Guide to Growth: Leveraging Research and Industry Experience to Achieve Best Practices

The Value of Referrals

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Cetera™ FINANCIAL INSTITUTIONS

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The Value of Referrals

The cornerstone of investment and insurance services in financial institutions is internal referrals, primarily from branch staff to financial advisors. This is what sets financial institutions apart from other providers of financial services, and is a key component of the competitive advantage of banks and credit unions—lower acquisition cost of new clients than other retail investment firms.

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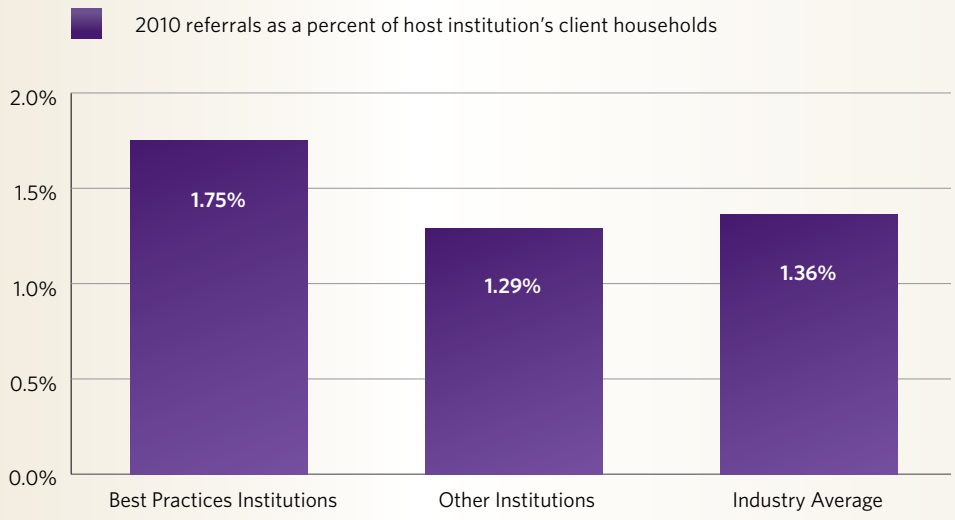
Referrals in Best Practices Firms

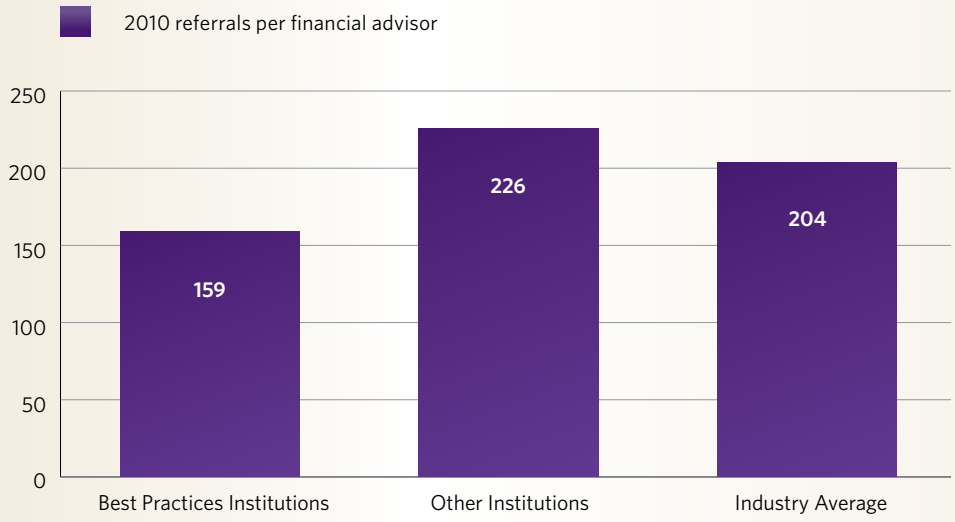
The importance of these referrals can be seen by examining the referrals in the most successful financial institution investment services units—the banks and credit unions in the top quartile of net income contribution from investment and insurance (I&I). According to the 2010 *Kehrer-LIMRA Financial Institution Investment Program Benchmarking Survey*, the latest data available and the source for all the data presented in this paper unless otherwise indicated, these institutions referred 1.75 percent of their customer or member households to their financial advisors in 2010, 36 percent more than less successful institutions (Figure 1). Clearly, the ability to achieve more referrals relative to their opportunity is a key driver of the success of these "best practices" institutions.

