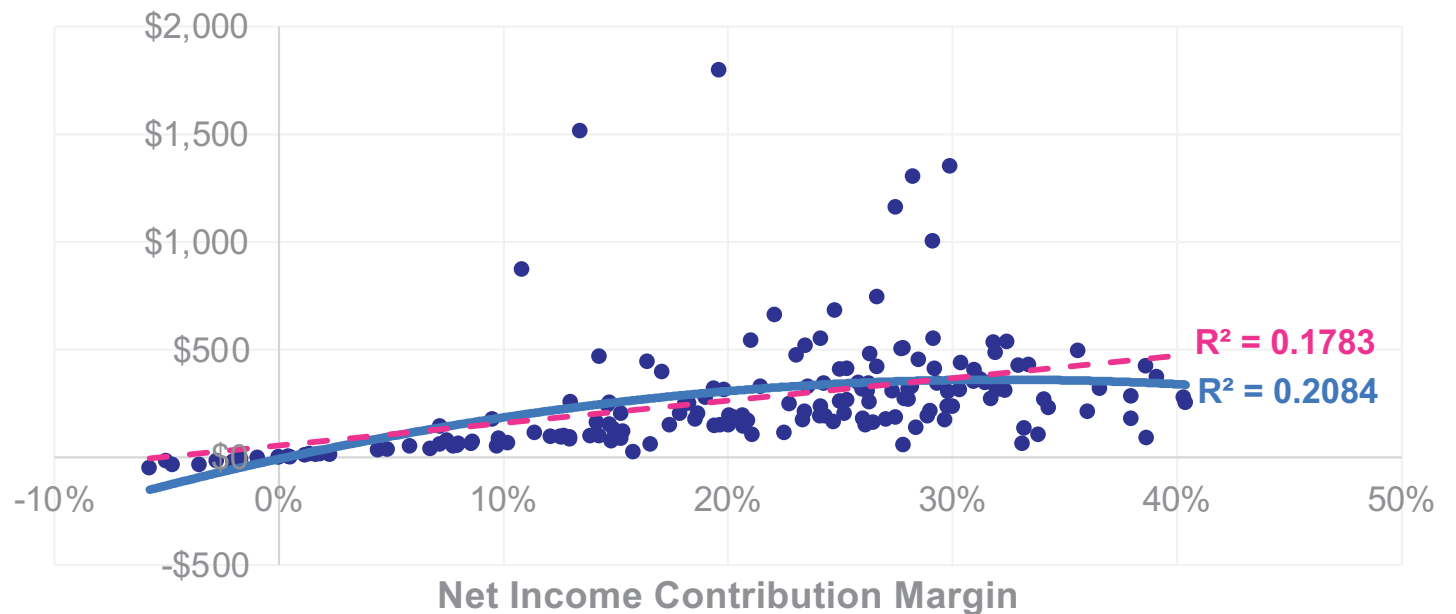
Investment Services Revenue per Million FDIC Core Deposits / NCUA Total Shares



Margin v Profit

Contribution to Profit per Million FDIC Core Deposits/NCUA Total Shares

Total profit does increase as the firm moves from unprofitable to somewhat profitable. But total profit declines as a firm widens its profit margin beyond the top quartile (30%).

