

**SCOTIABANK ACQUISITION OF DUNDEE WEALTH: A STRATEGIC  
ANALYSIS OF BRANDING, ADVISOR MODELS, AND CUSTOMER  
SEGMENTATION**

by

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## **Abstract**

With the completion of the acquisition of Dundee Wealth on February 1, 2011, Scotiabank now has two full-service investment broker-dealers – ScotiaMcLeod and DWM Securities. Each firm is pursuing a different strategy in order to attract the right advisors and the right clients. This paper addresses the questions of whether to retain, merge, or sell the DWM Securities brand; whether to keep both the Independent Agent and the Employee advisor models; and what customer segment(s) should be targeted – status quo (affluent plus high net worth) or high net worth focus only. A thoughtful analysis of the external environment, in particular advisor segments and customer segments, produced several alternatives for consideration. After further analysis, I recommend that the DWM Securities brand be retained along with both advisor models, and that a high net worth customer strategic focus be implemented for ScotiaMcLeod only.

**Keywords:** full-service broker-dealer; Independent Agent advisor; Employee advisor; affluent; high net worth.

This paper is dedicated to my wife, Pamela, who has always been there to offer support and encouragement. Her unwavering commitment to our family, and her courageous fight against cancer, inspire me to be a better person. Without her, my accomplishments in life would not have been possible, including this paper.

Love,

Gordon

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Cheers,

Gordon

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## Glossary

<b>Term</b>	<b>Definition</b>
<b>Advisor Managed</b>	A discretionary account where the AUM are directly managed by the advisor.
<b>AUM</b>	Assets under management - The market value of assets being managed on behalf of investors.
<b>Big Six</b>	A name given to the six largest banks in Canada.
<b>BNS</b>	Bank of Nova Scotia (or Scotiabank)
<b>Centre of Influence</b>	Influential people who are willing to provide sales a lead.
<b>CFO</b>	Chief Financial Officer – Primarily responsible for managing financial risk, financial planning, record keeping, and reporting.
<b>Commercial Banking</b>	Providing services, such as: accepting deposits, giving loans, brokering investments, etc., to businesses.
<b>Commission</b>	A service charge assessed by a broker of investment advisor in return for providing investment advice and/or handling the purchase or sale of a security.
<b>Discount Broker</b>	A stockbroker who carries out buy and sell orders at a reduced commission compared to a full-service broker, but provides no investment advice.
<b>Discretionary Portfolio Management</b>	Client allows a broker to act on his/her behalf to make certain types of trades without prior consent from the client.
<b>DWMS</b>	Dundee Wealth Management Securities
<b>Fee-Based Account</b>	An investment account in which the advisor's compensation is based on a set percentage of the client's assets instead of on commissions.
<b>Financial Advisor</b>	One who provides financial advice or guidance to customers in return for compensation. In Canada, financial

Term	Definition
	advisors are MFDA regulated and primarily provide financial planning and mutual funds.
<b>Financial Institution</b>	An establishment that focuses on dealing with financial transactions, such as investments, loans, and deposits (i.e. banks, trust companies, insurance companies, and investment dealers).
<b>Financial Planning</b>	A comprehensive evaluation of an investor's current and future financial state to determine if a person's financial goals can be met, and what steps need to be taken to ensure that they are.
<b>FC</b>	Fixed Cost(s) – Fixed costs are business expenses that are not dependent on the level of goods/services produced.
<b>Full-Service Investment Broker-Dealer</b>	A broker that provides a large variety of services to its clients, including research and advice, retirement planning, tax tips, and much more. Commissions are much higher than those at discount brokers.
<b>HNW</b>	High Net Worth – A classification used by the financial services industry to denote an individual or a family with high net worth, which is generally quoted in terms of liquid assets above a certain dollar amount.
<b>IIROC</b>	Investment Industry Regulatory Organization of Canada, which oversees all investment dealers and trading activity on debt and equity marketplaces in Canada.
<b>Investable Assets</b>	Liquid assets that you can invest (e.g. cash).
<b>Investment Advice</b>	Any recommendation or guidance that attempts to educate, inform, or guide an investor regarding a particular investment product or series of products.
<b>Investment Advisors</b>	Any person or group that makes investment recommendations or conducts securities analysis in return for a fee. In Canada investment advisors are IIROC regulated.
<b>Investment Banking</b>	A specific division of banking related to the creation of capital for other companies. Investment banks underwrite securities for corporations and aid in the sale of securities to investors. They also facilitate

Term	Definition
	mergers and acquisitions.
<b>Investment Management</b>	A generic term that most commonly refers to the buying and selling of investments within a portfolio. It can be done either by the consumer or a professional, and can be passive, active, aggressive, or conservative.
<b>Load</b>	A sales charge or commission charged to an investor in the purchase or sale of a mutual fund. The investor pays the load, which goes to compensate a sales intermediary (i.e. financial advisor, investment advisor, etc.).
<b>Loss Leader</b>	A product/service sold at a low price (at cost or below cost) to stimulate other profitable sales.
<b>Managed Assets</b>	Assets under discretionary management.
<b>MFDA</b>	Mutual Fund Dealer Association of Canada is the national self-regulatory organization for the distribution side of the Canadian mutual fund industry.
<b>Mutual Funds</b>	An investment vehicle that is made up of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, money market instruments, etc.
<b>No-Load</b>	No sales charge or commission in the purchase/sale of a mutual fund.
<b>Operating Leverage</b>	Operating leverage is a measure of how revenue growth translates into growth in operating income. It is a measure of leverage, and of how risky a company's operating income is. A business that has a higher proportion of fixed costs to variable costs is said to have used more operating leverage; businesses with lower fixed costs and higher variable costs are said to employ less operating leverage. One measure for operating leverage = $FC/VC$ .
<b>Retail Banking</b>	Providing services, such as: accepting deposits, giving loans, brokering investments, etc., to individuals.
<b>Return on Invested Capital (ROIC)</b>	A financial measure that quantifies how well a company/industry generates cash flow relative to the capital invested. It is defined as net operating income less

Term	Definition
	adjusted taxes, divided by invested capital, and is usually expressed as a percentage.
<b>SM</b>	ScotiaMcLeod
<b>VC</b>	Variable Cost(s) – Variable costs are expenses that change in proportion to the activity of a business.
<b>Wealth Management</b>	A professional service, which is the combination of financial/investment advice, accounting/tax services, and legal/estate planning. In general, wealth management is more than just investment advice, as it can encompass all parts of a person's financial life.

# 1 Introduction

On February 1, 2011, Scotiabank (BNS) completed its acquisition of Dundee Wealth from the Goodman-family-controlled Dundee Corporation. As a result of this acquisition, BNS will become the fourth largest mutual fund provider in Canada, and the third largest among the country's leading banks.<sup>1</sup> The deal, while not unexpected, came more quickly than anticipated, and appears to have been put together hastily; as such, many details still need to be worked out.

Much of the focus has been on how BNS will integrate Dundee Wealth's investment management business, specifically Dynamic Mutual Funds, into its own wealth management business. Of lesser note however, is that with the acquisition, BNS now has two retail full-service investment broker-dealer<sup>2</sup> platforms – ScotiaMcLeod (SM) and DWM Securities (DWMS). While both SM and DWMS offer many of the same products and services, each platform offers its respective advisors a different advisor model – DWMS provides an *Independent Agent* model, while SM provides an *Employee* model<sup>3</sup>.

This paper will focus on the integration of SM and DWMS, and will look at the issue from the corporate (BNS's) perspective. As part of the analysis, the interests of all stakeholders - clients, investing public, management, shareholders, and advisors – will be taken into consideration. In particular, this paper will initially address the following questions:

- Should BNS retain the DWMS brand?

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<sup>1</sup> Based on figures reported by the Investment Funds Institute of Canada (IFIC).

<sup>2</sup> Broker and dealer will be used interchangeably/synonymously throughout this paper; technically, a broker is only an agent who executes orders on behalf of clients, whereas a dealer acts as a principal and trades for his/her own account. Most brokerages act as both brokers and principals, so the term broker-dealer is commonly used to describe them.

<sup>3</sup> The *Employee* model is typical within the bank-owned broker-dealer firms where investment advisors receive lower payouts in exchange for more operational and cost support (e.g. premises, technology, staff, marketing, back office, etc.). The *Independent Agent* model offers higher payouts to advisors, but the advisor is responsible for most of the operational decisions and costs listed above.

- Should BNS offer advisors both the Independent Agent model and the Employee model?

This paper, including the Introduction is divided into five sections. Section 2 will provide an overview of BNS and the subsidiaries in question including current position, performance, and any current issues or problems. Section 3 will be an external analysis to identify relevant industry players, opportunities and threats facing the industry, sources of competitive advantage, how firms stack up against the sources of advantage, and the strengths and weaknesses of BNS, SM, and DWMS. Section 4 will outline strategic alternatives to the questions posed above, along with other options BNS should consider to exploit opportunities and strengths while mitigating any weaknesses and threats. Finally, Section 5 summarizes the feasibility of each option and concludes with a recommended alternative.

## 2 Organizational Overview

### 2.1 Scotiabank

Scotiabank (BNS-T) is one of North America's premier financial institutions, and **Canada's most 'international bank'**<sup>4</sup>. Founded in 1832 and headquartered in Canada, the bank employs over 75,000 people worldwide, and offers a diverse range of products and services to some 18.6 million customers, in more than 50 countries. BNS is divided into four business lines:

- Canadian Banking – Canadian Banking provides a diverse range of financial advice, solutions and services to more than 7.6 million retail, small business, and commercial clients, through a network of roughly 1,000 branches, 3,000 automated banking machines (ABM's), as well as telephone and internet banking, and third-party channels.
- International Banking – International Banking encompasses BNS's retail and commercial banking operations in more than 45 countries outside Canada – 48,000 employees, 11 million customers, a network of approximately 2,000 branches/offices and 3,700 ABM's, as well as telephone and Internet banking, in-store banking kiosks, and specialized sales forces.
- Global Banking and Markets – Global Banking and Markets is the wholesale banking arm of the bank, providing investment banking products and services to corporate, government, and institutional clients around the world.
- Global Wealth Management – Global Wealth Management combines wealth management and insurance services in Canada and internationally to affluent and high net-worth clients.

Scotiabank's framework for success involves:

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<sup>4</sup> Canadian financial institutions have a global reputation for stability.

- Executing its “Five-Point Strategy”;
  - Sustainable and profitable revenue growth
  - Capital and balance sheet management
  - Leadership
  - Prudent risk management and appetite
  - Efficiency and expense management
- Fostering a culture of collaboration;
- Living its values of integrity, respect, commitment, and spirit;
- All with a core purpose to be the best at helping customers become financially better off by providing practical advice and relevant solutions.

## 2.2 ScotiaMcLeod

Four young entrepreneurs originally formed ScotiaMcLeod in 1921 as a partnership: Donald McLeod, William Young, James Weir and John Ratcliffe. By the 1970’s, McLeod Young Weir offered a full range of investment banking services including: bond, stock, and money market trading; corporate and government finance; mergers and acquisitions (M&A); commodities and futures; personal investment services; and mutual funds. In 1987, BNS purchased McLeod Young Weir.

Today, ScotiaMcLeod is Canada’s fourth largest retail full-service brokerage, with over 750 advisors (plus 1,100 support staff) serving roughly 150,000 client households in more than 88 branches/sub-branches across the country. SM’s vision is “to be the leader at winning and retaining primary advisor relationships”. SM’s mission is to offer investment advice and money management. Investment advisors are able to offer a full range of investment products; and through SM’s *Team of Experts*<sup>5</sup>, advisors are able to offer comprehensive wealth management or planning services such as retirement planning, financial planning, will & estate planning, tax strategies, maximizing retirement income, philanthropy, and business planning.

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<sup>5</sup> Scotiabank provides teams of salaried wealth management specialists who support advisors in different regions.

ScotiaMcLeod's strategy is based on:

- Objectives:
  - Retain and attract more *right* advisors
  - Market and deliver strong value propositions
  - Create more capacity to grow, and reduce cost to serve
- Scope:
  - Affluent and high net worth clients
- Means:
  - Growth support – growth bonus, Growth Council/Club
  - Advisor training programs
  - Experienced recruiting
  - Centre of influence programs
  - “Second Opinion” campaign
  - Referral programs
  - “Team of Experts”
  - Increased collaboration between and within business lines
  - Technology

For entrepreneurial-spirited investment advisors, SM offers a small, boutique firm feel, with the strength and brand of BNS backing them up. The platform for advisors is an Employee model, where advisors are compensated through a combination of salary, commissions, growth bonus, partnership program (revenue sharing), and benefits. Commission pay-outs can be up to 51% of annual gross revenue, and are determined by a grid, which is dependent on: advisor experience, total gross annual revenue, and type of revenue (e.g. fee-based, transactional).

## 2.3 Dundee Wealth

Since its creation in 1998, Dundee Wealth (DW-T) has used strategic acquisitions to expand its investment management and advisory businesses by finding new distribution partners in key growth territories. The goal was to create a diversified and fully integrated wealth management business combining product development, investment management, and distribution that could leverage the strengths that each of those businesses afforded the others.

