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BD Back-Office Consolidation: Profit Bonanza or Service Boondoggle?

Even before the Labor Department fiduciary rule has been implemented and now likely delayed for 18 months, broker-dealers are making business changes due to lower revenue and higher expenses. One broker-dealer recently laid off employees due to a major slowdown in variable annuity revenue while another BD with a strong focus on alternative investments and REITs announced that 2017 would be break-even after years of consistent profitability; we see many broker-dealers raising costs or adding profit centers to help fill in the void.

For multiple broker-dealers operating under a single owner, the temptation to cut costs by consolidating back-office services is nothing new but with the added expenses and revenue decline of DOL rules, consolidation projects appear to be hitting fever pitch.

Below we examine three distinct consolidation models, which vary greatly in terms of the effect they have on the quality of service advisors receive, as well as their impact on overall culture. "The road to failure is paved with good intentions," comes to mind when looking at the most far-reaching consolidation models, while minimal consolidation models seem to be almost a non-event from the advisor perspective. Here are the three models.

Broker-Dealer Model 1: Minimal Consolidation Lowest cost savings, highest advisor loyalty

The minimal model is characterized by consolidation between broker-dealer departments such as accounting, legal and IT. These are the areas with which advisors typically have little to no direct contact. The broker-dealers benefit from cost savings by centralizing these services. For the advisor, the centralization goes largely unnoticed because they barely use these services, if at all.

This minimal approach is by far the most service-friendly, as advisor touch points stay within their own broker-dealer and culture remains intact. In this minimal model, rep-to-staff ratios are generally very healthy, keeping under 10:1, and for some broker-dealers, an advisor-pleasing 4:1 ratio.

While this model may offer the least cost savings, if broker-dealers want to maintain service quality, culture and advisor loyalty, this model comes out on top.

Broker-Dealer Model 2: Maximum Consolidation Relationships and culture adversely impacted

Maximum consolidation between broker-dealers results when nearly all departments are centralized. Advisor touch points (new accounts, ACATs, brokerage services, supervision, compliance, commissions, trading, advance sales desk) are each serviced out of a single location and service the advisors of all their broker-dealers. When an advisor calls in they are asked, "What is your rep number and what broker-dealer are you with?"

When we asked one advisor, 'When you call in for help, where are you calling?' he responded, 'I don't know where I'm calling but I'm nearly always on hold for a lengthy period of time.' He had been with his firm for over 20 years and his disdain for the changes he has experienced since the consolidation began has only grown.

A large producer we spoke with shared how back-office consolidation at his broker-dealer resulted in the advisors taking on numerous operational duties such as additional data entry that was previously handled by the back-office operations staff. Fewer staff due to centralization resulted in more work for the advisors, which this advisor found unacceptable. He explained further that the back-office consolidation that started after his firm was purchased had destroyed the qualities he had always appreciated about his firm. My comment to him was that he was no longer with a 1,000-advisor BD but was now a rep of a 5,000-advisor broker dealer (the grouping of BDs).

Extensive consolidation strips away any individual broker-dealer culture and you become part of a less distinguishable culture among the universe of broker-dealers. He agreed with my assessment, expounding how he missed the days prior to his firm getting sold, when the people he contacted for help were at his broker dealer's home office and he had his 'go-to' people for problem resolution.

"My 'Go-To' People Are Gone"

An advisor at another high-consolidation model broker dealer shared with us how he used to invite all the operations people out to a Christmas dinner at a nice restaurant near the home office. He explained, "My go-to people are now gone since they centralized services; the relationships are history." It is also not uncommon for us to hear stories from advisors that when they walk through some of these broker-dealers that were once bustling with activity, they are now like ghost towns, with staffing a shell of its former self as entire departments were moved to other broker-dealers.

In addition to the loss of relationships, this centralized staffing also makes gathering statistics such as advisor-to-staff ratios near impossible. In fact, we often don't hear these statistics released, because in addition to being more difficult to gather, these broker-dealers know that their back-office consolidation efforts result in unusually high advisor-to-staff ratios that are well above 10:1, making them stand out like a sore thumb in the industry.

While operating within a heavily consolidated back office environment can bring substantial frustration to advisors, some have learned to adapt by bypassing the need for the broker-dealer back office as much as possible. One way advisors adapt is to become self reliant on technology and reporting needs. Or they may custody their advisory assets away from the broker-dealer at TD Ameritrade, Fidelity or Schwab or with third-party money managers directly.

It is common for large producer groups within these broker-dealers to have their own back-office administration so their advisors don't have to call the broker-dealer back office, thus avoiding inevitable poor service issues. It's a testament as to how far advisors will go to avoid changing their broker-dealers by trying to make a bad situation work in their favor, working around the problem. Is there a point here that this workaround in effect simply shifts the burden onto the advisors' backs?

Broker-Dealer Model 3: Team Consolidation Working towards the best of both worlds

Team consolidation is a newer model that aims to deliver the best of all worlds: cost savings, relationship and culture. In this model, teams composed of six staff members are split into service, supervision and relationship management (growth), with approximately 125 advisors assigned to a team.

The goal with the multi-function team is to drive first-call resolution. However, if an advisor has to reach out to a subject matter expert, the individual on the team "holds" the issue and runs with it to ensure they own it through the entire process and manage the interaction of the subject matter expert with the advisor (to help with messaging, context, etc.).

This team model implements cross training between team members so the breadth and depth of the questions they can answer is increasingly substantial. Aside from owning the relationship between advisors and the teams, the teams and advisors assigned to them are all with the same broker-dealer to maintain cultural aspects. This model is structured specifically with the intention to maintain relationships and culture, which full consolidation between broker-dealers fail to achieve.

The team model is newer than the two previously described, so it doesn't have much of a track record. Time will tell if it can achieve its goal, which we'll be able to gauge by advisor feedback going forward. One primary concern is if the rep-to-staff ratios will be enough to handle call flow on a consistent basis.

Technology's Role in Consolidation

Technology has delivered substantial cost savings to broker-dealers, allowing them to cut back on staffing needs and run, as they put it, "lean and mean." For some of these broker-dealers, they will steer advisors to use various technologies as a substitute for personal service. This can be problematic, as advisors want and need to be able to call competent staff members and have a conversation when the need arises.

Extensive back office consolidation frequently results in difficulty reaching someone, needing to leave voice messages and return calls taking as long as several days and sometimes not at all. An advisor vented to me, "The quality of people helping me has declined and I no longer have my key people that I could count on. I just get whomever I happen to get through the phone tree order."

Cost cutting via back office consolidation is a bittersweet endeavor at best. From advisor feedback in our daily recruiting discussions, the message is quite clear, "The less consolidation the better!"

A broker-dealer's zeal to cut costs can end up undermining the very thing that made the BD successful—quality service, relationships and culture. We have yet to hear an advisor tout an improvement in their broker dealer experience through extensive back office consolidation. The savings broker-dealers seek via consolation often end up costing them dearly.

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