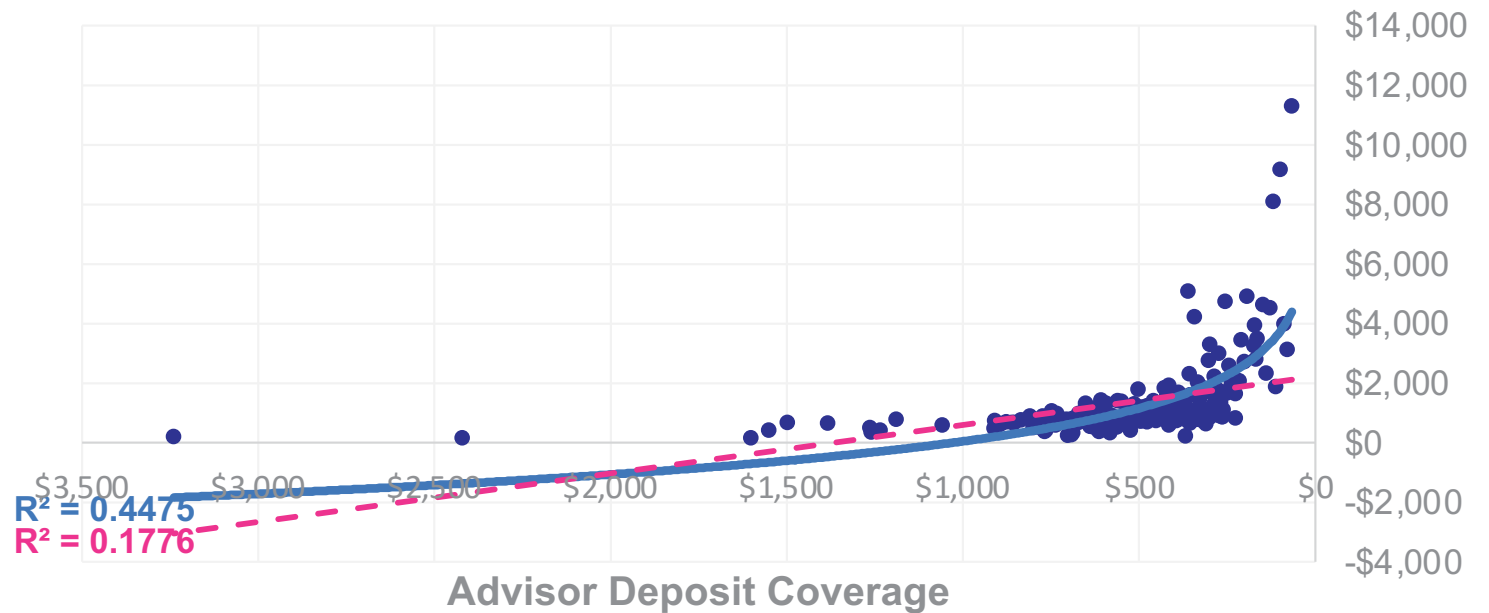


What is the impact of reinvestment on revenue and profit contribution?

Advisor Coverage v Revenue

Revenue per Million FDIC Core Deposits/NCUA
Total Shares

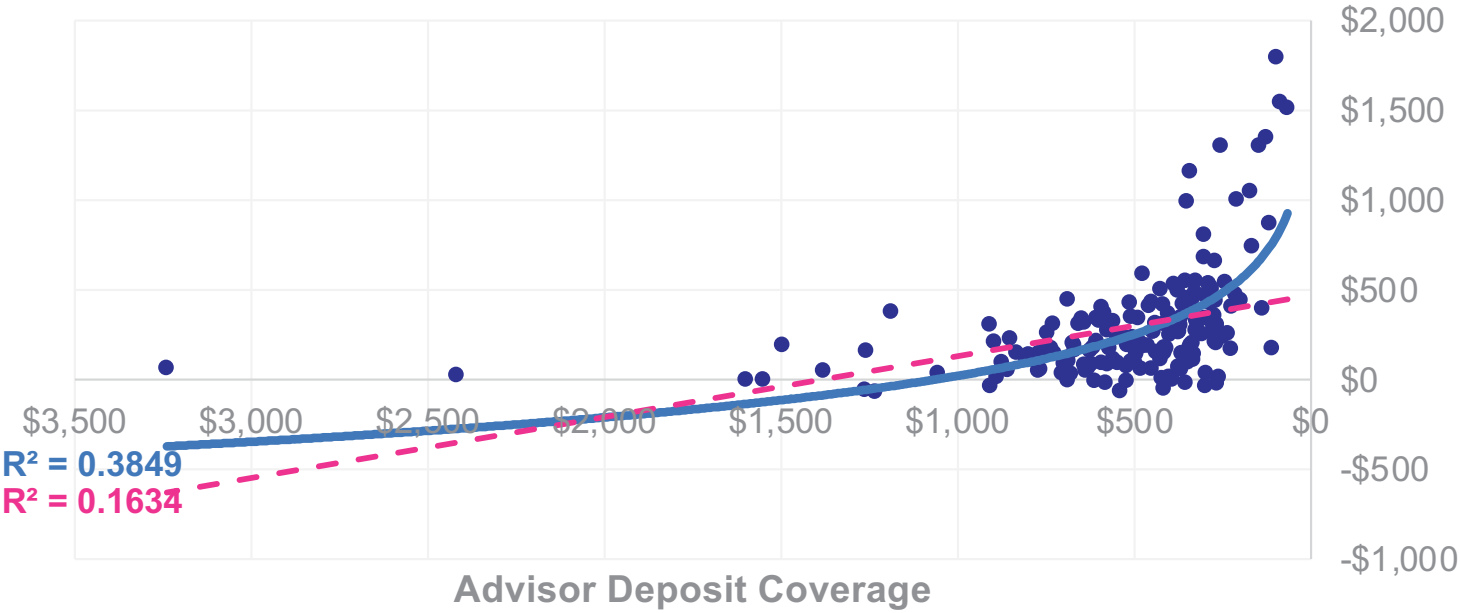
Revenue increases exponentially with advisor headcount, suggesting that the relationship between advisor headcount and total revenue goes beyond the new advisors' incremental additions to production.