Dundee Wealth is headquartered in Toronto, Ontario, and through its partners and subsidiaries, employs over 1,200 people in North America and Europe. DW creates and provides investment solutions and advisory services for financial advisors, institutions, corporations, and foundations through two main businesses:

- *Investment Management* - Dynamic Funds is an award-winning family of funds designed to provide investors with a full spectrum of investment solutions.
- *Financial Advisory* - DWM Securities offer investors a comprehensive selection of financial services and products that are distributed through a network of approximately 1,200 independent advisors. DWMS is a full-service retail broker and a member of the Investment Industry Regulatory Organization of Canada (IIROC)<sup>6</sup>. Advisors are able to provide a suite of products and services to investors, similar to those offered by SM. DWMS offers advisors an Independent Agent business model where advisors can earn commission pay-outs up to 85% of annual gross revenue, but are responsible for all their own operational and marketing costs.

In summary, as a result of the acquisition of DW, BNS now has two successful retail full-service investment dealer platforms, and has just started to address the questions posed in the Introduction. The next section will provide an external analysis,

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<sup>6</sup> IIROC is the national self-regulatory organization that oversees all investment dealers and trading activity on debt and equity marketplaces in Canada.

essentially a SWOT analysis, which will identify SM's and DWMS's key strengths and weaknesses, and the opportunities and threats facing the organization(s). This will serve as a basis for developing, evaluating, and selecting the organization(s)' strategic options, within the context of BNS's framework for success.

## 3 External Analysis

### 3.1 Industry Overview

The Canadian securities industry plays a key role in Canada's financial services sector. It enables businesses and governments to raise debt and equity capital, and allows investors to trade with confidence in open and fair capital markets. The industry is regulated at the national (IIROC and MFDA<sup>7</sup>) and provincial/territorial level; and the exchanges (e.g. the Toronto Stock Exchange) play an important regulatory role as well.

Canada's securities industry dates back to 1832, when shares of Canada's first railroad were traded by a small group of brokers in a Montreal coffee house. The chartered banks became the first and leading underwriters of Canadian securities. They maintained their lead for many years; however, by the turn of the 20<sup>th</sup> century, their dominance in underwriting had been diminished by the increasing number of specialized underwriting firms. By 1927, about sixty percent of securities issued were underwritten by five investment dealers and one bank, with the five dealers accounting for 47% of the total.

Until the late 1980's, most of the independent securities firms were owned by their senior partners, a structure that became increasingly difficult to maintain due to increasing demands for capital, growing global competition, greater market volatility, and cyclical earnings performance. In the mid-1980's, the federal and provincial governments introduced legislative changes to open up ownership of the securities industry to Canadian banks and trust companies, as well as foreign securities firms. In order to enter the retail brokerage sector and to strengthen their activities in investment banking, five of the 'Big Six'<sup>8</sup> banks acquired major investment dealers, while the sixth

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<sup>7</sup> The Mutual Fund Dealers Association of Canada (MFDA) is the national self-regulatory organization for the distribution side of the Canadian mutual fund industry.

<sup>8</sup> The six largest banks in Canada.

built its own brokerage from the ground up; today, all of Canada’s large integrated securities firms are bank-owned.

The securities industry is made of integrated, institutional and retail firms. Integrated firms offer products and services that cover all aspects of the industry, including both institutional and retail markets. Institutional firms provide services to pension funds, insurance companies, mutual fund organizations, banks, and trust companies; while retail firms, which include full-service firms and discount brokers, offer a wide range of products and services to retail investors. **For this paper, the industry context for comparison and discussion will be confined to the full-service retail brokerage industry (IIROC member investment dealer firms).**

Table 3.1 lists the suite of products and services a retail full-service investment dealer firm generally provides to its clients:

**Table 3.1 - Full-Service Broker-Dealer Products and Services**

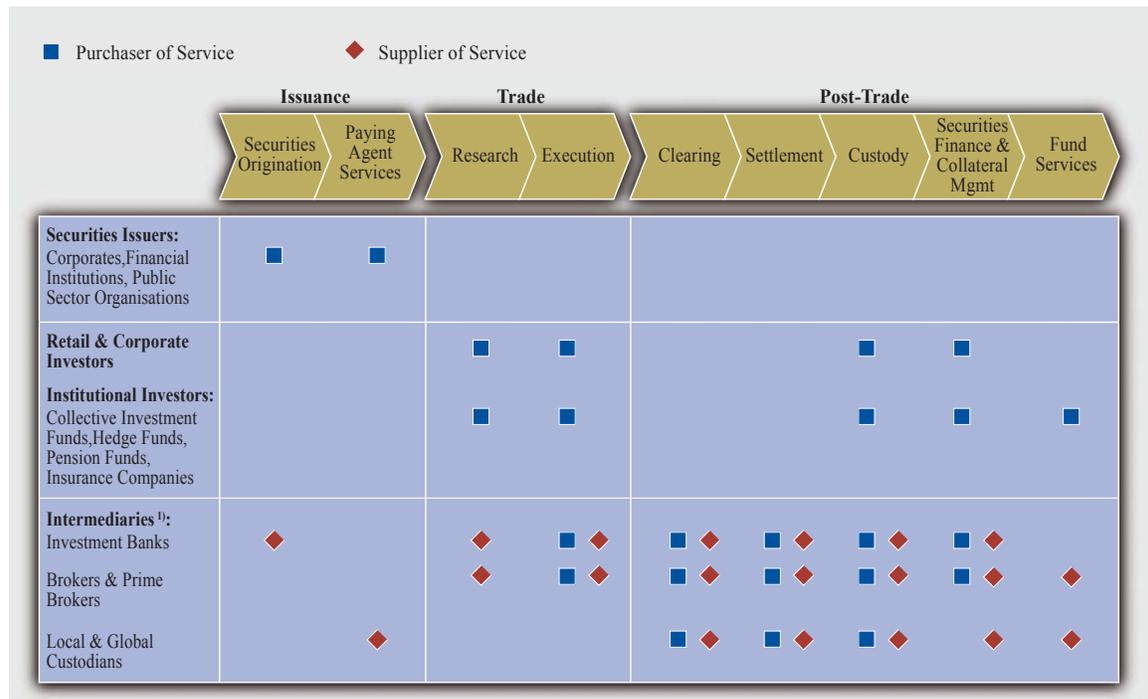
Products	Services
<ul style="list-style-type: none"> <li>• Common and preferred stocks</li> <li>• Bonds</li> <li>• Options and futures</li> <li>• Commodities</li> <li>• Mutual funds and ETF’s</li> <li>• New issues</li> <li>• Alternative investment strategies</li> <li>• Insurance</li> </ul>	<ul style="list-style-type: none"> <li>• Research/advice</li> <li>• Financial planning</li> <li>• Tax planning</li> <li>• Retirement planning</li> <li>• Succession planning</li> <li>• Wealth protection</li> <li>• Estate planning</li> <li>• Charitable giving</li> <li>• Discretionary portfolio management</li> <li>• Personal relationship</li> </ul>

The current industry business model used to deliver retail full-service brokerage services and products to investors is through investment advisors; however, there are a number of intermediaries before the investor, including custodians, broker-dealer firms, investment banks, and securities issuers.

### 3.2 Industry Value Chain

Private and public sector organizations raise needed capital by issuing debt and equity securities, which are underwritten by investment banks. Investment banks then sell these securities, along with research, to retail, corporate, and institutional investors through broker-dealer firms. These transactions are cleared and settled by the securities exchanges, and the domestic or foreign securities are held at a custodian bank in the home market or global custodian, respectively.

Figure 3.1 - Industry Value Chain



1) An intermediary may purchase and supply multiple services in the value chain, sometimes via different subsidiaries. A supplier may purchase services from a higher-tier intermediary.

Source: *European Central Bank*, "The Securities Custody Industry", Occasional Paper Series, Number 68/August 2007

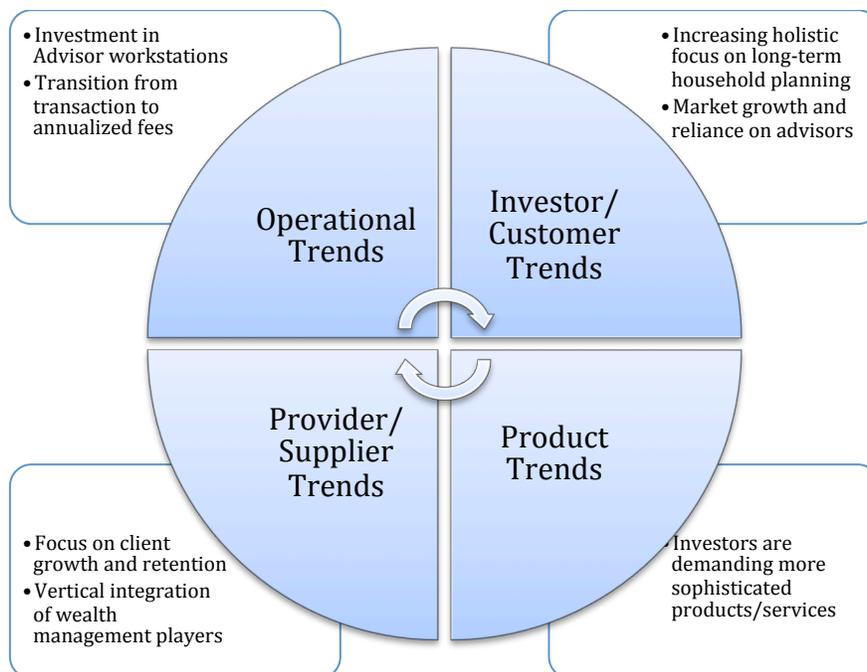
The securities industry today revolves around processing and dissemination of information on the one hand, and providing liquidity, financing, or yield-enhancing solutions on the other. Doing both functions well requires large investments in information technology. This **technology must continuously be adapted to changes in**

market practice, industry standards, legal requirements, and fiscal processes. These changes are driving up fixed costs and shrinking margins, resulting not only in further investment in technology, but industry consolidation, and vertical integration.

### 3.3 Industry Trends

The following figure highlights trends in Canadian wealth management in general, including the retail full-service broker-dealer industry:

Figure 3.2 - Canadian Wealth Management Trends



Source: Capgemini (2005), "Canadian Wealth Management Market 2004/2005 Report"

Investors today are more sophisticated and knowledgeable, and want better professional advice. Firms and advisors are targeting multiple customer segments; and **given recent economic and capital market trials and tribulations, firms and advisors are transitioning from transaction-based revenue, to fees based on AUM in order to**

**generate higher, more stable revenues. To improve operational efficiency and free-up more time for client acquisition and retention, firms and advisors are investing more money in technology.** Following is a more detailed analysis of these trends.

### 3.4 Competitors

The full-service broker industry currently consists of roughly 200 firms nationally,<sup>9</sup> and roughly 10,000 investment advisors.<sup>10</sup> Broker-dealer organizations can be divided into four distinct groups/clusters based on scope or type of investor served, national distribution, and independence:

- *Boutiques* (e.g. Richardson GMP, Wellington West) may be national or regional, and offer an Employee model that compensates advisors based on a revenue grid. The grid does not generally distinguish between the types of revenue (e.g. transactional, fee-based, etc.).
- *Regional Independents* (e.g. Odlum Brown, Leede Financial) only distribute products and services within certain regions (e.g. Western Canada, Eastern Canada). They offer advisors an Employee model that compensates advisors based on a revenue grid, which may or may not distinguish between revenue types, and treat these types differently.
- *National Independents* (e.g. Raymond James, Canaccord Financial, Edward Jones) are generally part of an integrated investment-banking firm. Firms such as Raymond James and Canaccord Financial offer advisors a higher pay-out Employee model, as well as an Independent Agent model.
- *Bank-Owned Broker-Dealers* (i.e. ScotiaMcLeod, BMO Nesbit Burns, TD Waterhouse PIA, RBC Dominion Securities, CIBC Wood Gundy, National Bank Financial) have the largest scale and are part of fully integrated (vertically/horizontally) banks. Advisors are compensated based on the Employee model.

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<sup>9</sup> IIROC

<sup>10</sup> *Investor Economics* (2010) “The Retail Brokerage Report – Spring 2010”

Market share in terms of AUM is concentrated in the bank-owned cluster, with RBC Dominion Securities ranked as number one. The ‘Big Six’ owned dealer firms control over 70% of AUM; the top 10 firms, including the national independents, control over 85% of AUM<sup>11</sup>. The boutiques and regional independents have 15% of the market. **Of note, is that the national independents and boutiques, while controlling a lower percentage of AUM, appear to be growing AUM at a higher rate**, which is illustrated in Table 3.2.

**Table 3.2 - Full-Service Brokerage Asset Ranking<sup>12</sup>**

Ranked by assets in billions of dollars, three-month growth rates and asset change

	Asset rank		Growth rank	
	Mar 2010	Dec 2009	3-mo growth rate	3-mo asset change
<b>Full-service brokerage assets</b>	<b>\$715</b>	<b>\$694</b>	<b>3.1%</b>	<b>\$21</b>
RBC Dominion Securities	1	1	10	1
CIBC Wood Gundy	2	2	12	3
BMO Nesbitt Burns	3	3	8	2
ScotiaMcLeod	4	4	11	4
TD Waterhouse Private Investment Advice	5	5	9	5
<b>Top 5</b>	<b>\$497</b>	<b>\$483</b>	<b>2.9%</b>	<b>\$14</b>
<b>Market share</b>	<b>69.4%</b>	<b>69.5%</b>		
National Bank Financial	6	6	13	6
Dundee Securities	7	7	5	8
Desjardins Securities	8	8	7	9
Raymond James	9	9	2	7
HSBC Securities	10	10	6	11
<b>Top 10</b>	<b>\$614</b>	<b>\$595</b>	<b>3.1%</b>	<b>\$18</b>
<b>Market share</b>	<b>85.8%</b>	<b>85.8%</b>		
Canaccord Financial	11	11	3	10
Macquarie Private Wealth	12	12	4	12
Wellington West	13	13	14	14
Odlum Brown	14	14	15	15
Credential Securities	15	15	16	16
ATB Securities	16	16	1	13

Source: *Investor Economics* (2010), “The Retail Brokerage Report – Spring 2010”

<sup>11</sup> *Investor Economics* (2010), “The Retail Brokerage Report – Spring 2010”

<sup>12</sup> Reproduced with the permission of Investor Economics. Any and all conclusions drawn from this table for the purpose of this paper are that of the author(s) and not of Investor Economics.

