Are hybrid sales teams the answer?

In part one of a two-part report, we look at the advantages of broker/banker investment sales programs

At a time when the investor's business has never been more prized, more banks are supplementing their existing full-time investment staffs by training and licensing their platform banking staff to sell annuities and mutual funds.

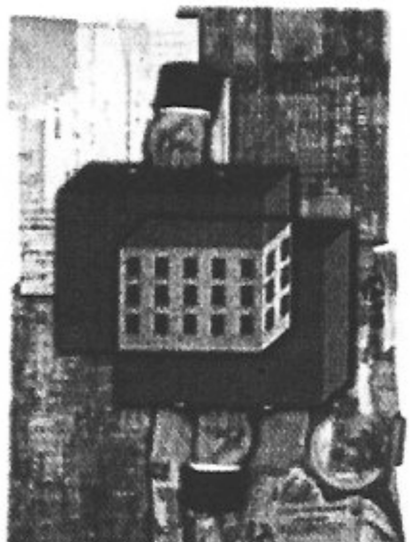
Forty-six of the 60 largest retail banks sell investments through licensed platform bankers instead of relying on brokers alone, and at least two of the remaining 14 are actively studying this option.

As banks rush to create these "hybrid" sales forces, keep in mind just what their key objectives have been—higher margins and wider distribution chief among them.

Why banks license bankers

Banks are turning to branch bankers to sell investments primarily as a way to cut costs: the acquisition cost of selling annuities and mutual funds through licensed bankers is significantly less than through full-time Series 7 brokers.

According to the *Kehrer-Essex Bank Investment Program Benchmarking Study*, the typical bank retail investment sales unit that sells only through full-time brokers pays out 38% of its investment sales commission revenue to those brokers. While that's less than nonbank brokerages pay out for the same services, it's still four to eight times the amount that bank broker dealers pay to licensed bankers in sales incentives. (See top chart on page 56. Licensed bankers typically earn about 5% to 10% of the commission revenue their sales generate.) These



lower sales or acquisition costs translate into higher profit margins. Our study results show that the revenue margin of hybrid investment programs is six percentage points higher than the 25% achieved by the typical broker-only program. The few banks that sell only through licensed bankers achieve revenue margins almost *three times* that of broker-only programs.

Coping with attrition

Banks also are turning to their branch platform staff to sell investments because it's the fastest way to substantially increase the number of investment sales people, or distribution points. In the 15 or so years that banks have been offering retail investments, they have struggled to build their sales forces.

According to last year's *CBA Consumer Investments Study*, 80% of the banks indicated that recruiting additional brokers was difficult. Half of those reported that recruiting was *very* difficult, and only 2% were not trying to increase their sales staff.

Compounding the recruiting problem is broker attrition; last year a typical bank broker-dealer lost 16% of its brokers. While some of the this turnover is the result of brokers being asked to leave, by and large it is the high performers who are jumping to jobs with nonbank securities firms, or even other banks.

Still, it should be noted that broker turnover has actually improved since 1994 and 1995, when it was running at an annual rate of 21% in bank brokers dealers. But it is still an issue. By licensing bankers, bank investment services programs can quickly increase the number of sales people, in many cases to five or ten times the current level.

Keeping the customer

A related advantage in licensing bankers is that it reduces the need to hand off prospects to a broker who's roving among branches, and not available on a given day. In fact, the typical bank has one full-time broker for every $219 million in retail deposits. With an average branch size of about $45 million, that means that the typical broker has to handle the business of five branches. If the broker makes the usual circuit around these branches, he or she may occupy any given office only one day a week.

A bank with a customer interested in investing, then, risks the chance that he or she will go elsewhere in the time between the initial walk-in visit, and when the bank can locate the broker's availability and arrange the referral, and finally when the broker arranges a meeting. To paraphrase a famous football coach, only two things can happen with a hand-off, and half of them are bad.

Banks have found that fewer invest-

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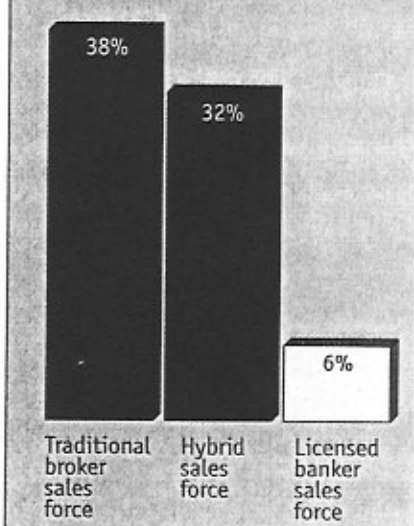
ment prospects fall through the cracks when there are licensed bankers available to discuss investments, whenever the branch is open for business.