Advisor Coverage v Profit

Contribution to Profit per Million FDIC Core Deposits / NCUA Total Shares

Profit increases exponentially as the firm thickens advisor coverage.



Advisor Coverage v Margin

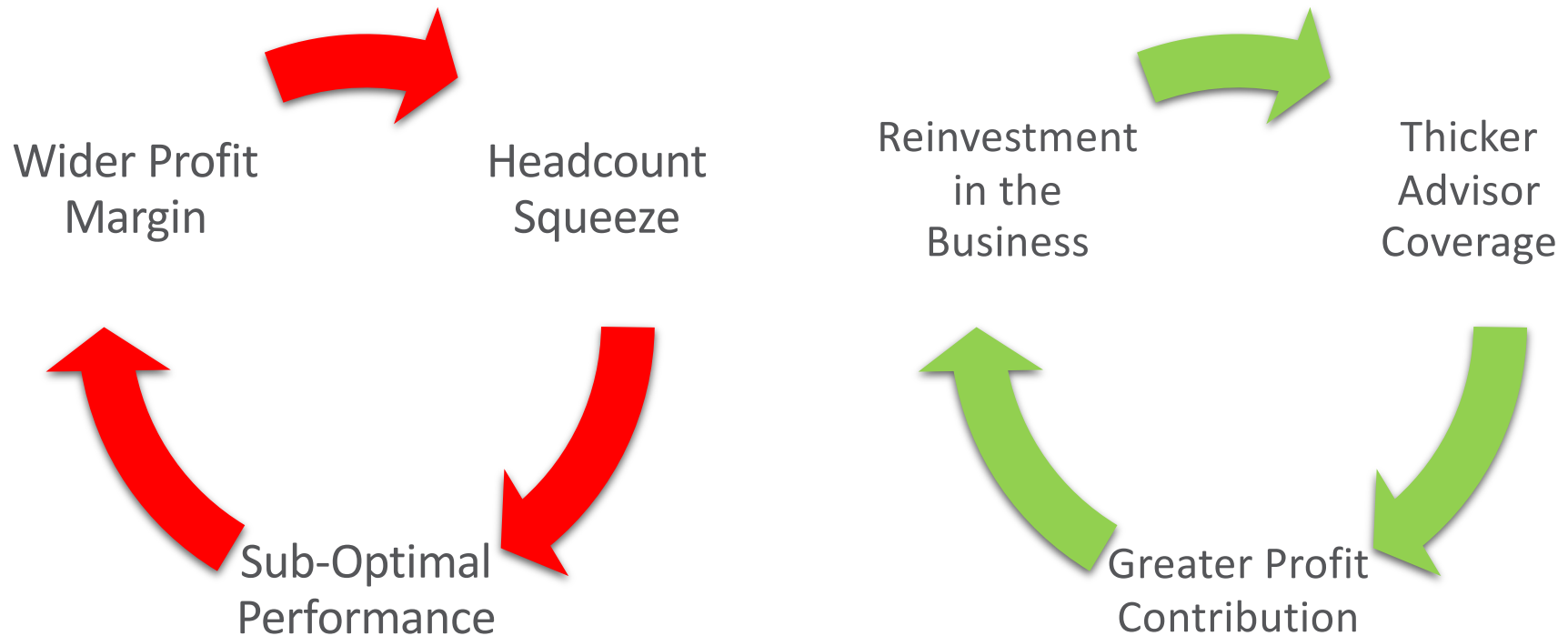
The addition of each advisor hurts the firm's profit margin in the short term.