The bank-owned broker firms also control, on average, the larger investment accounts, but once again, **it is the national independents that appear to be growing average account size at a higher rate.** Also of note, is that HSBC Securities, which is part of a large multi-national bank, controls on average the largest investment accounts (see Table 3.3).

**Table 3.3 - Full-Service Brokerage Average Account Size<sup>13</sup>**

Ranked by average account size in thousands of dollars

	Account size rank		Growth rank 3-mo growth rate
	Mar 2010	Dec 2009	
<b>Full-service brokers</b>	<b>\$126.2</b>	<b>\$124.0</b>	<b>1.8%</b>
HSBC Securities	1	1	15
RBC Dominion Securities	2	2	12
CIBC Wood Gundy	3	3	7
TD Waterhouse Private Investment Advice	4	4	10
BMO Nesbitt Burns	5	5	6
<b>Top 5</b>	<b>\$190.2</b>	<b>\$187.8</b>	<b>1.3%</b>
ScotiaMcLeod	6	6	13
Odlum Brown	7	7	11
Wellington West	8	9	9
National Bank Financial	9	8	14
ATB Securities	10	10	16
<b>Next 5</b>	<b>\$138.2</b>	<b>\$136.4</b>	<b>1.3%</b>
Desjardins Securities	11	11	8
Raymond James	12	12	2
Credential Securities	13	13	5
Dundee Securities	14	14	4
Macquarie Private Wealth	15	15	3
Canaccord Financial	16	16	1

Source: *Investor Economics* (2010), "The Retail Brokerage Report – Spring 2010"

<sup>13</sup> Reproduced with the permission of Investor Economics. Any and all conclusions drawn from this table for the purpose of this paper are that of the author(s) and not of Investor Economics.

### 3.5 Customers

As previously mentioned in the industry value chain analysis and industry trends analysis (Sections 3.2 and 3.3), industry costs are trending higher. The response by brokerage firms, and advisors in particular, has been, in part, to increase productivity by targeting fewer, but larger customer accounts. To focus their efforts, the market has generally been divided into four distinct groups as shown in Table 3.4:

Table 3.4 - Customer Segments<sup>14</sup>

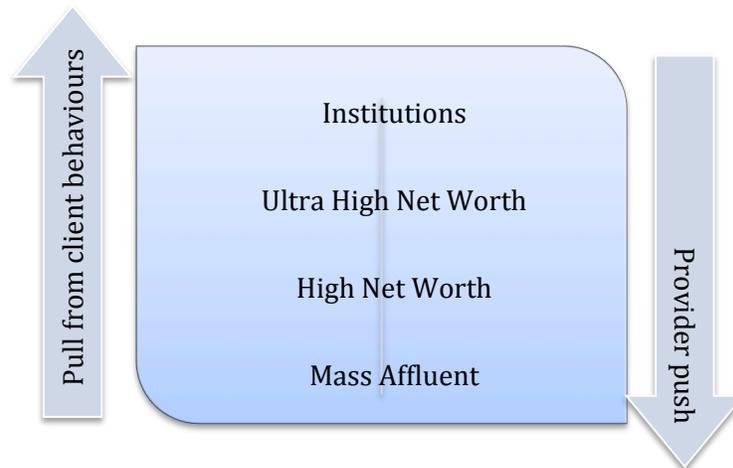
Segment	Definition	People (000's)	% of Population	\$Billions	% of Market
<b>Pre-Mass Affluent</b>	Under \$100k	5,265	17.0	108	6.1
<b>Mass Affluent</b>	\$100k-\$1MM	1,897	6.1	513	29.0
<b>High Net Worth</b>	\$1MM-\$20MM	444	1.4	852	48.2
<b>Ultra High Net Worth</b>	Over \$20MM	7	< 1	296	16.7
<b>Total</b>		<b>7,613</b>		<b>1,769</b>	

Source: Capgemini (2005), "The Canadian Wealth Management Market 2004/2005 Report"

Customer segments are adopting the investment behaviours and demands of the segments above them, seeking more sophisticated products and services (see Figure 3.3). The higher customer segments can be used as a leading indicator for lower customer segments.

<sup>14</sup> Reproduced with the permission of Franklin Templeton. Any and all conclusions drawn from this table for the purpose of this paper are that of the author(s) and not of Franklin Templeton. **This paper will treat high net worth and ultra-high net worth as one customer segment.**

Figure 3.3 - Customer Preferences and Behaviours



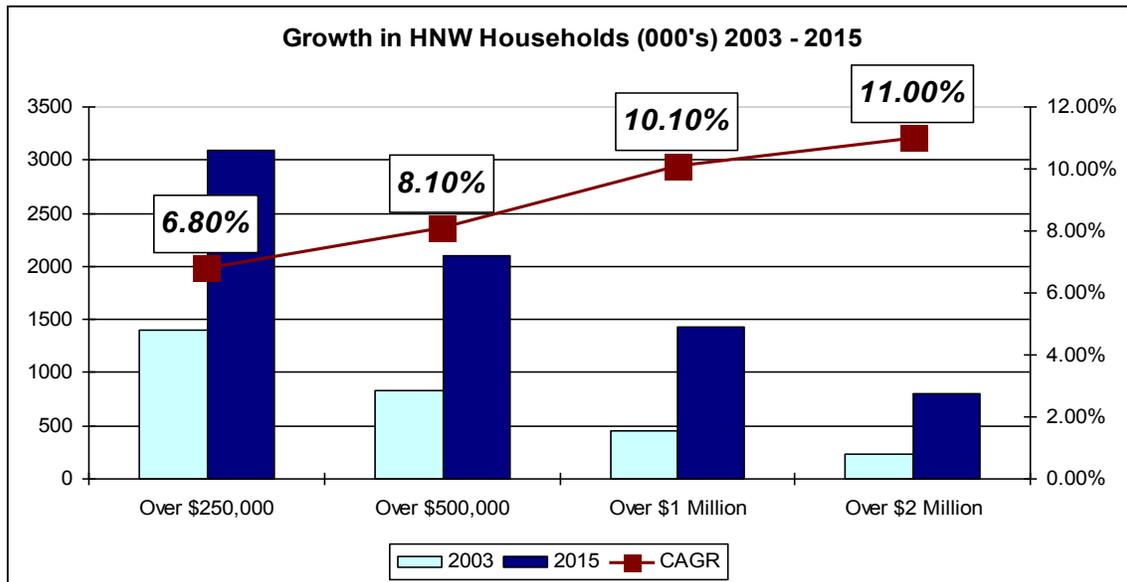
Source: Capgemini (2005), "Canadian Wealth Management Market 2004/2005 Report"

While all customer segments may want the same products and services, not all customer segments offer broker-dealer firms and advisors the same opportunity to improve productivity. According to industry researcher, *Investor Economics*, **the number of HNW households in Canada is set to double by 2018**. At the end of 2009, Canada had more than 550,000 high net worth (HNW) people. AUM of HNW people totalled roughly \$1.7 trillion, which was marginally higher from the \$1.6 trillion in AUM at the end of 2007. Assuming there is reasonable economic growth, it is estimated that by 2018, there will be approximately 900,000 HNW people with at least \$1,000,000 in investable assets.<sup>15</sup>

As shown in Figure 3.4, the wealthier customer segments are growing at the fastest rate; so brokerage firms and advisors are increasingly targeting them in order to improve productivity. Firms/advisors are able to generate more revenue for the same amount of work (or the same amount of revenue for less work) by targeting HNW customers vs. affluent customers. In order to attract HNW investors, more research is being directed towards understanding what they want.

<sup>15</sup> *Advisor.ca* (2011), "HNW Report: What wealth wants"

Figure 3.4 - Growth in HNW Households<sup>16</sup>

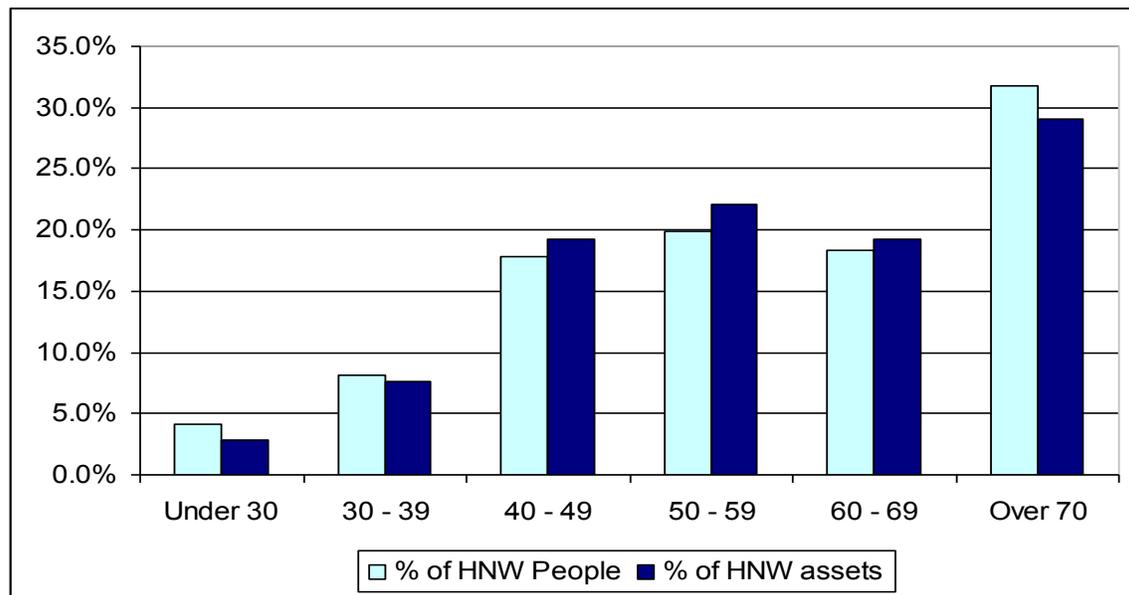


Source: *Capgemini* (2005), "The Canadian Wealth Management Market 2004/2005 Report"

According to *Capgemini*, in their report: "The Canadian Wealth Management Market 2004/2005", 7.5% of the population in Canada controls over 90% of investable assets; the top 1.5% of the population controls over 65% of investable assets. As Figure 3.5 shows, HNW investors over the age of 60 control 50% of total investable assets; Canadians over age 70 represent almost a third of the HNW market.

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Figure 3.5 - Percentage of HNW People/Assets by Age Group<sup>17</sup>



Source: Capgemini (2005), "The Canadian Wealth Management Market 2004/2005 Report"

How do HNW investors choose an advisor? Performance - but performance is only one of several factors. In order of importance, these other factors are:<sup>18</sup>

- Brand/reputation
- Transparency
- Quality of interaction/relationship
- Proactive and deep insight about needs
- Product/service breadth
- Communication of processes
- Disciplined investment style
- Research capabilities
- Product/service specialties
- Retention of talent

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<sup>18</sup> *Economist Intelligence Unit* (2008), "High-net-worth investors and asset managers: Bridging the gap"

While investment management services are important, they are only part of the complete wealth management suite. **Canadian HNW investors are challenging their advisors to deliver more than just investment advice**; the list of planning services increasingly being sought after includes:

- Portfolio management
- Retirement planning
- Tax planning
- Inheritance/estate plans
- Trust planning and administration
- Next generation mentoring
- Succession planning

The reasons HNW investors cited most for terminating the services of an advisor/firm were:

- Change in strategy/allocation
- Performance
- Change in family situation
- Outgrowing advisor

### **3.5.1 Summary of Customer Opportunities and Threats**

In short, all investors want their own CFO who can provide them with more planning; and are willing and able to change brokerage firms and advisors in order to get it. Table 3.5 summarizes possible customer opportunities and threats.

**Table 3.5 - Summary of Customer Opportunities and Threats**

Opportunities	Threats
<ul style="list-style-type: none"> <li>• Targeting HNW prospects will allow firms and advisors to be more productive.</li> <li>• Firms/advisors who can deliver more without significantly increasing costs will have an advantage.</li> <li>• The 50-59 and 40-49 customer segments are the second and third largest customer segments in terms of percentage of HNW people and percentage of HNW assets, respectively. These two customer segments have longer investing time horizons and they likely have more (unmet) needs; therefore, there is more opportunity to add value and earn revenue; they also stand to inherit substantial wealth from the Over Age 70 customer segment.</li> <li>• HNW investors are asking for more service and products, and may be willing to pay more.</li> </ul>	<ul style="list-style-type: none"> <li>• Canadian investors as a whole are challenging their advisors/firm to deliver more; to do so may entail higher costs and lower margins.</li> <li>• Unmet needs are going to be met by another advisor/firm.</li> <li>• While the Over Age 70 customer segment represents the highest percentage of HNW people and percentage of HNW assets, they also have the shortest investing time horizons and most likely have most, if not all, of their planning needs met.</li> </ul>

### 3.6 Suppliers

Investment advisors are considered both customers (buyers of research, execution, back office operations, etc.) and suppliers to the full-service brokerage channel<sup>19</sup> of product and service distribution; however, **this paper will analyse advisors as suppliers.**

After a tumultuous few years, in which advisors suffered then began to recover from the global financial crisis, it appears that it's full speed ahead for the foreseeable future. Although the crisis hit all parts of the financial services industry, the full-service

<sup>19</sup> A substitute to the full-service broker-dealer channel and posing an increasing threat of entry is the *financial advisory channel*, which has historically offered financial planning and mutual funds. Advisors who work in the full-service channel are commonly referred to as investment advisors, while those that work in the financial advisory channel are commonly referred to as financial advisors.

brokerage channel suffered the biggest blow among the various front-line retail investment businesses. Advisors in other channels didn't have quite the same level of exposure to the markets, so didn't suffer as acutely when the markets went into the tank. Advisors in the financial advisor, banking, and insurance channels, for which the margin of safety may be perceived to be greater, may have taken some share of Canadian wallets from brokers.