Figure 1 | Household Referral Penetration



The higher household referral penetration in the banks and credit unions with the highest revenue and net income contribution from investment and insurance services does not translate into more referrals per financial advisor because, as we demonstrated in *Optimizing the Advisor-to-Client Ratio*, part of Cetera Financial Institutions' *Guide to Growth* series, these best practices institutions tend to deploy relatively more financial advisors relative to the size of their opportunity. Thus, while these best practices institutions generate more referrals relative to their number of client households, the referrals are spread over disproportionately more financial advisors. As a result, the firms in the top quartile of net income contribution from I&I per client household of the bank or credit union received only 159 referrals per advisor from the host institution in 2010, 30 percent fewer than firms that actually had lower household profit penetration from investment and insurance services (Figure 1). The density of advisors per household appears to be even more important to top quartile performance than referral penetration.

Figure 2 | Referrals per Advisor

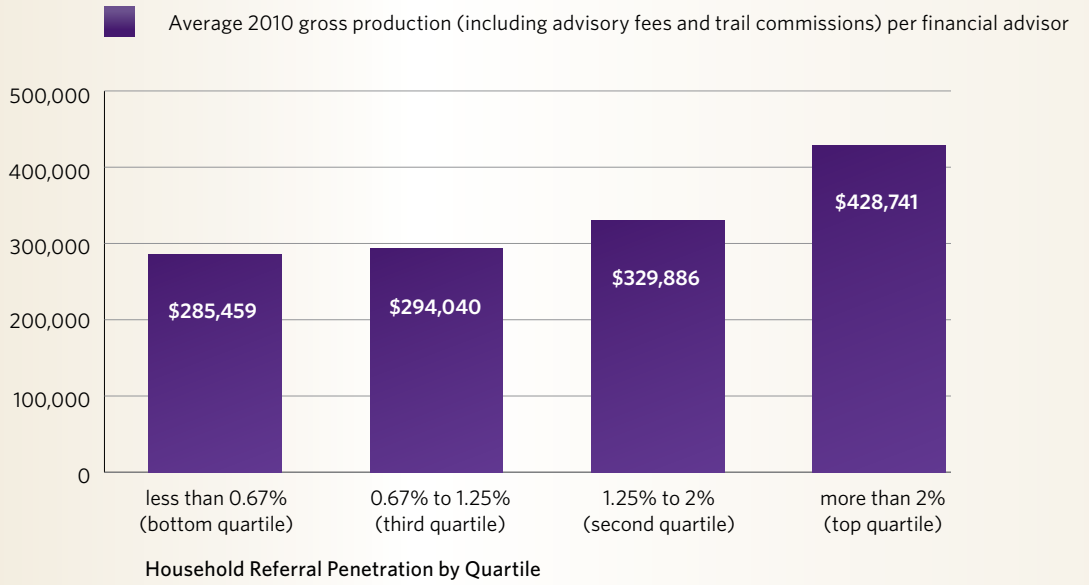


Impact of Referrals on Financial Advisors and Profit Contribution

Nevertheless, referrals are an important and critical driver of the success of financial advisors. In Figure 3, we compare the average annual gross production of financial advisors in institutions with different levels of referral penetration of their opportunity, by quartile. The average productivity of financial advisors in banks and credit unions that refer less than 0.67 percent of their customer or member households per year (the bottom quartile of household referral penetration) was $285,459, only slightly less than that of financial advisors in institutions in the next quartile of referrals per household.

On the other hand, the average production of financial advisors in institutions that refer more than 2 percent of their client households for investment and insurance services (the top quartile of household referral penetration) was $428,741, which is 30 percent higher than that of financial advisors in institutions that referred between 1.25 and 2 percent of their customer households, and 46 percent above financial advisors in institutions that had household referral penetration below the median of 1.25 percent but above the bottom quartile. Reading the chart from left to right demonstrates vividly the impact on financial advisor productivity of increasing the number of referrals in a bank or credit union with a given client base.

