Too Many Brokers?

By Andre Cappon, Guy Manuel and Kevin Mellyn

Feb 1, 2004 12:00 PM

In the course of every bear market — especially towards the end of the down cycle — the securities industry typically decides it has excess capacity in the advisory channel and takes appropriate action.

But according to our research, it's not just in these downswings that the industry is overpopulated with reps. Indeed, our conclusion is that there is *chronic* excess capacity, and that the business of advising investors and selling them appropriate products could be handled in most markets by a third fewer people.

This state of overpopulation is best explained by the term "dynamic equilibrium." In short, even though the industry has too many producers overall, the marginal ones who drop out most frequently are constantly replaced by newcomers attracted, in part, by the vacancies in the industry. The survival rate among these is small: Perhaps one in four or five trainees/rookies becomes a bona fide producer.

By contrast, established, seasoned producers — the undisputed core of the advisory business — are in it for the long haul, typically their entire career. Among these seasoned vets, attrition rates are minimal. Their income may fluctuate with market conditions, but it will always be enough for them to continue in business.

In short, there is no "excess capacity" of truly good advisors. The challenge facing the industry is to get more efficient at converting new entrants into long-term players.

How Big is the Breadbox?

The advisor channel as it currently exists is a diverse place, including several types of professionals who advise households on their finances.

- Retail-oriented registered representatives or brokers.
- Financial planners of various types.
- Life insurance producers.
- Bank-affiliated advisors.
- Others (e.g. dual professionals, in firms such as HD Vest).

The total number of registered representatives is somewhere between 600,000 and 650,000, depending on whose numbers you put more faith in (the former number is from the SIA and the latter is from the NASD). However, because the employment totals include a host of non-advisory financial professionals with Series 7 certification (bankers, traders, sales assistants, for instance), the number of active financial advisors in the securities industry is much smaller.

It's safe to assume that the 125,000 or so employed by the top 50 retail-oriented securities firms are active advisors. Plus, since most of the smaller securities firms are primarily retail-oriented, and the majority of banking and insurance professionals with securities registration are retail-oriented, we will make the working assumption that about 80 percent of registered reps are retail-focused brokers and other kinds of producers. This yields an estimated 480,000 brokers, as of year-end 2002.

Financial planners are a fuzzier category, since there is no single registration or accreditation process for this group. As a working assumption, we might include the 43,000 advisors with CFP accreditation (which is conservative, given how tough it is to acquire a CFP designation). Life insurance producers, according to LIMRA, included about 178,000, as of year-end 2002. Most life insurance producers, these days, sell investment products in the form of mutual funds, annuities, variable life and "over-funded" whole-life policies (a fixed-income investment in an insurance wrapper). Headcounts in other categories, in particular bank-affiliated advisors, are difficult to determine accurately.

So, as a rough estimate, recognizing there is clearly some overlap among the categories, let's say there are about 500,000 professionals in the advisory channel.

This establishes the “supply” side of our employment equation. Now onto demand: How many available clients are there?

Of the 106 million households in the United States, only about 53 million have investable assets over $10,000. This suggests a ratio of around 100 investor households per advisor. We know from our experience with sales forces in the securities industry that a broker or financial advisor can easily handle 250-plus clients and a life insurance producer even more (thanks to the non transaction-intensive product mix that characterizes life insurance business).

Thus, the ratio of 100 households per advisor suggests significant excess capacity — perhaps as much as 50 percent. This excess capacity is manifesting itself in the form of underutilized producers.

The Finer Picture

This fact becomes even more clear when we zero in on the specifics of certain “skews” within the industry. For instance, at wirehouses, where the breakeven level of production for an advisor is between $250,000 and $300,000, around 60 percent of advisors sit below the profitability threshold. If we exclude the producers with length of service (LOS) shorter than four years (on the grounds that they're basically trainees) we're still left with 35 percent of the experienced advisors underproducing, that is, not covering their costs.