**Investment advisors are the major suppliers to the full-service brokerage channel, and the largest cost** - up to 85% of gross revenues in the case of independent broker-dealers firms where advisors are on the Independent Agent model. *Investor Economics* segments advisors into two broad segments based on the 80/20 rule:

- The top 20% of producers in terms of AUM per client
- The remaining 80%

Isolating the top performers from the rest of the investment advisor population is a handy way of drilling into trends, as the industry's top performers generally lead the way. Top advisors are already more productive than the average advisor, and are able to leverage that position into better performance through market cycles.

Advisors have been rebuilding their books steadily, making gains in overall AUM and in their productivity. **The average advisor has seen a healthy gain in AUM to \$82 million in 2011 from \$77 million in 2010; more impressive is this gain in AUM occurred amid a trimming of client rosters, thereby boosting productivity; overall, advisors are shifting their books out of smaller accounts and reporting higher allocations to larger accounts.**<sup>20</sup>

In its inaugural "Annual Report on the State of Retail Wealth Management", *PriceMetrix*<sup>21</sup> revealed several investment advisor trends:

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<sup>20</sup> J. Langton and O. Li (2011), "Lower-end advisors lead rebound", *Investment Executive* Special Feature.

<sup>21</sup> PriceMetrix is a software firm that helps retail wealth management firms and their advisors optimize selling efforts, manage clients, identify growth opportunities, and enhance practice management. Through its exclusive relationships with North American retail wealth management providers, PriceMetrix directly measures aggregated data representing 2.3 million investors, 380 million transactions, 1 million fee-based accounts, 4 million transactional accounts, and over \$850 billion in investment assets.

- Table 3.6 shows that asset and revenue levels for advisors have reached record highs.

**Table 3.6 - Advisor Performance<sup>22</sup>**

Advisor Performance	2008	2009	2010	Growth Since 2008
Advisor Assets (\$M)	\$66.2	\$60.5	\$71.5	8%
Gross Annual Production (\$000)	\$488	\$444	\$522	7%
Top Producers' Production (top 10% of advisors, \$000)	\$1,124	\$1,034	\$1,243	11%
RoA (12 month total revenue/12 month average assets)	0.74%	0.73%	0.73%	-1%
New Accounts Opened per Advisor	14	25	22	57%

Source: *PriceMetrix (2011)*, “Annual Report on the State of Retail Wealth Management”

- Table 3.7 below shows that advisors are looking to increase productivity by focusing on fewer, but more profitable (more AUM) households.

**Table 3.7 - Household Quality<sup>23</sup>**

Household Quality	2008	2009	2010	Growth Since 2008
Households per Advisor	202	201	193	-4%
Households with Less than \$50,000 in Assets (percentage)	56%	50%	45%	-20%
Annual Household Revenue (average)	\$2,453	\$2,405	\$2,944	20%
Households with More than 1 Account (percentage)	51%	52%	54%	6%

Source: *PriceMetrix (2011)*, “Annual Report on the State of Retail Wealth Management”

- Advisors are increasing the number of fee-based accounts to increase and stabilize revenue (see Table 3.8).

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<sup>23</sup> Reproduced with the permission of PriceMetrix. Any and all conclusions drawn from this table for the purpose of this paper are that of the author(s) and not of PriceMetrix.

**Table 3.8 - Fee Business<sup>24</sup>**

Fee Business <sup>4</sup>	2008	2009	2010	Growth Since 2008
Fee Accounts per Advisor	53	61	76	43%
Average Fee Account Size (\$000)	\$289	\$249	\$255	-12%
Fee Assets as a Percentage of All Assets	19%	20%	24%	26%
Fee Accounts Priced Above 1%	71%	62%	60%	-15%
Fee RoA	1.41%	1.31%	1.32%	-6%

Source: *PriceMetrix* (2011), “Annual Report on the State of Retail Wealth Management”

- Transactional business is recovering after the 2008 capital bear market (see Table 3.9).

**Table 3.9 - Transactional Business<sup>25</sup>**

Transactional Business	2008	2009	2010	Growth Since 2008
Equity Trades per Advisor	446	417	457	2%
Equity Trades per Household	3.1	3.0	3.0	-3%
Buys	51.2%	52.9%	52.2%	2%
Average Equity Trade Principal	\$21,932	\$20,744	\$20,060	-9%
Equity Trade Pricing (commissions as a percentage of principal)	1.02%	1.08%	1.15%	13%
Average Equity Ticket	\$224	\$224	\$231	3%
Percentage of Equity Trade Commissions Priced at Full Firm Schedule ('list price')	34.7%	34.3%	32.2%	-7%
Percentage of Discounted Equity Trade Commissions Priced Below \$100	17.4%	17.5%	17.6%	1%

Source: *PriceMetrix* (2011), “Annual Report on the State of Retail Wealth Management”

<sup>24</sup> Reproduced with the permission of PriceMetrix. Any and all conclusions drawn from this table for the purpose of this paper are that of the author(s) and not of PriceMetrix.

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What's interesting is that it appears the channel's high fliers are having a harder time than run-of-the mill producers in recovering lost ground. Among the top 20% of advisors, average AUM is down to roughly \$149 million from \$157 million; in contrast, the remaining 80% of brokers recorded a strong gain in average AUM, pushing their total by a healthy 12.5%, to roughly \$64 million from \$56 million.<sup>26</sup>

The drop in AUM and the resulting decline in productivity for the top 20% is largely a result of a reduction in the largest accounts – those worth more than \$2 million. In contrast, the remaining 80% have seen accounts in the \$250,000 to \$1 million range grow to almost 51% of this broker segment's book, up from 45%; these advisors are also enjoying growth in the \$1 million plus accounts, including those worth more than \$2 million, up to roughly 19% from 16%. Not only are the remaining 80% of advisors driving the increase in overall channel AUM and productivity, they are also leading a trend toward a greater reliance on insurance revenue throughout the channel.

The full-service broker channel can also be segmented based on revenue driver and region:

*Revenue driver* – There are different ways in which an advisor can generate revenue; some advisors focus on commission-generating buy/sell transactions; others focus on charging a flat fee or a percentage fee on AUM. The list of revenue drivers includes:

- Commissions
- Fees
- Spread
- Other

**Fee-based revenue streams are growing at the fastest rate** - over 30% year-over-year growth to March 2010 vs. under 20% for commission revenue, and roughly 25% for all revenues in total; but fee-based revenue can be further segmented as follows:

- Mutual Funds

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<sup>26</sup> J. Lanton and O. Li (2011), "Lower-end advisors lead rebound", *Investment Executive* Special Feature.

- Managed Assets:
  - Fund Wraps
  - Fee-Based Brokerage
  - Discretionary Assets
  - Separately Managed Wraps
  - In-House Managed Wraps
  - Advisor Managed

Within the fee-based segment, managed assets continue their upward trend and now constitute over 25% of all assets. The top drivers of growth in fee-based assets are Advisor Managed (AM), with over 40% year-over-year growth to the end of March 2010, and fee-based brokerage at just under 40% growth.<sup>27</sup>

The growth of fee-based assets, and in particular AM programs at rates well above the overall average asset growth rate of just under 25%, indicates a continued preference for these flexible and more productive non-discretionary and discretionary programs.

*Region* – Table 3.10 looks at the regional distribution of assets and advisors. Assets grew in all regions, particularly in Ontario, which claimed a bigger share of the overall pie at the expense of regions such as Quebec. At the same time, the majority of regions experienced a decrease in advisors year-over-year, with the exception of Ontario and Manitoba and Saskatchewan. Overall, assets grew at faster rate than advisors across all regions, resulting in average AUM per advisor of over \$70 million.

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<sup>27</sup> *Investor Economics* (2010), “The Retail Brokerage Report – Spring 2010”

**Table 3.10 - Full-Service Brokerage Assets and Advisors by Region (March 2010)<sup>28</sup>**

Assets in billions of dollars

	Assets			Growth	
	Mar 2009	Dec 2009	Mar 2010	3-mo	Yr/yr
<b>Canada</b>	<b>\$573</b>	<b>\$694</b>	<b>\$715</b>	<b>3.1%</b>	<b>24.8%</b>
Atlantic	21	27	28	3.1%	28.8%
Quebec	114	136	138	1.1%	21.0%
Ontario	242	290	302	4.3%	24.6%
Manitoba and Saskatchewan	27	33	34	3.2%	24.3%
Alberta	74	93	95	2.2%	28.8%
B.C. and Territories	94	115	119	2.9%	26.2%
	Number of advisors*			Growth	
	Mar 2009	Dec 2009	Mar 2010	3-mo	Yr/yr
<b>Canada</b>	<b>10,430</b>	<b>10,237</b>	<b>10,305</b>	<b>0.7%</b>	<b>-1.2%</b>
Atlantic	500	466	473	1.5%	-5.4%
Quebec	2,007	1,805	1,816	0.6%	-9.5%
Ontario	4,130	4,231	4,266	0.8%	3.3%
Manitoba and Saskatchewan	517	527	537	1.9%	3.8%
Alberta	1,286	1,243	1,264	1.7%	-1.7%
B.C. and Territories	1,990	1,965	1,949	-0.8%	-2.0%

*\*Industry number of advisors is estimated based on survey respondents plus a gross-up factor.*

Source: Investor Economics (2010), "The Retail Brokerage Report – Spring 2010"

### 3.6.1 Summary of Supplier Opportunities and Threats

It is important to highlight that advisors represent a very important, if not the most important, part of the value chain. HNW investors want to work with an advisor; and to be more productive, advisors are increasingly targeting HNW investors, are focusing on generating fee-based revenue, and are more willing to change firms in order to do so. The following table summarizes advisor related opportunities and threats.

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**Table 3.11 - Summary of Supplier Opportunities and Threats**

Opportunities	Threats
<ul style="list-style-type: none"> <li>• Advisors are becoming more productive by targeting HNW investors and focusing on generating fee-based revenue. HNW investors have more complex needs. Firms that can best support advisors in becoming more productive will attract more/better advisors.</li> <li>• Firms with a national footprint allow advisors to be where the HNW investors are.</li> <li>• The customer market is growing at a faster pace than the advisor market.</li> </ul>	<ul style="list-style-type: none"> <li>• The top 20% of advisors are having a tougher time with growth, perhaps because there is less opportunity to increase productivity, and perhaps because the HNW investor is more on the move (including wealth transfer).</li> <li>• Firms are looking to attract advisors and many advisors are making the switch to a new firm.</li> </ul>

### **3.7 Five Forces Synthesis**

The most recent down cycle, in concert with growing regulation, has simultaneously put pressure on the three key elements of the economic equation: revenues, cost, and operational risk management. To combat economic pressures and chart a path to expansion, healthy firms are making larger bets on the future, committing resources and capital to ensure success. Other firms are envisioning a different future in which the channel's business models will multiply and diverge from the current prevalent linkage of planning and sales, as well as the existing advisor compensation paradigms. For example, the trend towards offering the Independent Agent model by the independent broker-dealer firms vs. the Employee model.

There are those in the industry who believe a secular shift away from direct-drive high pay-out compensation, to a salary/bonus structure is inevitable. The drivers include all the previously mentioned pressures: economic, regulatory, operational risk, and the aging of the existing sales force. There is a growing belief that the next generation of advisors would be more suited to the salary/bonus structure, trading off the upside reward of a direct-drive model for the stability and life-balancing of a salary/bonus model.

The following analysis will examine the five competitive forces<sup>29</sup> that influence both the current profitability of the full-service broker-dealer industry, and perhaps more importantly, by analysing all five competitive forces, a more complete picture of what influences industry profitability will identify “game-changing” trends early so that BNS can exploit them, or reshape the forces in its favour.

### 3.7.1 Rivalry

Despite roughly 200 firms and 10,000 investment advisors nationally, rivalry within the full-service brokerage channel is moderate. What factors influence the *intensity* of rivalry?

First, while the number of competitors is numerous, as previously mentioned, the ‘Big Six’ bank owned full-service brokerage firms control over 70% of AUM, while the top ten firms overall control over 85% of AUM. Second, the market for affluent and HNW customers is growing at a faster rate than the number of advisors. Third, exit barriers are low; however, there may be high commitment to maintaining a full-service brokerage subsidiary, particularly by the ‘Big Six’ in order to offer a full line of products and services, or support other subsidiaries/divisions (e.g. investment banking). Finally, firms are able to read each other’s signals well, as industry players are very familiar with one another, and information is shared with/by mutually affiliated third party organizations (e.g. mutual funds companies, PriceMetrix, Investor Economics).