- Onboarding an additional advisor costs time and money
 - Advisors are least productive during their first 1-3 years with the firm
 - Making them less profitable than the firm's other advisors
 - Which results in thinner profit margins for the firm

Result: The financial institution views advisor headcount restriction as being akin to expense control.

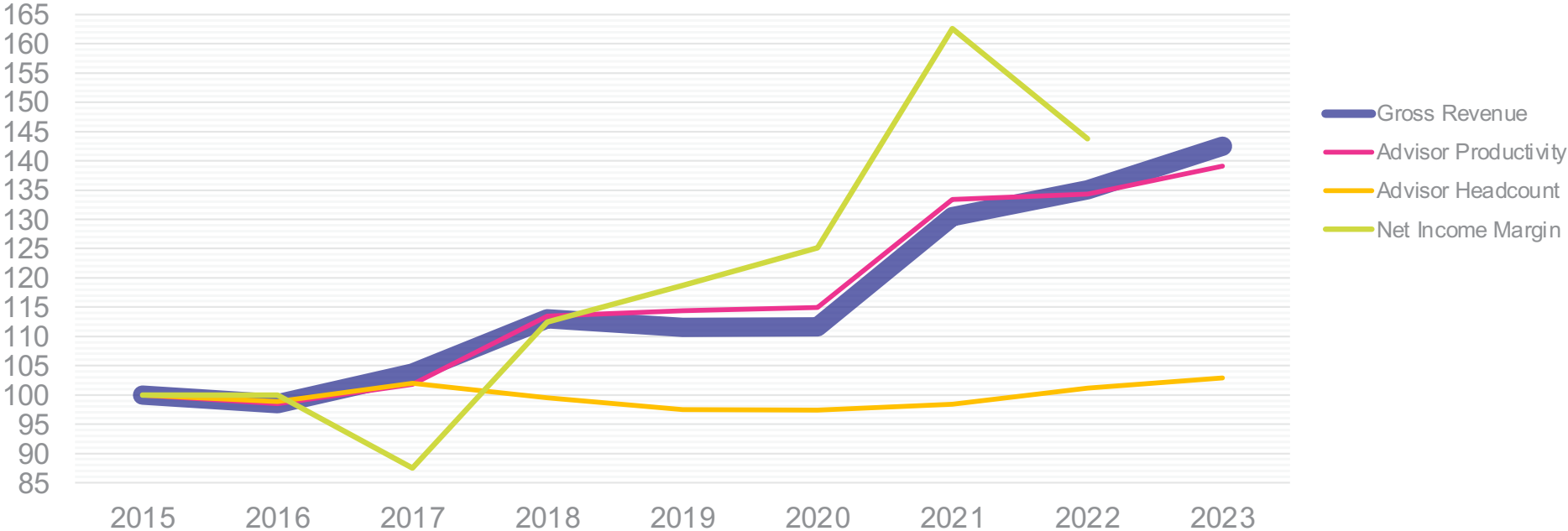
But making net additions to advisor headcount is the best way to grow the investment services business.

Negative Feedback Loop, or Virtuous Circle?



Who's Winning the Debate?

Change in Gross Revenue, Productivity, Headcount, and Margin (indexed to 2015)



The Case for Zero Margin

What if we could illustrate the advantages of managing to growth, rather than profit margin, to the financial institution?

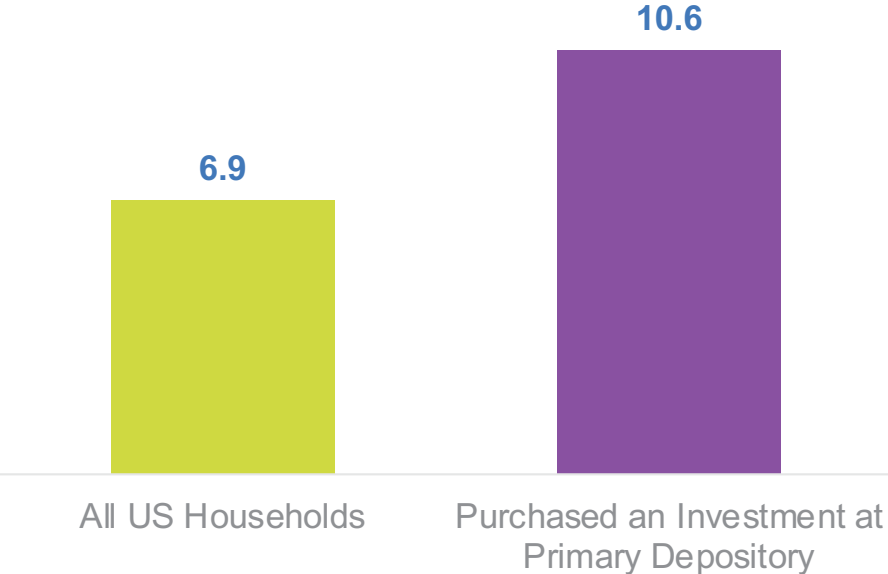
In order to do that, we would need to understand the full value of the investment services business to the banking enterprise.