Figure 3 | Impact of Referral Penetration on Financial Advisor Productivity



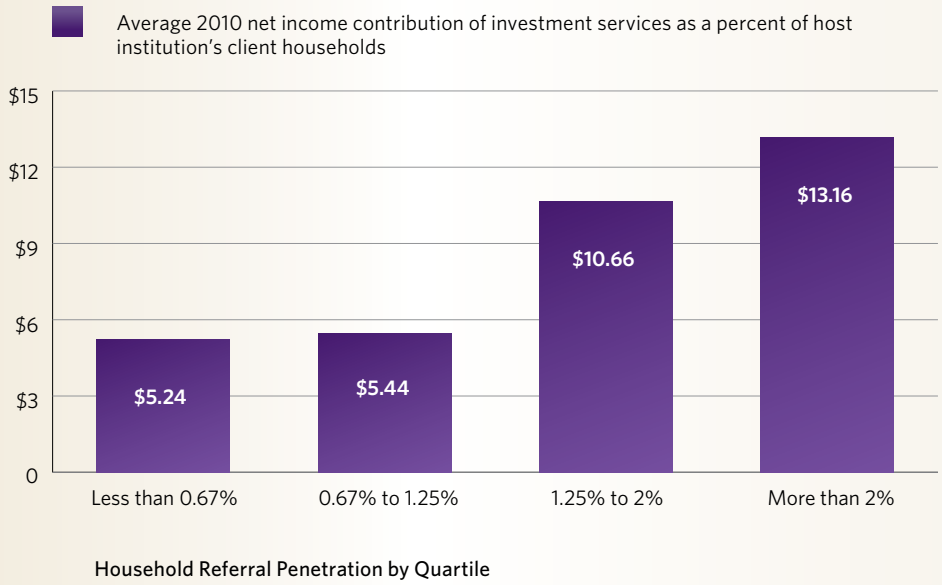
A strong flow of referrals creates a cyclical self-generating effect on the growth of the business—more referrals result in more business. A strong pipeline of referrals creates a more desirable environment for financial advisors, which leads to the ability to recruit more experienced financial advisors, and in turn instills confidence in the referral sources to provide more referrals—all building increased business.

Net Income Contribution

Even more important than the impact on financial advisor productivity is how referrals drive the net income contribution of the investment and insurance services business in financial institutions. Figure 4 provides the average net income contribution (i.e., revenue minus expenses before corporate G&A and taxes) for I&I per bank customer or credit union member household for each quartile of household referral penetration. Again, reading the chart from left to right indicates the impact of increasing the number of referrals in an institution with a given client base.

Banks and credit unions that provide fewer than the median number of referrals per year (referring less than 1.25 percent of their customer or member households) generate a little more than $5 in net income from their investment and insurance services per household of the host institution. But institutions in the quartile above the median in referrals per household have average net income contribution of $10.66 per household, double the net income contribution of institutions with less than the median household referral penetration. And banks and credit unions that refer more than 2 percent of their client households to financial advisors—the top quartile in household referral penetration—enjoy profits from investments and insurance that are 25 percent higher than the quartile above the median and 2.5 times the net income contribution of institutions with referral penetration below the median.

Figure 4 | Impact of Referral Penetration on Household Profit Penetration



It might be helpful to provide some concrete examples of the impact of additional referrals on the profit contribution of an institution's investment and insurance business. In Figure 5, we have calculated the number of referrals and the resulting net income contribution for four levels of referral penetration for institutions with either 10,000 or 100,000 customer or member households. These four levels (0.50 percent, 1.00 percent, 1.67 percent and 2.25 percent) lie approximately in the middle of each of the four quartiles of referral penetration observed in the sample.

For example, an institution with 10,000 households would increase its annual referrals from 50 to 167 if it increased its referral penetration rate from 0.50 percent to 1.67 percent. The net income contribution from those referrals would increase from $52,400 (i.e., $5.24 times 10,000) to $106,600 ($10.66 times 10,000). In effect, the profit from investment and insurance services would more than double.