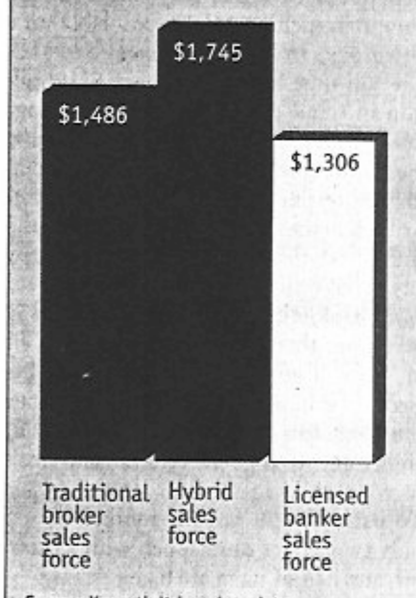
This brings us to yet another reason why licensing branch bankers is an attractive option. Many bankers already have relationships with customers, so customers are more comfortable discussing their personal finances than with the stranger they're referred to with the broker-only approach. This is especially the case when there is high turnover among brokers, so that even the *bankers* are not familiar with the broker.

Percent of commission revenue paid out to sales staff



Source: Kenneth Kehrer Associates

Deposit revenue penetration by distribution method



Source: Kenneth Kehrer Associates

How proprietary products fare

For banks with proprietary mutual funds and annuities, licensed bankers are much more receptive to selling the bank's own products than the Series 7 brokers.

The brokers have almost all come from another sales environment, typically wire houses or regional firms, where the culture is to shun proprietary products. At the very least, experienced brokers tend to have their favorite mutual funds or annuities before they came to the bank, and prefer not to sell the banks' funds and annuities. The bankers, for their part, find it natural that the bank would sell its own investment products, and are enthusiastic about them.

To illustrate this, the benchmarking study shows that the share of mutual fund sales captured by proprietary products is *twice* as high in hybrid sales teams as in traditional broker-only sales teams. The larger sales forces of hybrid programs result in more sales and more revenue than broker-only programs in the same size bank. Hybrid sales forces average 3% investment product sales penetration of a bank's consumer deposit base, compared to 2.7% for broker-only sales forces. And hybrid programs generate $1,745 in investment sales revenue per million in retail deposits, 17% more than broker-only programs (see chart at left). What accounts for the greater difference in revenue? Usually, a platform banker sales team sells more annuities than mutual funds, and annuities tend to generate sales commissions at least 50% higher than mutual funds.

Of course, higher revenue at fatter margins translates into an even larger profit contribution for hybrid programs. According to the benchmarking study, the typical hybrid program contributed $586 toward the overall bank's net income per million in bank retail deposits, a whopping 58% more than broker-only programs.

Less razzle dazzle—more service

Finally, another possible advantage of licensed bankers is that they are *not* very aggressive sales people. While this may drive sales managers up the wall, there are real compliance advantages in the service-oriented culture of branch platform bankers.

We've often overheard platform investment sales staff suggesting that the customer go home and think over the investment—a real "no no" in investment sales training. But customers who *do* invest through a licensed banker are unlikely to later return to the bank claiming that they were pushed into the investment should it happen to perform poorly.

According to the benchmarking study, hybrid sales teams receive only five complaints for every 10,000 investment sales. By contrast, broker-only programs receive eight complaints per 10,000 investment transactions. The benchmark survey separated complaints into two categories: those related to sales practices; and those resulting from paperwork problems—and found that each group received about two customer sales practices complaint for every 10,000 sales.

Curiously, the seasoned broker sales forces have higher paperwork complaints than the hybrid programs, suggesting that bankers pay more attention to order-processing details.

In sum: hybrid sales forces give banks a competitive advantage. Banks' principal competitors for investment business—the wire houses and regional brokerages—cannot provide this kind of high-touch, low-cost sales service.

Challenges, too

Are hybrid sales forces all gain, and no pain? What about the difficulty of selecting, training, and managing a platform banker investment sales force? Potentially problematic, too, are the challenges of integrating the licensed bankers and the existing Series 7 sales force. Note also that the compliance problems that have surfaced to date may be the tip of the iceberg. Next month, we'll examine these challenges. *BJ*