Key findings of the BISA study:

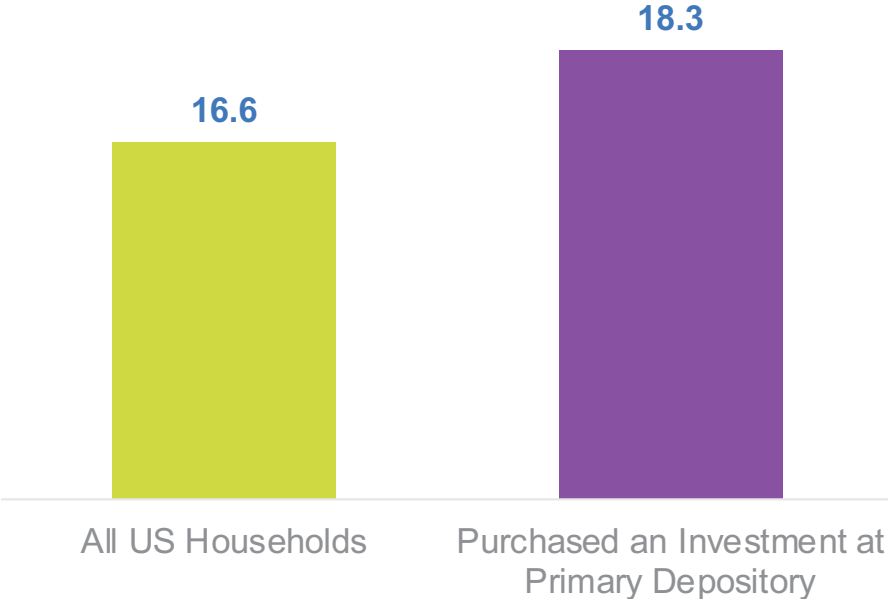
- Investment services clients use more core banking products and services compared to the typical bank customer
- And they keep a larger share of their household assets at the institution, maintain higher account balances, and remain customers for longer
- Quantified the additional income to the institution attributable to the existence of investment services
- The impact of expanding investment services engagement on total contribution dwarfs the direct profit contribution from investment services