For regional firms, where support costs are more modest, the breakeven production level is lower, around $200,000. Still, almost 55 percent of brokers operate below it. If, once again, we exclude the LOS 0-4 category, we get around 40 percent of the salesforce not pulling its weight.

Why do firms tolerate this? One answer is that producers below the breakeven production level help cover fixed costs. Empty desks are an obvious net loss. By keeping the small producers, the firms can absorb their overhead and make money overall. Furthermore, analysts covering the brokerage industry view large sales forces as a sign of a business' health. The value of appearances in this case is very important.

Firms can of course reduce their fixed costs by permanently rooting out the poor performers. This is, in fact, the most direct path to improved profitability, and it thus has been an ongoing priority for many wirehouses. Their favored tool: steadily increasing minimum gross production requirements. Many of the producers who depart the wirehouses join independents, financial advisor networks and life insurance companies, where support costs are minimal and minimum production requirements are lower. Others drop out of the business altogether. In each case, the excess capacity problem is resolved dynamically.

History's Fault?

Yet another way to look at the excess capacity issue is to take a historical perspective. Advisory-channel headcount has been growing at 3 percent a year since 1990. Is 3 percent a high or low number? The only way to answer this is to place it in the context of the growth in the underlying “raw material” that advisors work with: the investable assets of the overall population. According to the household financial assets monitored by the Federal Reserve flow-of-funds analysis, investable assets between 1990 and 2002 have grown at a rate of 1 percent per year, settling in at around $25-30 million per advisor. In short, producers' earnings dropped significantly in the post bubble world, but producer headcounts did not drop very much, and a new equilibrium level was reached.

Recruit or Train?

In conclusion, there is ample evidence of excess capacity in the financial advisory business — up to 33 percent, depending on how you measure it. However, the industry has learned to live with this chronic excess capacity, by being extremely adaptable and by offering multiple business models — wirehouses, regionals, independents, discounters, dual professional firms, etc. — which can make money under a variety of scenarios.

For any single firm, though, there are interesting management implications built into these employment numbers. For instance, a firm might rationally choose to upgrade its sales force, gradually eliminating small producers and reducing overhead. This is very likely a winning strategy in terms of profitability, and many of the biggest firms are actually pursuing it.

Another implication is that training is an increasingly difficult proposition, while recruiting experienced producers can be a more economical growth strategy

Overall, it's clear that there is much to be gained from firms who examine their workforces closely, and advisors need to be aware that coming off the hard lessons of the down market, many more firms are likely to do so.

Writer's Bio:
>Andre Cappon, Kevin Mellyn and Guy Manuel are consultants with The CBM Group, Inc. a management consulting firm specialized in financial services.
www.thecbmgroup.com

Marina Alcalde and Stephane Mignot contributed to the research used in this article.

> > > > > > >

Breakeven production levels at wirehouses (top) and regional/local firms (bottom)