Figure 5 | Impact of Additional Referrals on Net Income Contribution					
Referral Rate	Household Profit Penetration	10,000 Households		100,000 Households	
		Referrals	Net Income	Referrals	Net Income
0.5%	$5.24	50	$52,400	500	$524,400
1.00%	$5.44	100	$54,400	1000	$544,400
1.67%	$10.66	167	$106,600	1670	$1,066,000
2.25%	$13.16	225	$131,600	2250	$1,316,000

For an institution with 100,000 client households, the same kind of improvement in referral penetration would result in a $542,000 increase in net income contribution, from $524,000 to $1,066,000—once again, more than double.

An institution can use the table to estimate the financial impact of increasing its referrals. For example, a credit union with 57,000 member households that is currently referring 1 percent of them to its financial advisors could increase its net income from investment and insurance from $310,080 (i.e., $54,400 times 5.7) to $750,120 (i.e., $131,600 times 5.7). This demonstrates that increasing referrals from 570 to 1,283 boosts profits by $440,040.

Similarly, a bank with 320,000 customer households and a referral rate of 1 percent can multiply the 100,000 panel of the table by 3.2 to estimate the financial impact of different levels of referrals.

Referral Challenges

In the upcoming *Guide to Growth* white paper, *Sources of Business,* we describe how referral penetration has been declining due to secular and cyclical factors, including the maturation of the investment and insurance services business in banks and credit unions. As the business matures, financial advisors tend to rely increasingly on other sources of business rather than referrals.

Another challenge to maintaining a strong flow of referrals to financial advisors is the regulatory environment. The emergence of the Regulation R debate about compensating bankers who do not have a securities license for referrals to financial advisors undoubtedly influenced referral activity starting in 2005. Now that the restrictions have been clarified—that the financial institution can pay only a one-time nominal referral fee, not conditioned on whether the referral results in a sale—many banks have shied away from using incentives to encourage branch staff to support the investment and insurance services business.

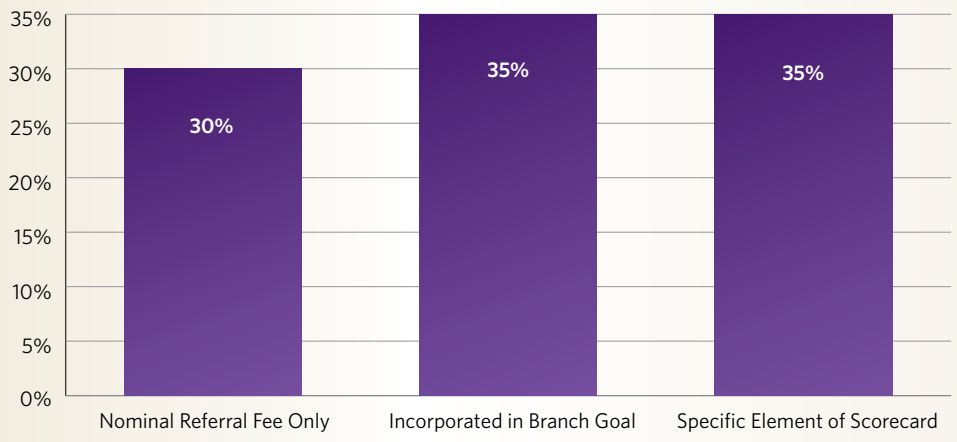
But other institutions understand that support for investment and insurance services needs to go beyond referral training and referral incentive payments. Best practices institutions integrate investment and insurance services referrals into their mission statement and the fabric of the day-to-day activity of branch staff. This, of course, includes how branch staff and management are hired, trained, deployed, focused, and evaluated—and especially, how they are compensated.

The Impact of Branch Incentive Plans on Referrals and Investment Services Performance

Some institutions have developed compensation plans for branch staff and management that provide incentive rewards for the success of the investment and insurance services business. These approaches, compliant with Regulation R, either count investment and insurance services as one component of the branch revenue or activity goal, or include investments and insurance as a distinct element on the branch staff and branch manager's performance scorecard.