Impact of Investment Relationship

Number of Banking Products at Primary Depository, by Investment Relationship

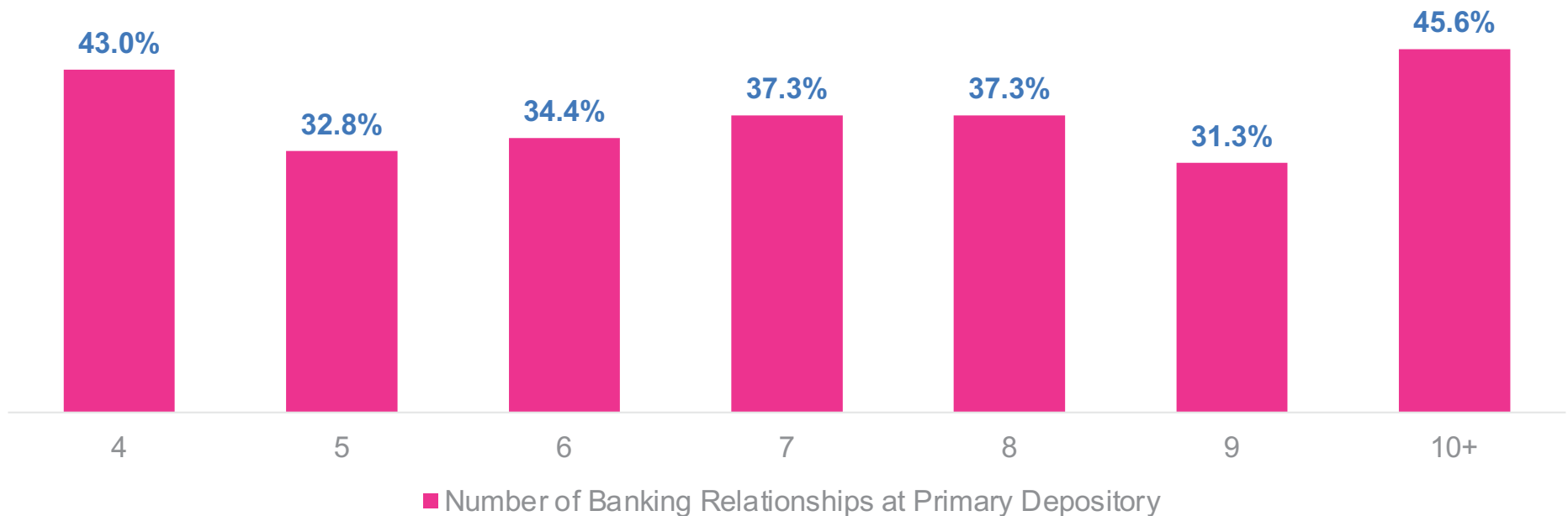


Number of Years Household Has Been Using Primary Depository, by Investment Relationship



Chicken or Egg?

Impact of Number of Banking Products on Customer Loyalty
– No Investment Relationship with Primary Depository



Quantifying the Contribution of Investment Services to Core Banking Revenue

The BISA study included a dynamic calculator, reproduced here.

The first column compares the difference between ownership of each product for households with an investment relationship and those without investments. The third column is the average balance for each account for the households with an investment relationship.

The second column multiplies the percentages in column 1 by the number of bank customer households with an investment relationship (provided by the user).

The fourth column is the net interest margin at the reader's institution for each product (provided by the user).

The last column computes the additional income to the institution attributable to the existence of investment services.

	Difference in Account Ownership of Investment Households	Number of Accounts due to Investment Services	Average Balance with Investment Relationship (thousands)	Net Interest Margin	Increase in Income with Investment Relationship (thousands)
Checking Accounts	-0.8%	(56)	\$ 32	2.25%	\$(40)
Savings Accounts	8.1%	567	\$ 38	1.51%	\$325
MMDA	43.4%	3,038	\$ 43	0.90%	\$1,165
Credit Card	23.0%	1,610	\$ 1,984	2.45%	\$78
First Mortgage	21.0%	1,470	\$ 192	2.75%	\$7,762
Second Mortgage	22.0%	1,540	\$ 65	3.00%	\$3,003
HELOC	22.0%	1,540	\$ 44	1.984%	\$1,247
Total					\$13,539

Live Calculator Demonstration

Provide your firm's:

- Annual GDC
- Net Income Margin
- Household Penetration

The calculator will display:

- Your present-state profit contribution and the additional core banking revenue your firm contributes to your institution
- What your household penetration and contribution to revenue would be if you reinvested all direct profits to activities to grow the business

Net Income Margin : Household Penetration

(Margin Mismatch, Kehrer/Cetera, 2023)

+

Household Penetration : **Enterprise Contribution**

(Smart Investment, Kehrer/BISA, 2020)

=

Net Income Margin : **Enterprise Contribution**

Q&A

Questions from the audience.

Thank You

Kehrer Group is the financial advice community's trusted partner for original thought leadership, insight based in data, and strategies that drive success.

Kehrer Group's legacy of research and analysis has advanced the delivery of investment services in banks and credit unions and shaped the industry into what it is today. Kehrer Group's principals meld the wisdom gained from its long history in the industry with cutting-edge analytics, data that is robust and diverse, and a deep understanding of the key drivers of performance

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The BISA logo is located in the bottom right corner of the page. It consists of the letters "BISA" in a bold, white, sans-serif font, set against a dark blue background. The background of the entire page features a decorative footer with abstract geometric shapes in shades of blue, purple, and pink.



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**Please
take a
moment to
complete a
session
evaluation**