The strength of rivalry is also dependent on the *basis* of competition, which is increasingly on other dimensions (e.g. service, brand) and less on price; in fact, the most recent trend in pricing is upwards, as full-service brokers strengthen relationships and bundle more services and products to meet the increasing demands of investors. **Price competition is limited as products/services are increasingly more complex and perceived to be highly differentiated; switching costs are high as it takes time to research products, services, advisors, firms, and develop new relationships; and the**

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<sup>29</sup> Michael E. Porter (2008), “The Five Competitive Forces That Shape Strategy”, *Harvard Business Review*

industry has low operating leverage (advisors are the largest cost – variable cost). Lastly, the different competitor segments discussed in Section 3.4 to a large degree target different customer segments (see Section 3.5). This may increase industry profitability as the needs of different customer segments are better met. Table 3.12 maps out the important factors which drive rivalry among competitors.

Table 3.12 - Competitor Rivalry<sup>30</sup>

Rivalry		Very Unattractive		Neutral		Very Attractive	
# Of Equals	Large				→		Small
Industry Growth	Slow					X	Fast
Operating Leverage	High				X		Low
Differentiation	Low			X			High
Capacity Increases	Large		→				Small
Competitor Diversity	High			→			Low
Strategic Stakes	High	X					Low

### 3.7.2 Threat of Entry

The threat of entry into the full-service broker industry is moderate. Barriers to entry include:

- *Supply-side economies of scale/scope* - Rising costs argue for a solution in the form of larger scale, some form of integration, or both. The ‘Big Six’ are

<sup>30</sup> D. Dunne and D. Beatty (2011), “The Top Manager’s Top Ten”, *Rotman School Of Management, University of Toronto*

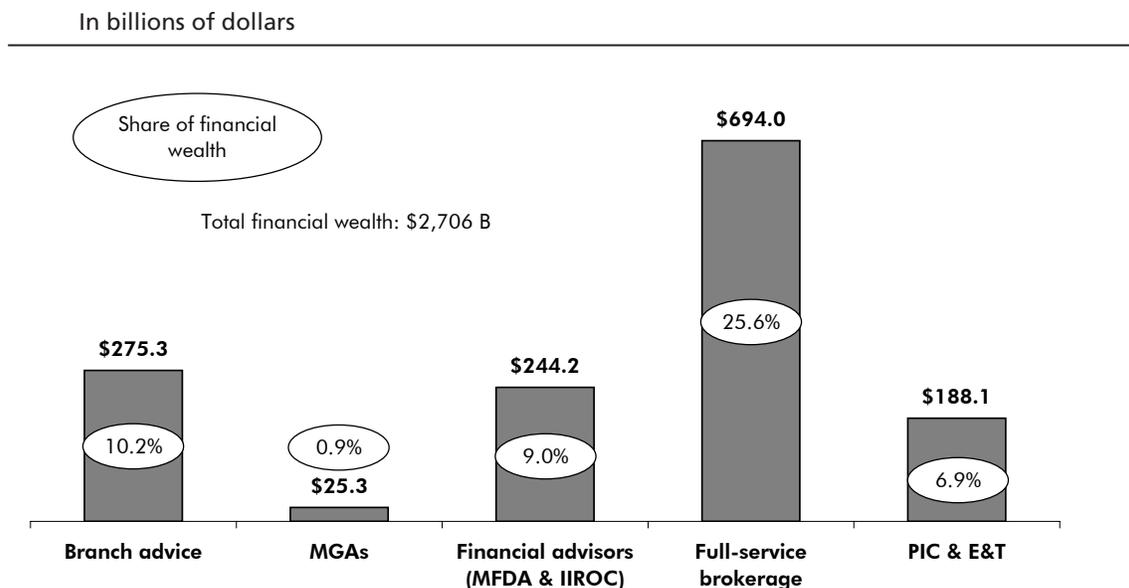
leading the way, as they are able to offer the full suite of brokerage and banking products and services, plus they are able to benefit from cross-referrals of customers between different business lines. Technology has become a critical element of success, and smaller firms often cannot afford access to the efficiencies technology can provide. For mid-sized broker-dealer firms, building scale has become increasingly difficult, and consolidation offers limited opportunity, as the prevailing view is that there are few attractive acquisition opportunities left.

- *Demand-side benefits of scale/scope* – Both customers and advisors derive peace-of-mind from “too big to fail” and a recognized brand name; again, the bank owned firms are the leaders.
- *Customer switching costs* – While direct fixed costs are low, it takes time to research a new product, service, firm, advisor, and develop a new relationship. As previously mentioned, the bank owned firms are not only able to offer the full suite of brokerage and planning services, but also deposits, lending, foreign exchange, etc. Often it’s all-or-nothing when it comes to customers’ holistic financial affairs, meaning if they move, they have to move everything
- *Capital Requirements* – Operational leverage is low and capital requirements for fixed costs such as premises and technology can be overcome with minimal scale.
- *Incumbency Advantages* – The biggest sources of incumbency advantage independent of size are brand, proprietary technology (resulting in better and more consistent performance) and experienced advisors.
- *Access to Distribution Channels* – Advisors are the primary distribution channels for the full-service brokerage industry, and attracting advisors is largely dependent on being able to overcome many of the other barriers to entry.
- *Government policy* – Regulatory changes require investments in technology, staffing and training; and specific licensing is required in order to offer certain products/services and operate in different regions.

The biggest threat of new entry comes from the financial advisor channel (mutual fund dealers), which is regulated by the MFDA, and the insurance industry, also partly regulated by the MFDA, crossing over into the full-service brokerage channel (e.g. Manulife Securities). Their value proposition has historically been anchored around financial planning and mutual funds. **Several of these firms have added the IIROC platform to accommodate individual advisors’ business objectives of being able to offer a full range of products and services.**

The financial advisor channel is large in terms of the number of firms, advisors, and AUM. Over time, the cadre of competitors with financial advisor firms has expanded to include companies outside the channel such as branch advice arms of the banks, and some full-service brokerage firms. The following figure illustrates assets by advice distribution channel and share of financial wealth. The full-service channel controls the largest share of AUM.

**Figure 3.6 - Assets by Advice Distribution Channel and Share of Financial Wealth (December 2009)<sup>31</sup>**

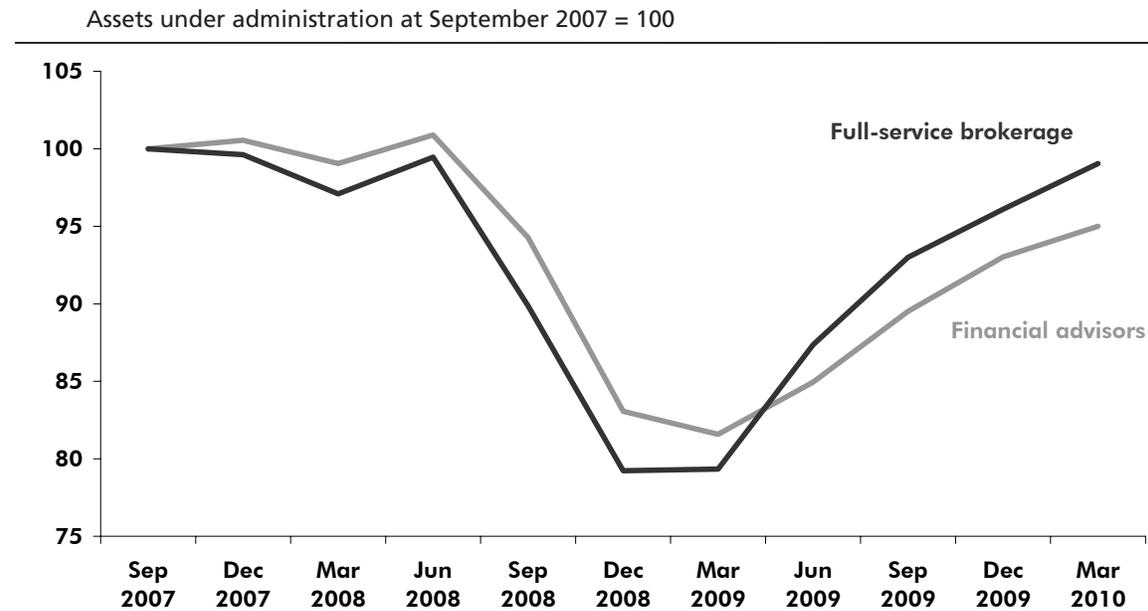


Source: *Investor Economics* (2010), “The Retail Brokerage Report – Spring 2010”

<sup>31</sup> Reproduced with the permission of Investor Economics. Any and all conclusions drawn from this figure for the purpose of this paper are that of the author(s) and not of Investor Economics.

Figure 3.7 indicates indexed asset growth for the full-service brokerage and financial advisor channels. The full-service channel appears to be more sensitive to economic cycles.

**Figure 3.7 - Indexed Asset Growth for Full-Service Brokerage and Financial Advisor Channels<sup>32</sup>**



Source: *Investor Economics* (2010), "The Retail Brokerage Report – Spring 2010"

All of these channels/firms, including large international financial institutions, pose a threat as they are able to overcome many, if not all, of the entry barriers with strong distribution networks, access to capital, strong brand names, loyal customers, and economies of scale/scope. Table 3.13 highlights the factors that affect the threat of entry.

<sup>32</sup> Reproduced with the permission of Investor Economics. Any and all conclusions drawn from this figure for the purpose of this paper are that of the author(s) and not of Investor Economics.

Table 3.13 - Threat of Entry<sup>33</sup>

Threat of Entry		Very Unattractive		Neutral		Very Attractive	
<b>Economies of Scale</b>	Small					X	Large
<b>Differentiation</b>	Little			X			Big
<b>Brand</b>	Low					X	High
<b>Switching Cost</b>	Low				X		High
<b>Access to Distribution</b>	Ample			X			Rest
<b>Capital Requirements</b>	Low				←		High
<b>Access to Technology</b>	Ample				←		Rest
<b>Access to Materials</b>	Ample			←			Rest
<b>Experience Effect</b>	Un-NB				→		Very-NB

### 3.7.3 Power of Suppliers

Human capital (i.e. advisors) and technology (e.g. CRM, analytics, integration) are the major suppliers to the full-service brokerage channel. Most of the value chain (research, underwriting, marketing, sales, trading, and back office, compliance) has been vertically/horizontally integrated, particularly among the ‘Big Six’ banks.

The power of technology providers is moderate-to-high. Full-service brokerage firms are increasingly dependent on technology to reduce costs, save time, and squeeze every ounce of value from their information assets, as it pertains to advisor productivity (e.g. client relationship management, analytics, operating system, desktop). The number

<sup>33</sup> D. Dunne and D. Beatty (2011), “The Top Manager’s Top Ten”, *Rotman School of Management, University of Toronto*

of ‘brand name’ firms that can provide integrated technology platforms is consolidating (i.e. technology providers are more concentrated than the full-service brokerage industry), and they are able to diversify their revenue sources by adapting and supplying their products and services to many other industries. These same products and services are differentiated, and once in place, are highly integrated into processes, and across systems; as a result, the cost to switch is high (including significant retraining), and at present, there is no feasible substitute. Technology suppliers also pose a credible threat to integrating forward into the full-service brokerage industry (see Section 3.7.5), although this can work both ways.

The power of advisors has historically been low given the large number and fragmentation of advisors; however, this power is growing as full-service brokerage firms look to grow their share of the HNW customer market. **It’s cheaper to lure experienced advisors (the top 20% segment) and the high growth advisors, than to acquire whole firms, or train new advisors that can provide the level of service that HNW customers demand.**<sup>34</sup> The number of experienced and high growth advisors is more concentrated, and they can redeploy their skills (i.e. sales, relationship management, negotiations, specific industry knowledge) to other industries.<sup>35</sup> What does it take to attract the *right* advisors?

In its most recent annual “Brokerage Report Card”, *Investment Executive* asked 629 advisors across fourteen retail brokerages what is most important to them – of the 36 categories measured, freedom to make objective service/product choices, firm ethics, and firm stability, were ranked highest in importance “year after year”, regardless of the prevailing economic conditions. Full-service brokerage firms that performed the best across the categories listed in Table 3.12 below were the firms whose advisors were the most satisfied.

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<sup>34</sup> Advisors can be incented to move for a lower earnings multiple vs. acquiring a firm.

<sup>35</sup> It is less feasible for advisors to forward integrate with any scale as industry regulation prohibits any collusion.

Table 3.14 – 2011 Brokerage Report Card - What Matters to Advisors<sup>36</sup>

The top categories, as ranked by average overall importance ratings:	
	Overall rating
Freedom to make objective product choices	9.7
Firm's ethics	9.6
Firm's stability	9.5
Firm's delivery on promises	9.3
Advisor's relationship with compliance department	9.1
Firm's image with the public	9.1
Quality of firm's product offering	9.1
Firm's total compensation	9.1
Back office & administrative support	9.0
Firm's strategic focus	8.9
Support for discretionary portfolio management	8.9
Firm's corporate culture	8.9
Technology tools & advisor desktop	8.9

SOURCE: INVESTMENT EXECUTIVE RESEARCH  
INVESTMENT EXECUTIVE CHART

The following tables highlight important factors, which influence the power of advisors and technology providers, respectively.

Table 3.15 - Advisor Power<sup>37</sup>

Advisor Power		Very Unattractive		Neutral		Very Attractive	
# Of Advisors	Few					←	Many
Substitutes	Low		→				High
Switching Costs	High			←			Low
Forward Integration	High				X		Low
Backward Integration	Low	X					High

<sup>36</sup> Reproduced with the permission of Investment Executive. Any and all conclusions drawn from this table for the purpose of this paper are that of the author(s) and not of Investment Executive.