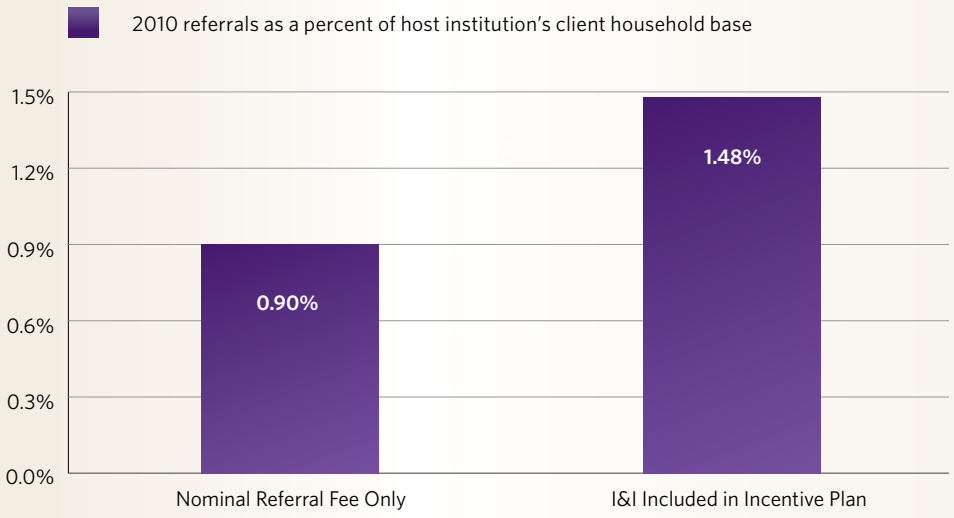
Last year Ken Kehrer and Peter Bielan surveyed 22 institutions about their branch incentive plans. As Figure 6 shows, 30 percent of them had no investment and insurance incentives in place for branch staff and management beyond nominal referrals fees, typically $10 to $25 per qualified referral. The balance was evenly divided between institutions where investment and insurance counted as part of their banking revenue or goals, and institutions where branch staff and management earned points on a scorecard specifically for investment and insurance revenue or activity which rolled up to the overall performance scorecard evaluation.

Figure 6 | Branch Incentives for Investment & Insurance Services



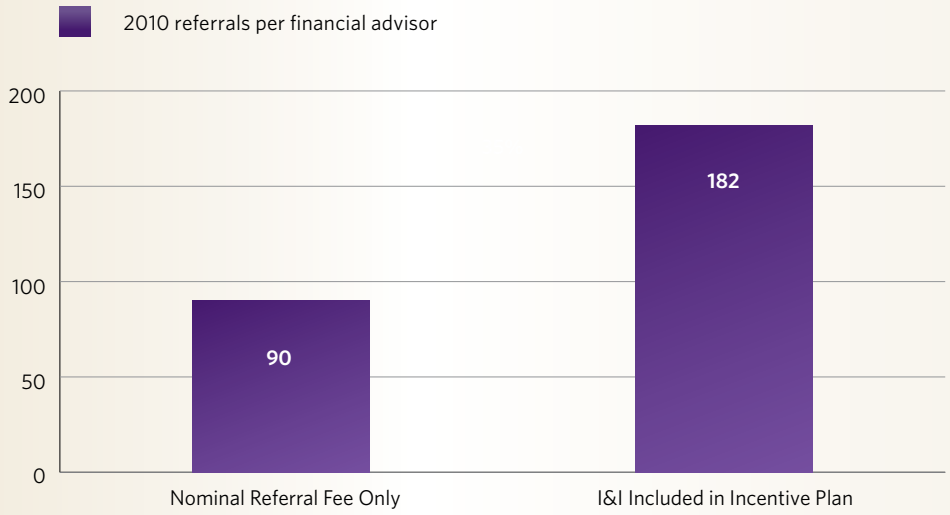
Not surprisingly, institutions that incorporate incentives for the performance of investment and insurance services in the overall branch incentive plan generate 64 percent more referrals, relative to the opportunity, than institutions that rely only on nominal referral payments to support this business line (Figure 7).