>	Length of Service						>
Production Bucket	**0-4 years**	**5-9 years**	**10-14 years**	**15-19 years**	**20-24 years**	**25 years**	**Subtotal**
>							
Less than $100,000	14.5%	3.6%	1.4%	0.9%	1.6%	0.2%	22.2%
$100K to $149.9 K	5.7%	2.3%	1.4%	0.7%	0.7%	0.9%	11.6%
$150K to $199.9K	2.3%	2.7%	0.9%	0.7%	0.9%	0.2%	7.7%
$200K to $249.9K	2.0%	3.6%	0.5%	2.0%	1.8%	0.9%	10.9%
$250K to $299.9K	1.4%	2.5%	1.4%	1.4%	0.7%	0.7%	7.9%
Breakeven							
$300K to 349.9K	0.5%	1.1%	1.6%	1.6%	1.1%	1.1%	7.0%
$350K to 399.9K	0.2%	1.1%	1.1%	0.9%	0.5%	0.2%	4.1%
$400K to 449.9K	0.0%	0.5%	0.5%	1.8%	0.9%	0.7%	4.3%
$450K to $499.9K	0.2%	0.2%	0.2%	1.6%	0.5%	1.1%	3.9%
$500K to $549.9K	0.0%	0.5%	0.9%	0.7%	0.7%	0.5%	3.2%
$550K to $599.9K	0.0%	0.0%	0.7%	0.5%	0.7%	0.2%	2.0%
$600K to $649.9K	0.5%	0.2%	0.9%	0.0%	0.5%	0.0%	2.0%
$650K to $699.9K	0.0%	0.5%	0.2%	0.2%	0.0%	0.0%	0.9%
$700K to $749.9K	0.0%	0.5%	0.0%	0.5%	0.7%	0.0%	1.6%
$750K to $799.9K	0.0%	0.2%	0.2%	0.2%	0.2%	0.0%	0.9%
$800K to $849.9K	0.0%	0.5%	0.2%	0.0%	0.2%	0.0%	0.9%
$850K to $899.9K	0.0%	0.0%	0.5%	0.5%	0.2%	0.2%	1.4%
$900K to $949.9K	0.0%	0.0%	0.5%	0.5%	0.2%	0.5%	1.6%
$950K to $999.9K	0.0%	0.0%	0.0%	0.2%	0.0%	0.2%	0.5%
$1,000K to $1,999.9K	0.7%	0.0%	0.2%	1.6%	0.9%	0.9%	4.3%
More than $2 million	0.0%	0.5%	0.2%	0.2%	0.0%	0.2%	1.1%
Subtotal	27.9%	20.4%	13.4%	16.6%	12.9%	8.8%	100.0%

> > > > > > >

>	Length of Service						>
Production Bucket	**0-4 years**	**5-9 years**	**10-14 years**	**15-19 years**	**20-24 years**	**>25 years**	**Subtotal**
>							
Less than $100,000	9.0%	4.5%	3.2%	2.6%	3.2%	2.6%	25.0%
$100K to $149.9 K	2.6%	3.8%	0.6%	1.3%	2.6%	0.6%	11.5%
$150K to $199.9K	1.9%	3.8%	1.3%	0.6%	1.3%	1.9%	10.9%
$200K to $249.9K	1.3%	1.3%	1.3%	1.3%	2.6%	0.0%	7.7%
Breakeven							
$250K to $299.9K	0.0%	1.9%	1.9%	3.8%	2.6%	1.3%	11.5%
$300K to 349.9K	1.3%	1.3%	0.0%	0.0%	0.6%	0.6%	3.8%
$350K to 399.9K	0.0%	0.6%	0.6%	0.6%	0.6%	0.0%	2.6%
$400K to 449.9K	0.0%	0.6%	1.9%	0.6%	0.0%	0.6%	3.8%
$450K to $499.9K	0.0%	0.6%	1.3%	0.0%	2.6%	0.0%	4.5%
$500K to $549.9K	0.6%	0.0%	0.6%	1.3%	0.0%	2.6%	5.1%
$550K to $599.9K	0.0%	0.6%	0.0%	0.6%	0.0%	1.3%	2.6%
$600K to $649.9K	0.0%	0.0%	0.6%	0.0%	0.0%	0.6%	1.3%
$650K to $699.9K	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
$700K to $749.9K	0.0%	0.0%	0.0%	0.6%	0.0%	0.0%	0.6%

Production Bucket	0-4 years	5-9 years	10-14 years	15-19 years	20-24 years	>25 years	Subtotal
>		Length of Service					>
$750K to $799.9K	0.0%	0.6%	0.0%	0.0%	0.0%	0.0%	0.6%
$800K to $849.9K	0.0%	0.0%	0.0%	0.0%	0.6%	0.0%	0.6%
$850K to $899.9K	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
$900K to $949.9K	0.0%	0.0%	0.0%	0.0%	0.6%	0.0%	0.6%
$950K to $999.9K	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%
$1,000K to $1,999.9K	0.0%	0.6%	1.3%	1.9%	0.6%	0.0%	4.5%
More than $2 million	0.0%	0.6%	0.6%	0.6%	0.6%	0.0%	2.6%
Subtotal	16.7%	21.2%	15.4%	16.0%	18.6%	12.2%	100.0%