<sup>37</sup> D. Dunne and D. Beatty (2011), "The Top Manager's Top Ten", *Rotman School of Management, University of Toronto*

<b>Advisor Power</b>		<b>Very Unattractive</b>		<b>Neutral</b>		<b>Very Attractive</b>	
<b>Quality Contribution</b>	High		←				Low
<b>Advisors' Cost</b>	Large Bit	X					Small Bit
<b>Advisors' Profitability</b>	Small				X		Large

Table 3.16 - Power of Technology Providers

<b>3.7.3.1.1.1 Technology Providers</b>		<b>Very Unattractive</b>		<b>Neutral</b>		<b>Very Attractive</b>	
<b># Of Providers</b>	Few		X				Many
<b>Substitutes</b>	Low	X					High
<b>Switching Costs</b>	High		←				Low
<b>Forward Integration</b>	High				←		Low
<b>Backward Integration</b>	Low	X					High
<b>Quality Contribution</b>	High		←				Low
<b>Providers' Cost</b>	Large Bit	X		X			Small Bit
<b>Providers' Profitability</b>	Small			←			Large

### 3.7.4 Power of Buyers

The power of individual retail customers is low, but may be on the rise, particularly within the HNW customer segment, as competition for their business likely intensifies; however, while products and services are standardized, they are increasingly more complex to understand, and perceived to be highly differentiated. Switching costs are high in terms of time and effort to do the due diligence on new products, services, advisors, firms, and developing new relationships. While the HNW customer market is the fastest growing customer segment and demands/purchases products and services in larger volumes; it is still highly fragmented, and there are fewer advisors that have the expertise to deliver all they want/need. While it may not be feasible for customers to backward integrate, there are customer segments, such as retirees, who may have the time to do their own research and switch to a substitute for execution (see Section 3.7.5).

In terms of buyer price sensitivity, brokerage commissions/fees are a relatively small percentage of AUM and in many cases there is lack of transparency. Economic and market cycles can influence price sensitivity – buyers are more sensitive during recessions and bear markets. Great planning and investment performance (or lack thereof) can significantly impact investors' current and future quality of life. **Ultimately, customers are price insensitive when it comes to the quality of their current and future lifestyle.**

Of note (and mentioned at the start of Section 3.6), advisors could be considered (intermediate) buyers of full-service brokerage products/services. Highly experienced and knowledgeable advisors can influence end buyer purchase decisions, and so would have greater buyer (supplier) power. Advisors who possess certain credentials and affiliated association membership could market directly to end buyers through their associations, which promote the benefit of dealing with advisors who have earned their awarded designation (e.g. Chartered Financial Analyst, Chartered Accountant, Certified Financial Planner). Table 3.16 highlights the factors that influence the power of buyers.

Table 3.17 - Buyer Power<sup>38</sup>

Buyer Power		Very Unattractive		Neutral		Very Attractive	
# Of Buyers	Few					X	Many
Substitutes	Many				←		Few
Switching Costs	Low				X		High
Backward Integration	High				←		Low
Forward Integration	Low	X					High
Quality Contribution	Small					X	Large
Buyers' Cost	Large Bit				←		Small Bit
Buyers' Profitability	Low				X		High

### 3.7.5 Threat of Substitutes

The threat of substitutes is moderate-to-high. The biggest threat is from discount brokers and other specialized providers, who together have captured a significant slice of the retail market with generally lower prices and more enterprising use of technology. In particular, these new entrants have capitalized on the growth of direct channels (i.e. internet).

<sup>38</sup> D. Dunne and D. Beatty (2011), "The Top Manager's Top Ten", *Rotman School of Management, University of Toronto*

**Table 3.18 - Online/Discount Brokerage Asset Ranking<sup>39</sup>**

Ranked by assets in billions of dollars, three-month growth rates and asset change

	Asset rank		Growth rank	
	Mar 2010	Dec 2009	3-mo growth rate	3-mo asset change
<b>Online/discount brokers</b>	<b>\$213</b>	<b>\$202</b>	<b>5.8%</b>	<b>\$11.7</b>
TD Waterhouse Discount Brokerage	1	1	8	1
RBC Direct Investing	2	2	7	2
BMO InvestorLine	3	3	3	3
ScotiaMcLeod Direct Investing*	4	4	9	4
CIBC Investor's Edge	5	5	6	5
<b>Top 5</b>	<b>\$184</b>	<b>\$174</b>	<b>5.8%</b>	<b>\$10.1</b>
<b>Market share</b>	<b>86.4%</b>	<b>86.4%</b>		
National Bank Direct Brokerage	6	6	10	7
HSBC InvestDirect	7	7	4	6
Disnat	8	8	5	8
Questrade	9	9	1	9
Credential Direct	10	10	2	10
JitneyTrade	11	11	11	11

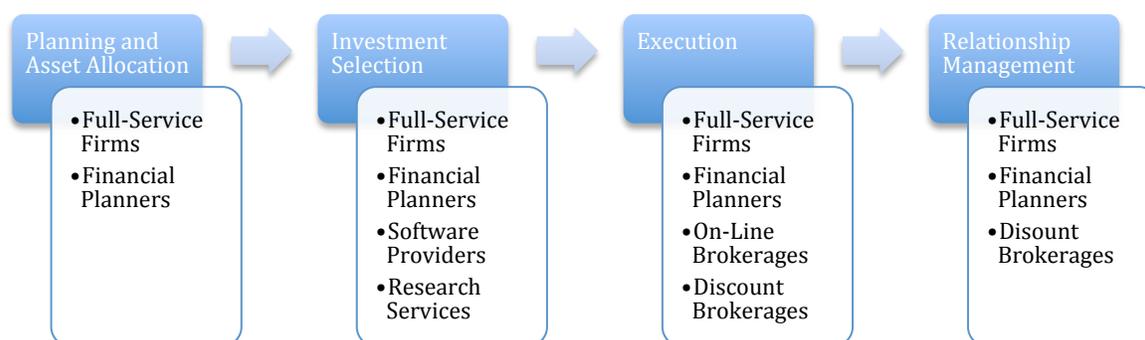
\*As of December 2008, includes Scotia iTRADE.

Source: *Investor Economics* (2010), "The Retail Brokerage Report – Spring 2010"

These firms unbundle the offerings of the full-service providers and concentrate on specific sources of value to investors, addressing targeted customer needs, and fostering the perception that their services are cheaper (see Figure 3.8). They have developed direct channels to circumvent the physical footprint advantage of the incumbents at a time when consumer adoption of electronic and other forms of direct access is increasingly replacing the need for face-to-face dealings.

<sup>39</sup> Reproduced with the permission of Investor Economics. Any and all conclusions drawn from this table for the purpose of this paper are that of the author(s) and not of Investor Economics.

**Figure 3.8 - Unbundling the Sources of Value to the Customer**



Source: Booz-Allen & Hamilton

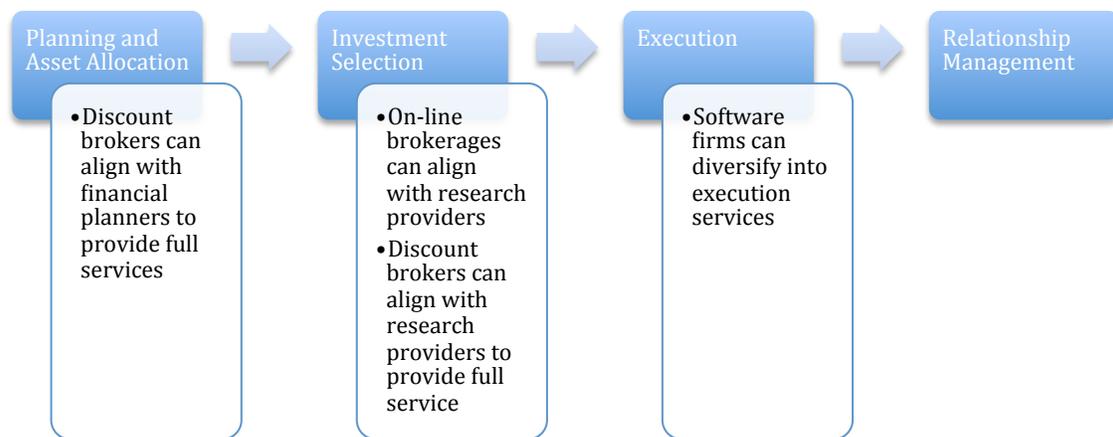
By unbundling full-service brokerage services, specialized providers have been able to appeal to specific investor groups, particularly the self-directed investors. In using these specialized providers, customers can reduce their overall cost of investing by accessing only the services they need (e.g. transaction execution). To obtain investment selection advice, self-directed investors pay directly for financial research material. While such advice is available at no additional charge as part of a full-service firms bundle of services, the price differential for transaction execution makes the specialized provider a much more cost-efficient choice.

Investors who are less self-directed and more concerned with developing and executing an in-depth financial plan are more likely to realize value from a full-service provider. The costs of preparing a financial plan and obtaining asset allocation and investment selection advice on an unbundled basis quickly levels the playing field between specialized and full-service providers if the customer invests largely in ‘load’ mutual funds; however, if that planning based investor is oriented toward the purchase of individual securities (stocks, bonds, etc.) or ‘no-load’ mutual funds, the cost gap between specialized and full-service providers reappears.<sup>40</sup>

<sup>40</sup> N. Nandra, P. Davis, and M. Kumar (1997), “Shifting Competition in the Brokerage Industry: New Imperatives for Full-Service Firms”, *Strategy + Business*, Issue 6

As Figure 3.9 shows, perhaps a more significant threat is the increasing ability of specialized providers to integrate their offerings, thereby enhancing their appeal to full-service customers. For example, providers of financial software could expand their capabilities to include portfolio planning and execution services, thereby combining profiling and asset-allocation capabilities with discounted transaction execution. Alliances among specialized providers could further blur competitive distinctions.

**Figure 3.9 - Potential Threat to Full-Service Firms from Specialized Providers**



Source: S.I.A. Fact Book and Booz-Allen & Hamilton

Table 3.18 summarizes the availability of substitutes.

**Table 3.19 - Threat of Substitutes<sup>41</sup>**

Substitutes		Very Unattractive		Neutral		Very Attractive	
<b>Close Substitutes</b>	Large		←				Small

<sup>41</sup> D. Dunne and D. Beatty (2011), “The Top Manager’s Top Ten”, *Rotman School of Management, University of Toronto*

Substitutes		Very Unattractive		Neutral		Very Attractive	
Switching Costs	Low				X		High
Aggressiveness	High	X					Low
Price/Value	High		←				Low

### 3.7.6 Five Forces Analysis – Industry Attractiveness and Summary of Threats and Opportunities

The full-service broker-dealer industry has historically been very attractive with relatively low-to-moderate rivalry between competitors, high barriers to entry, low-to-moderate supplier power, low buyer power, and low-to-moderate threat of substitutes. Sourcing information from Standard and Poor’s and Compustat, Michael Porter in his article “The Five Competitive Forces That Shape Strategy” demonstrated that the securities brokers and dealers industry (in the United States) was the most profitable in terms of average return on invested capital (ROIC) from 1992 to 2006. During that time period, average industry ROIC was 14.9% vs. 40.9% for the security brokers and dealers industry. In recent years however, trends favouring the power of buyers/suppliers and the increasing threat of new entry and substitutes, is putting downward pressure on industry profitability.

The strengths of the full-service brokerage channel include its service and product breadth, personalized service, and ‘one-stop-shopping’ convenience. As for its weaknesses, the channel will need to manage costs and operational efficiency.

Government regulation, advisors, and clients are pushing the cost envelope higher. The growing need for functionality and efficiency in servicing the increasing sophistication and demands of HNW clients, and supporting/attracting advisors in that task, is driving investment in technology and infrastructure on a scale reserved for only

the largest and most vertically/horizontally-integrated firms. Besides advisor compensation, compliance, technology, and operational risk management are the most significant costs.

The biggest threat to the full-service broker channel is from substitutes, such as discount brokers, that unbundle and target specific parts of the customer value chain with greater efficiency and at a lower cost (if lower quality). The volumes in the online/discount broker channel remain high by historical comparison and there is no retraction from the strong growth momentum since 2008. Investors are increasingly optimizing their channel usage, or ‘multi-channelling’, rather than devoting the entirety of their investment relationship to one advisor/channel.

The biggest opportunity for the full-service brokerage channel is that the HNW customer segment is the fastest growing customer segment and they want the peace-of-mind and convenience of working with an advisor who can deliver a bundle of services/products; more importantly, they may be willing to pay for that peace-of-mind and convenience. Full-service firms must proactively promote their strengths and manage client relationships to ensure that the value of their complete range of capabilities is being utilized and appreciated. HNW customers and advisors are on the move to firms that can best deliver those strengths with complete objectivity, full transparency, a competitive advantage, defined processes and brilliant service; so, how do competitor firms stack up?

### **3.8 Sources of Advantage and Competitive Analysis**

The goal of this section is to determine if some firms have features that give them a competitive advantage. These features can be grouped into cost advantages and customer utility advantages.

### 3.8.1 Cost Advantages

**The biggest cost to the full-service brokerage channel is advisors.** This can range from 50% of gross revenues for the ‘Big Six’ bank owned firms (i.e. RBC Dominion Securities, CIBC Wood Gundy, BMO Nesbitt Burns, ScotiaMcLeod, TD Waterhouse Private Investment Advice, and National Bank Financial) to 80-85% for some of the Boutique firms and Independent Agent model firms (e.g. Raymond James, Canaccord Financial, and Dundee Securities). Other operational costs are estimated to be roughly 10-20% of gross revenue.