Figure 7 | Impact of Integrated Branch Incentives on Referral Penetration



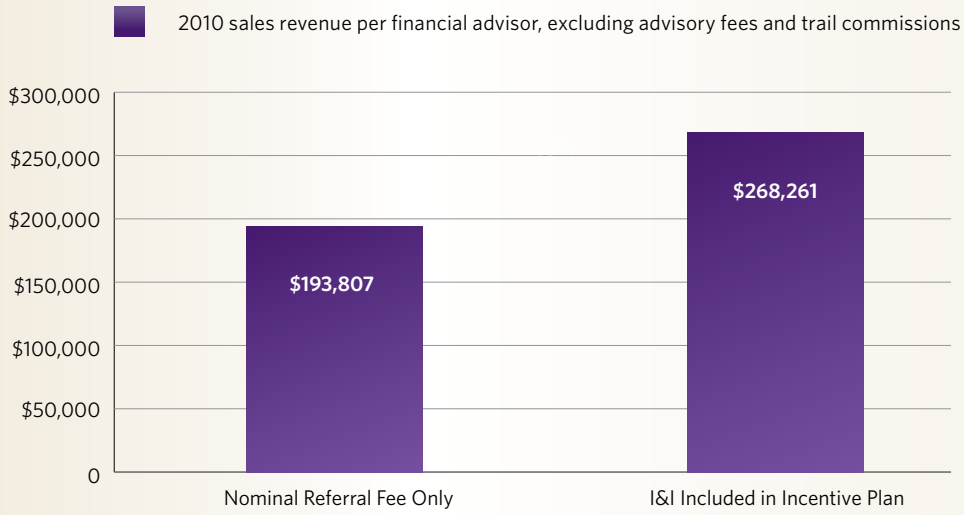
The impact of integrated branch incentives for the I&I business is even greater on the number of referrals available for each financial advisor. Compared to financial advisors in institutions that are just relying on nominal referral payments, financial advisors in institutions that include I&I in the overall branch incentive plan or break the business out separately on the branch scorecard receive twice as many referrals.

Figure 8 | Impact of Integrated Branch Incentives on Referrals per Advisor



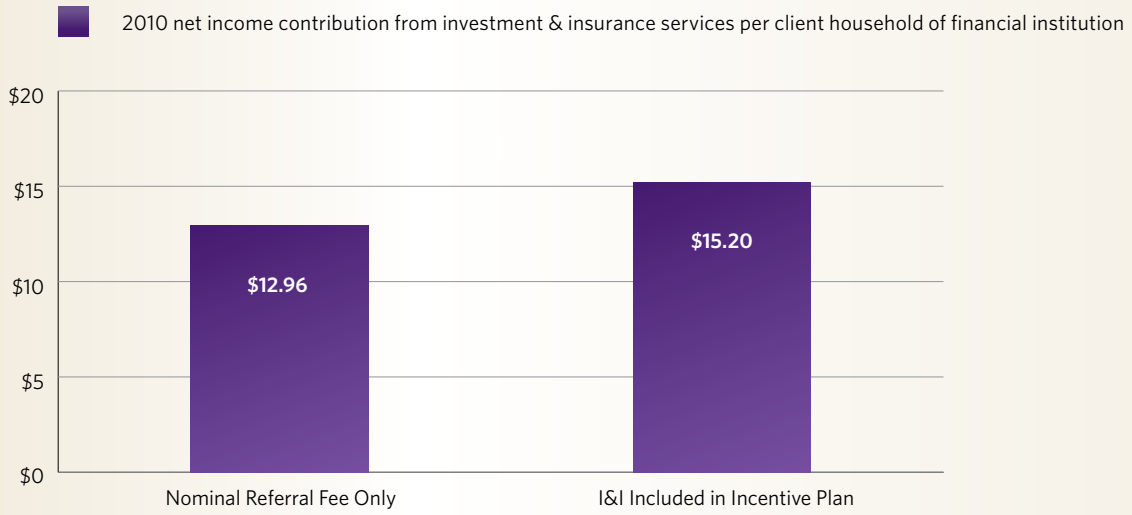
But integrating rewards for the success of the I&I business into the branch incentive structure pays off beyond the number of referrals. As shown in Figure 8, financial advisor sales productivity is 38 percent higher than in institutions that rely only on nominal referral fees.

