

Financial Planning

FP50: Small Wonders

Smaller broker-dealers vow to retain their personalized service as they pursue ambitious goals.

By Elizabeth O'Brien

June 1, 2007- Payouts, revenue growth, rep count. Many gauges of the broker-dealer industry--including our own FP50--focus on numbers. But small to midsize broker-dealers say the numbers tell only part of the story. In fact, some say their main strength is their ability to forge personal relationships with advisors and treat them as something other than a rep number.

Pundits have wondered whether the broker-dealer industry will experience a "barbell effect," with mega-firms on one end, small boutiques on the other and the middle either gobbled up by bigger firms or squeezed out of business. NASD defines small broker-dealers as those with up to 150 registered reps, and medium-size firms as those with up to 499 reps. While smaller broker-dealers face a myriad challenges, plenty of firms have proven that there's room in the middle--at least for now.

Size works both ways for small and midsize broker-dealers. On the one hand, industrywide pressures such as margin compression, compliance and technology hit them particularly hard because they can't leverage the economies of scale of their larger counterparts. Yet on the other, smaller firms say that with increasing consolidation in the industry creating ever bigger firms, advisors are seeking out more personalized service. "Every one of these large acquisitions is an opportunity for me," says Jeff Auld, president of Berthel Fisher, an Iowa-based broker-dealer with roughly 325 reps.



Marshall Leeds, CEO of 180-rep Summit Brokerage Services, offers reps the security of a firm that's not for sale.

"PURE" INDEPENDENTS

While many small to midsize broker-dealers remain founder-owned, rising costs have pushed others to sell themselves to parent firms like larger broker-dealers or insurance companies, which began acquiring B-Ds in the 1990s. Small and midsize broker-dealers that are still owned by their founders say their "pure" independent position creates stronger ties with their advisors than if they answered to a corporate parent. To some industry participants, "independent broker-dealer" means a firm whose reps are independent contractors who own their client books. Founder-owned firms call their ownership status an extra layer of independence.

Executives at small and midsize broker-dealers say the majority of reps who join them come from larger independent B-Ds. They say these reps follow a similar course: Many leave wirehouses to become independent, only to find their independent broker-dealer aligning with a larger entity that changes the company's character. So they make the move to a smaller firm. "They're looking for a broker-dealer that's more objective," says Nathan Stibbs, vice president of business development at 325-rep Triad Advisors. These reps find themselves caught in *deja-vu*: "All of a sudden they're back in that world where there are call centers, where no one picks up the phone," says Dave Fischer, chief managing officer of 200-rep Independent Financial Group.

Marshall Leeds, CEO and president of 180-rep Summit Brokerage Services, says the reps who join Summit are "looking for their last home." They know Summit won't pay them the big signing bonuses that some bigger firms offer, but instead, Leeds says, reps have the security of knowing that they're joining a broker-dealer that is not for sale. That is, they won't have to face the upheaval that comes with a change in ownership. With a sale, changes can come in the form of technology--or even more troubling to advisors, in the form of company policy. For example, Leeds says, a larger company might decide that reps are no longer allowed to operate under their own RIA.

Lon Dolber, chairman and CEO of privately held American Portfolios, has an equity-sharing plan for his 450 reps. They own units of "phantom stock," based on their production. Dolber, who is still a producing rep as well as the company head, doesn't intend to sell his firm. He previously worked at two firms that were acquired, and he was dismayed by the outcome. His equity-sharing plan isn't just an intellectual exercise: Dolber says it gives him a ready-made ownership mechanism should he take his company public.



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DELIBERATE GROWTH

Many smaller broker-dealers want to grow without losing the personalized character that sets them apart. Auld, for example, would like to see Berthel Fisher grow from \$52 million to \$100 million in annual revenue in about three years. He would prefer not to double the rep count, now 325, to get to \$100 million, but would rather add fewer, higher-producing reps. He also doesn't want to get too hung up on his three-year time frame. "One of the reasons I came here is because I have the luxury of growing the firm on my schedule," says Auld, who joined the

company last September after overseeing rapid growth at broker-dealer Next Financial Group.

Managing growth is indeed a difficult proposition for midsize firms, says Charles "Chip" Roame, managing principal of Tiburon Strategic Advisors. "There's always a market for the small, homey B-D," Roame says. But when that homey broker-dealer starts to grow, it enters tricky terrain, losing its main selling point while having to beef up its technology and product offerings to compete with the biggest firms. "The midsize guy is the one in trouble," Roame says.

Sometimes growing means discontinuing relationships with reps who don't meet performance targets. Kevin Twohy, vice president of partner development at 380-rep PlanMember Securities, says his firm let go 200 reps over the past three years. PlanMember generally looks for reps who generate a minimum of \$150,000 in annual revenue. The B-D assumes the same compliance liability for all its reps, and it shouldn't have to shoulder that responsibility for those who aren't earning enough to justify their 90% payouts, Twohy says.

Like Berthel Fisher, PlanMember is shooting for \$100 million in annual revenue. The firm pulled in \$30 million in 2006, and officials hope to reach \$100 million within the next three to four years; Twohy expects the company's rep count to increase to between 700 and 900. Like many peers, PlanMember has added new compliance staff in recent years and expects to add more this year. Even so, PlanMember won't be able to maintain its current four-to-one ratio of reps to home-office employees. But Twohy says the company will retain other distinctive elements of its service, such as the call center that frees up advisors by answering their clients' routine questions.

Summit is looking to grow through acquisition, Leeds says. The firm has the capital to buy a midsize firm, and he could envision bringing on hundreds of reps. "Without a doubt, service would take a little hiccup," Leeds acknowledges. He would take the transition very slowly to minimize disruptions.

As they chase growth, many smaller B-Ds are optimistically heading into the difficult territory that Roame describes. Small firms that want to stay small can focus very successfully on a niche market based on a product, geographic area or specific type of client, without having to offer the depth and breadth of service that the big firms provide, he notes.

However, small and midsize firms with ambitious growth goals will be expected to provide services comparable to those of broker-dealer behemoth Linsco/Private Ledger, for example, even though they lack the resources of these big players. So they have to ramp up their offerings at the same time as they risk losing the personal touch that attracted reps to them in the first place. "The middle strategy starts to get confusing," Roame says. Some firms might not make it: "I still think the barbell effect would be my prediction."

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