The smaller Boutique and Independent firms may run a leaner and more efficient operation, but the ‘Big Six’ bank owned firms might have a cost advantage in lower pay-outs to their advisors, even though they provide more operational support.<sup>42</sup> They have also vertically/horizontally integrated and achieved significant economies of scale/scope and bargaining power.

### 3.8.2 Customer Utility Advantages

*J.D. Power and Associates’ “Canadian Full-Service Investor Satisfaction Study”*<sup>43</sup> which provides benchmarks for investor satisfaction that allow firms to evaluate how they compare to other firms, measures seven factors: investment advisor, account offerings, investment performance, account information, commissions and fees, website, and problem resolution.<sup>44</sup>

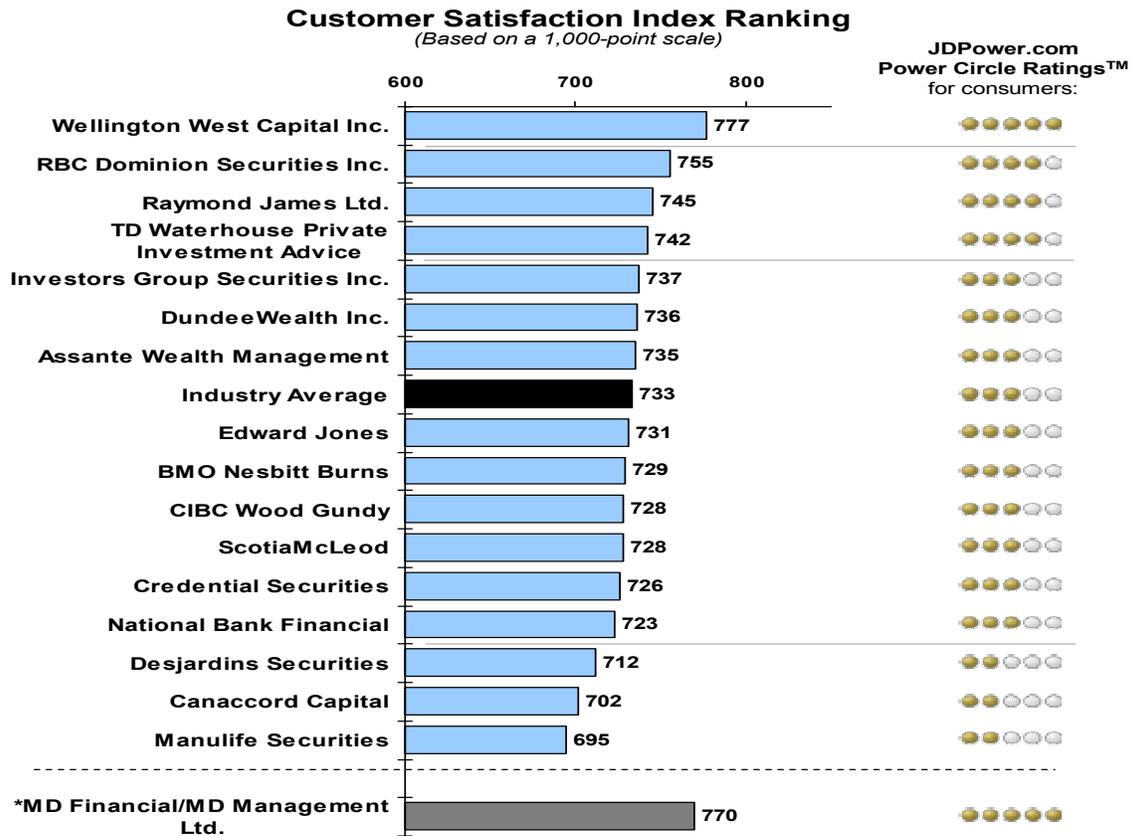
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<sup>42</sup> Specific P&L information could not be acquired so this cost advantage can’t be confirmed.

<sup>43</sup> J.D. Power and Associates is a global marketing information services company providing forecasting, performance improvement, social media, and customer satisfaction insights and solutions. To see the 2011 Canadian Full-Service Investor Satisfaction Study, go to <http://canada.jdpower.com/ratings/finance/canadian-full--service-investor-satisfaction-study/>

<sup>44</sup> In remaining consistent with the customer preferences highlighted earlier in the paper, the factors: Investment advisor, account offerings, investment performance, account information, and problem resolution are representative.

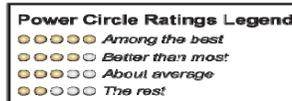
Figure 3.10 - J.D. Power and Associates 2011 Canadian Full-Service Investor Satisfaction Study<sup>45</sup>



*\*MD Financial/MD Management Ltd. is available exclusively to CMA (Canadian Medical Association) members and therefore is not included in the official rankings.*

*Included in the study but not ranked due to small sample size are: ATB Securities; HSBC Securities (Canada) Inc.; Laurentian Bank Securities; Odlum Brown Limited; Philips, Hager & North; and Richardson GMP Ltd.*

*Source: J.D. Power and Associates 2011 Canadian Full Service Investor Satisfaction Study<sup>SM</sup>*



*Charts and graphs extracted from this press release must be accompanied by a statement identifying J.D. Power and Associates as the publisher and the J.D. Power and Associates 2011 Canadian Full Service Investor Satisfaction Study<sup>SM</sup> as the source. Rankings are based on numerical scores, and not necessarily on statistical significance. JDPower.com Power Circle Ratings™ are derived from consumer ratings in J.D. Power studies. For more information on Power Circle Ratings, visit [jdpower.com/faqs](http://jdpower.com/faqs). No advertising or other promotional use can be made of the information in this release or J.D. Power and Associates survey results without the express prior written consent of J.D. Power and Associates.*

As shown in Figure 3.10, Wellington West Capital ranked highest in overall investor satisfaction, thanks to high scores in investment advisor, investment performance, account information, account offerings, and commissions and fees. Following in the rankings were RBC Dominion Securities and Raymond James. **The most critical element, or source of advantage, to scoring high in all the factors is the investment advisor.** So what matters most to (attracting) advisors?

<sup>45</sup> Reproduced with the permission of J.D. Power and Associates. Any and all conclusions drawn from this chart for the purpose of this paper are that of the author(s) and not of J.D. Power and Associates.

As mentioned earlier in the paper, the top five criteria to advisor satisfaction (attracting the best advisors) are:

- Freedom to make objective product choices
- Firm's ethics
- Firm's stability
- Firm' delivery on promises
- Firm's total compensation, quality of product offering, image with public (brand), and advisor relationship with compliance all ranked equally as fifth

Table 3.14 also highlights a significant increase in the importance of “support for discretionary portfolio management”, which is consistent with advisors moving towards more productive discretionary fee revenue; and “firm's consumer website”.

Table 3.20 - 2011 Brokerage Report Card - How Advisors Rated Their Firms<sup>46</sup>

	BOUTIQUES		REGIONAL INDEPENDENTS		NATIONAL INDEPENDENTS				BANK-OWNED INVESTMENT DEALERS						Performance average	Importance average
	Richardson GMP	Wellington West	Leede Financial	Odium Brown	Canaccord Financial	Edward Jones	Macquarie Private Wealth	Raymond James	BMO Nesbitt Burns	CIBC Wood Gundy	National Bank Financial	RBC DS	Scotiabank McLeod	TD Waterhouse PIA		
Firm's total compensation	9.0	9.1	9.5	8.9	8.1	8.7	9.3	8.5	7.3	7.7	7.8	8.0	7.6	7.6	8.4	9.1
Technology tools & advisor desktop	9.0	8.4	8.2	7.2	8.2	8.5	8.5	8.1	8.3	7.8	7.3	7.7	5.6	5.6	7.7	8.9
Support for mobile technology & the mobile advisor	9.6	8.4	8.9	7.6	8.5	7.7	8.6	8.8	N/A	7.2	7.8	7.8	7.3	7.1	8.1	7.7
Back office & administrative support	8.7	8.9	9.2	9.0	7.5	8.6	8.7	8.6	7.4	7.9	7.7	7.8	7.0	6.4	8.1	9.0
Firm's consumer website	8.4	8.2	7.5	6.8	7.3	8.0	8.7	8.1	7.3	7.5	7.0	7.9	6.7	6.9	7.6	7.6
Firm's consumer advertising	N/A	7.4	5.8	7.3	4.5	7.1	8.4	6.6	5.1	7.4	4.8	5.7	5.1	7.4	6.3	7.3
Firm's marketing support for advisor's practice	9.2	8.7	7.7	7.4	6.6	7.0	9.6	7.9	6.3	6.6	6.6	7.7	7.1	6.5	7.5	8.1
Client account statements	8.0	7.9	8.2	8.2	6.9	8.7	8.0	8.2	7.5	7.4	7.2	7.5	6.5	6.5	7.6	8.6
Online account access for clients	9.4	9.1	8.8	8.7	8.5	8.4	8.7	9.0	8.5	8.5	8.0	8.7	8.3	8.6	8.6	8.5
Ongoing training	9.0	8.4	7.1	7.0	8.3	9.0	8.9	8.0	7.7	7.8	7.5	8.3	7.5	7.6	8.0	7.8
Your branch manager	9.2	7.8	8.6	7.5	8.0	N/A	8.0	8.5	8.0	8.2	7.7	8.5	7.9	8.0	8.1	8.4
Products & support for high net-worth clients	9.5	8.9	8.2	7.8	7.3	8.0	8.2	8.0	7.8	8.0	7.6	9.0	7.5	7.1	8.1	8.6
Support for wills and estate planning	9.4	N/A	N/A	8.1	7.9	7.8	N/C	8.0	7.4	7.8	7.0	8.9	7.7	7.8	8.0	7.9
Support for tax planning	9.4	N/A	N/A	8.6	7.2	N/C	N/C	6.6	7.2	8.4	7.2	8.9	6.3	6.8	7.7	7.7
Support for insurance planning	8.9	N/A	8.1	8.4	7.9	8.3	8.1	8.4	7.8	8.2	6.6	8.5	8.2	8.0	8.1	7.8
Support for helping clients accumulate assets for retirement	9.5	8.9	7.6	8.3	7.1	9.2	7.8	8.1	7.9	8.4	7.8	8.6	7.5	7.7	8.2	8.3
Support for helping clients plan for post-retirement income	9.4	8.9	7.3	8.5	7.1	9.1	7.8	8.0	7.9	8.4	7.7	8.5	7.3	7.5	8.1	8.3
Support for discretionary portfolio management	9.8	9.1	N/A	6.6	N/C	N/A	N/C	N/C	N/C	8.2	8.4	N/C	N/C	N/C	8.4	8.9
Support for developing a financial plan for clients	9.3	7.7	N/C	7.9	6.8	8.8	6.9	7.9	7.9	7.8	7.6	8.7	7.7	8.0	7.9	8.4
Firm's succession program for advisors	9.0	8.5	N/C	8.2	8.3	7.6	8.7	8.4	7.5	7.9	7.5	8.1	6.9	7.3	8.0	8.2
IPOs & new issues	9.4	8.8	8.2	N/A	8.7	N/A	8.6	7.6	7.8	8.1	7.2	8.0	7.5	6.8	8.1	7.4
Quality of equities research	9.0	9.1	N/A	8.0	8.7	8.1	9.5	8.6	8.9	7.8	7.2	8.5	7.3	7.4	8.3	8.5
Quality of mutual fund research	N/C	7.9	N/A	N/A	4.9	8.3	7.5	8.1	8.4	7.4	6.4	7.9	7.8	7.0	7.4	6.9
Availability of fixed-income products	8.4	9.0	8.9	7.9	6.9	8.4	9.0	8.1	7.8	8.0	7.3	8.4	7.7	7.2	8.1	8.3
Pricing of fixed-income products	8.9	9.0	9.0	9.0	6.6	8.7	8.9	8.2	7.6	7.4	6.8	8.3	7.3	6.9	8.0	8.5
Firm's due diligence process for new products	9.2	9.1	8.7	8.6	8.3	9.2	9.1	8.2	7.7	8.0	7.8	8.6	7.7	7.7	8.4	8.4
Quality of firm's product offering	9.5	9.3	8.3	8.6	8.6	8.8	9.1	8.7	8.6	8.6	8.4	9.1	8.4	8.0	8.7	9.1
Firm's stability	9.4	9.5	9.7	9.8	8.8	9.2	9.9	9.0	8.7	8.8	8.7	9.9	8.8	9.2	9.2	9.5
Firm's strategic focus	9.5	9.2	9.1	8.9	8.0	8.8	9.8	8.5	7.6	8.3	7.6	9.0	8.0	8.0	8.6	8.9
Firm's corporate culture	9.5	9.5	9.6	9.0	7.9	8.8	9.7	8.4	7.8	8.1	7.8	8.8	8.4	8.0	8.7	8.9
Firm's diversity & inclusion strategy	8.8	9.6	N/A	N/A	8.5	9.2	9.5	9.0	7.9	8.8	N/A	8.6	8.2	8.7	8.8	7.3
Firm's image with the public	8.9	8.8	8.4	9.4	6.9	9.0	8.7	7.8	7.5	8.1	7.2	9.1	8.2	8.9	8.4	9.1
Firm's ethics	9.7	9.6	9.8	9.8	8.8	9.5	9.8	9.1	8.9	9.0	8.8	9.2	8.8	8.9	9.3	9.6
Advisor's relationship with compliance department	9.8	9.3	9.4	9.3	9.1	9.3	9.4	9.3	8.8	8.8	8.3	9.0	9.2	8.5	9.1	9.1
Freedom to make objective product choices	10.0	9.0	9.9	9.5	9.7	8.9	9.9	9.7	9.5	9.5	9.0	9.6	9.3	8.7	9.5	9.7
Firm's delivery on promises	8.8	9.0	9.8	9.3	8.5	8.7	9.5	9.0	8.1	8.1	8.2	8.8	8.0	6.9	8.6	9.3
<b>IE RATING (AVERAGE OF ALL CATEGORIES)</b>	<b>9.2</b>	<b>8.8</b>	<b>8.5</b>	<b>8.3</b>	<b>7.7</b>	<b>8.5</b>	<b>8.8</b>	<b>8.3</b>	<b>7.8</b>	<b>8.1</b>	<b>7.5</b>	<b>8.5</b>	<b>7.6</b>	<b>7.6</b>	<b>8.2</b>	
Overall rating by advisors	9.4	9.2	9.5	9.0	8.4	8.8	9.3	8.7	8.1	8.2	8.2	8.8	7.9	7.8	8.7	