Figure 9 | Impact of Integrated Branch Incentives on Advisor Sales Productivity



And that higher advisor productivity translates into 17 percent greater profit contribution to the overall banking enterprise (Figure 9). Banks or credit unions that integrate incentives for the success of their I&I business into their branch incentive plan generate $15.20 in net income contribution from I&I per client household, compared to only $12.96 in net income for institutions that rely only on nominal referral fees (Figure 10).

Figure 10 | Impact of Integrated Branch Incentives on Household Profit Penetration



Of course, successful integration of the investment and insurance services into the branch requires more than compensation incentives. Training to identify I&I prospects, sales management, and recognition for referral excellence all contribute to making investments and insurance a core service at the institution.

Summary

Referrals from frontline bank or credit union staff to financial advisors are where the rubber meets the road in financial institutions that are trying to capture the investment and insurance business of their customers or members. The experience of the most successful investment and insurance businesses in financial institutions and the data on the impact of referral penetration of the institution's opportunity all point to the leverage that referrals provide.

But the referral environment is challenging. Branch staff must manage a diverse and growing menu of products and services. Institutions have encouraged clients to use remote banking, reducing traffic in branches, and have cut back on branch staffing. Cyclical loan demand can raise the importance of focusing on gathering or retaining deposits instead of investment and insurance services. And Regulation R has put constraints on the incentives that can be paid to branch staff that do not have securities licenses.

Institutions that see the opportunity in investment and insurance services to build better relationships with important segments of their client base have been integrating I&I into the fabric of the branch. A key element of that integration is to include investment and insurance in the reward structure of the branch. The banks and credit unions that have designed such incentive plans compliant with Regulation R have been rewarded with increased referral flow and greater success for their investment and insurance services business.

Conclusion

If you are thinking about boosting your investment and insurance sales force and maximizing your revenue goals and referral numbers, Cetera Financial Institutions is ready to work with you on meeting your objectives.

As one of the largest broker-dealers exclusively focused on banks and credit unions, we understand the importance of referrals and the impact it has on your business. Cetera Financial Institutions has the tools and support ready to help you increase your branch referral activity and capture your value.

Cetera Financial Institutions' local field support through our relationship managers and sales support teams provides timely ideas and coaching to help investment programs and advisors gain greater branch referral success. Our Referral Training programs train staff on the art of the referral while building stronger client relationships and generating more selling opportunities.

Additionally, we offer proprietary turnkey marketing campaigns, from branch campaigns that drive branch activity and referrals to our Connect2Clients℠ program, which gives you direct access to valuable marketing resources, tools and support. Connect2Clients is designed to help you develop the relationship between the financial advisor and the branch team to aid in the growth of referral generation with a variety of offerings, including access to an extensive online library of marketing materials, campaigns and pre-approved social media messages.

To learn more about how Cetera Financial Institutions can help you achieve your goals, contact Sean Casey by phone at 800.245.0467, ext. 65014; by email at sean.casey@ceterafi.com; or visit us at www.ceterafinancialinstitutions.com.

About Kehrer Saltzman & Associates

Dr. Kenneth Kehrer has been studying the transformation of banks and credit unions to financial services stores since the early 1980s. His research has influenced how a generation of industry practitioners assess their businesses and assimilate best industry practices. He also pioneered the concept of forming bank roundtable discussion groups that bring together professionals with similar job responsibilities to share experiences and react to the latest research. The research and consulting he formerly did through Kehrer-LIMRA is now a foundation of Kehrer Saltzman & Associates, a strategic management consulting firm for the financial advice industry.

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Cetera Financial Group is committed to helping advisors grow their business and strengthen their relationships with clients. For more information, visit www.cetera.com.

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