ALL SCORES ARE BASED ON A SCALE OF 0 TO 10. A BOLD NUMBER INDICATES THE COMPANY PLACED FIRST IN THAT CATEGORY IN THE REPORT CARD. COMPANIES CAN BE TIED. NO EXTRA POINTS ARE AWARDED FOR A FIRST-PLACE POSITION  
NUMBERS IN GREEN INDICATE A SCORE HAS INCREASED BY AT LEAST 0.5 OF A POINT FROM LAST YEAR. NUMBERS IN RED INDICATE A SCORE HAS DECREASED BY AT LEAST 0.5 OF A POINT FROM LAST YEAR  
THE "PERFORMANCE AVERAGE" TALLIES ALL THE SCORES IN A GIVEN CATEGORY AND AVERAGES THEM TOGETHER. YOU CAN CHECK TO SEE IF A COMPANY IS ABOVE OR BELOW THE AVERAGE  
THE "IMPORTANCE AVERAGE" TALLIES ALL THE IMPORTANCE SCORES IN A GIVEN CATEGORY AND AVERAGES THEM TOGETHER. IT IS INTENDED TO MEASURE HOW IMPORTANT ADVISORS THINK A REPORT CARD CATEGORY IS TO THEIR BUSINESSES  
THE "IE RATING" IS AN AVERAGE OF ALL OF A COMPANY'S CATEGORY SCORES, EXCLUDING THE "OVERALL RATING BY ADVISORS"  
THE "OVERALL RATING BY ADVISORS" IS THE RATING ADVISORS GAVE THEIR FIRM AS A WHOLE  
N/A MEANS A CATEGORY DOES NOT APPLY TO A COMPANY; N/C MEANS THE CATEGORY IS NOT CALCULABLE AS NOT ENOUGH ADVISORS RATED IT TO BE A REASONABLE SAMPLE  
SOURCE: INVESTMENT EXECUTIVE RESEARCH

Boutique firm, Richardson GMP, ranked #1 overall and received the top score in: “freedom to make objective choices”, “advisor relationship with compliance department”, “quality of firm’s product offering”, “support for discretionary portfolio management”, and second highest score in “firm’s consumer website”. In general, the boutiques and independents ranked highest overall with advisors. Within the ‘Big Six’ bank-owned firms, Royal Bank is the out front leader with a clear advantage in all five of the most important categories.

<sup>46</sup> Reproduced with the permission of Investment Executive. Any and all conclusions drawn from this table for the purpose of this paper are that of the author(s) and not of Investment Executive.

Ultimately, sources of advantage boil down to the following lowest common denominators: firm size, advisors, leadership, and brand. The boutique firms have a clear advantage in advisors, thanks in large part to strong leadership<sup>47</sup>. The bank owned firms appear to have a cost advantage in terms of size and, arguably, advisor pay-out. Within the ‘Big Six’ bank owned group, RBC Dominion securities is the clear frontrunner in size, advisors, leadership, and brand.

### **3.9 Other Topics/Trends of Note**

In recent years, there has been further consolidation within the Canadian full-service broker channel. Bank owned broker-dealers are the dominant distributors of products and services; however, advisors will continue to be the primary method of distribution in an increasingly complex investment environment. In addition to BNS acquiring DW, National Bank Financial in the past year has acquired Wellington West Capital and HSBC Securities, in order to increase its scale and geographic distribution/diversification; however, it’s getting harder to find value and so the trend may slow, as it is currently cheaper to compensate individual advisors to switch firms. SM is aggressively trying to attract advisors from other firms, and word on the street is SM is offering attractive incentives to the *right* advisors to move. SM has also introduced a growth bonus program that pays advisors a bonus for every new household with investable assets exceeding a specified amount.

With the exception of Macquarie Private Wealth, foreign firms generally seem to be looking towards other higher growth marketplaces outside of Canada, which might explain HSBC Securities exit; of note, is that HSBC Securities was ranked #1 in 2012 for average account size (perhaps its international brand attracted large immigrant accounts).

There is a trend in revenue generation towards fee business, particularly discretionary portfolio management, including advisor-managed assets. This is consistent with HNW investors wanting more institutional like objectivity, transparency,

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<sup>47</sup> Arguably, leadership is representative of the top four advisor satisfaction criteria.

and value; and consistent with advisors trying to become more productive. SM is ranked #2 within the full-service channel in AUM in fee-based programs, and #3 in AUM in advisor managed programs.<sup>48</sup> This puts them in striking distance to become number one.

HNW clients want more planning services, and advisors want more HNW clients; but planning is hard to scale. In the financial advisor channel, and to a lesser extent brokerage firms that offer the Independent Agent model, financial advisors and investment advisors tend to do the planning themselves; in the full-service broker channel, firms are providing salary paid ‘Teams of Experts’ that investment advisors can leverage for planning, so they can concentrate on investment management, which is more easily scalable/productive.

Within Dundee Wealth, DWMS appears to have been a loss leader for Dynamic Mutual Funds. Advisors at DWMS hold on average over 50% of their client’s money in Dynamic Mutual Funds. Up until the last couple of years, DWMS appears to have been operating at a loss. The culture at DWMS is very entrepreneurial, and any significant change to the advisor model could result in advisors leaving.

The following figure highlights key success factors to a superior client experience:

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<sup>48</sup> Investor Economics, The Retail Brokerage Report – Spring 2010

Figure 3.11 - Key Success Factors



Source: Capgemini (2005), "The Canadian Wealth Management Market 2004/2005 Report"

So how does SM/DWMS stack up to the competition?

### 3.10 External Analysis – Summary and Conclusion

Neither ScotiaMcLeod nor DWM Securities has a leadership position in the full-service broker channel; however, while SM may not rank number one in any particular consumer or advisor satisfaction category, of note is that **SM is moving in the right direction, with the most improvements across all advisor criteria, including firm's delivery on promises, which could be a reflection of improving leadership; also, firms which offer the Independent Agent model are growing AUM and average account size at a faster rate than the bank owned dealers, of which DWMS is one of them.** The following table is a SWOT analysis for SM/DWMS:

Table 3.21 - External Analysis - SWOT

Strength	Weaknesses
<ul style="list-style-type: none"> <li>• Canadian financial institutions have a global reputation for stability.</li> <li>• BNS is Canada’s most international bank.</li> <li>• <b>SM/DWMS currently offers two advisor models – Independent Agent and Independent Employee - to suit different individual advisor business models, the <u>only bank-owned firm(s) to do so.</u></b></li> <li>• Leadership is moving SM in the right direction.</li> <li>• SM offers a ‘Team of Experts’ for advisors to leverage so they can focus on more productive/scalable activities.</li> <li>• SM offers advisors a strong fee-based and discretionary portfolio management platform.</li> </ul>	<ul style="list-style-type: none"> <li>• Based on customer score in terms of commissions and fees, clients may not perceive they’re getting enough value.</li> <li>• SM needs to address the following:               <ul style="list-style-type: none"> <li>• Technology tools and advisor desktop;</li> <li>• Firm’s consumer advertising;</li> <li>• Client account statements;</li> <li>• Support for tax planning;</li> <li>• Firm’s succession program for advisors;</li> <li>• Firm’s due diligence; process for new products;</li> <li>• Firm’s ethics.</li> </ul> </li> </ul>
Opportunities	Threats
<ul style="list-style-type: none"> <li>• An improving global economy will lead to an increase in wealth.</li> <li>• HNW investors are the fastest growing investor segment, control the majority of investable assets, and are on the move.</li> <li>• HNW investors have more planning needs, and so present more opportunity for advisors to add value and be more productive.</li> <li>• HNW investors and the advisors who (can) serve them are on the move.</li> <li>• It’s cheaper to buy experienced advisors vs. buying firms or training new advisors.</li> <li>• Age 70+ HNW investors will need transition planning, and age 40-60-customer segment will inherit the wealth.</li> <li>• SM/DWMS may be best able to replace HSBC Securities in serving immigrant investors, leveraging BNS’s “most international Canadian bank” brand.</li> </ul>	<ul style="list-style-type: none"> <li>• European sovereign debt crisis could lead to a global economic slowdown, which would reduce wealth.</li> <li>• Aging advisor force could lead to a shortage of experienced advisors.</li> <li>• HNW investors and advisors are on the move.</li> <li>• Firms are stepping up efforts to attract advisors and HNW investors, leading to increased costs.</li> <li>• A third of HNW investors are age 70+.</li> <li>• The threat of online discount brokers and other specialized providers, which efficiently target certain segments of the customer value chain, will limit fees/prices that can be charged.</li> <li>• Advisor succession – There’s a lack of new advisors being developed.</li> <li>• Boutiques and independents are leading in percentage growth of AUM and account size.</li> <li>• All customer segments want more planning, which is more costly to deliver and harder to scale.</li> </ul>

## 4 Strategic Alternatives

After careful review of the previous sections, the original two questions posed in the introduction have been revised as follows:

- Should DWMS be retained as is, merged into SM, or sold?
- What advisor model should be adopted – Independent Agent or Employee?
- What business strategy should be pursued – status quo or HNW *scope* and related *means*?

These questions are not independent of one another, and the answer to one may affect the answer to another; however, the following table first highlights the important pros and cons of each of the strategic options independently.

Table 4.1 - Pros and Cons of Strategic Options

	Pros	Cons
<b><i>DWMS</i></b>		
<b>Retain</b>	<ul style="list-style-type: none"> <li>• Different strategies can be pursued/associated with each brand.</li> </ul>	<ul style="list-style-type: none"> <li>• There are two brands to manage.</li> <li>• There might be advisor/customer confusion between the two brands.</li> </ul>
<b>Merge</b>	<ul style="list-style-type: none"> <li>• There is only one brand to manage.</li> </ul>	<ul style="list-style-type: none"> <li>• Some advisors/customers, including those of DWMS, may not appreciate the SM brand.</li> </ul>
<b>Sell</b>	<ul style="list-style-type: none"> <li>• There is only one brand to manage.</li> <li>• Proceeds can be reinvested in SM.</li> </ul>	<ul style="list-style-type: none"> <li>• Will lose a large advisor distribution force, and some advisors may reduce/eliminate holdings of Dynamic Mutual Funds.</li> </ul>
<b><i>Advisor Model</i></b>		
<b>Employee</b>	<ul style="list-style-type: none"> <li>• Ideal for advisors who are focused on growth/who don't want to worry about operational issues/cost, and</li> </ul>	<ul style="list-style-type: none"> <li>• The Employee model doesn't accommodate advisors who want to, and are capable of managing operational issues.</li> </ul>

	<b>Pros</b>	<b>Cons</b>
	<ul style="list-style-type: none"> <li>can leverage the ‘Team of Experts’.</li> <li>• Possible cost advantage with lower advisor payouts.</li> <li>• Profitability ratios may be higher.</li> </ul>	<ul style="list-style-type: none"> <li>• The Employee model limits what business strategies advisors can pursue.</li> <li>• Operational costs are higher.</li> </ul>
<b>Agent</b>	<ul style="list-style-type: none"> <li>• There are advisors who want to, and are capable of managing operational issues.</li> <li>• Advisors have more freedom to choose their own business strategy, including target market, based on individual strengths/weaknesses and preferences.</li> <li>• Operational/marketing costs are lower.</li> </ul>	<ul style="list-style-type: none"> <li>• Profitability ratios may be lower.</li> <li>• The Agent model may be a ‘loss leader’ model.</li> </ul>
<b>Target Client</b>		
<b>Status Quo (relative to HNW strategic focus)</b>	<ul style="list-style-type: none"> <li>• Operational costs are lower (e.g. smaller ‘Team of Experts’).</li> </ul>	<ul style="list-style-type: none"> <li>• Market scope is too broad.</li> <li>• Servicing the affluent customer segment is less productive.</li> </ul>

Each of these strategic options in Table 4.1 were evaluated on how well they fit the following criteria:

- BNS’s framework for success
- Attracting the *right* (more profitable) advisors, who have the experience, credentials, and skills to attract and retain more of the right clients
- Attracting the *right* (more profitable) clients
- Improving the value proposition (for both advisors and customers)<sup>49</sup>
- Increasing productivity and capacity

<sup>49</sup> Greater value is derived from more choices, more flexibility, and more quality services.

These criteria were chosen based on the corporate objectives identified in sections 2.1 and 2.2, and the issues identified in the SWOT analysis (Table 3.15). The criteria are also consistent with the key success factors identified in Figure 3.11. Table 4.2 scores each option (on a scale of 1 to 5; 1 being poor and 5 indicating a good fit) based on how well it meets each criterion (equal weight of 20%), and then adds up each score to produce a final total (out of 25). For example, for the option to retain the DWMS brand, the 3 representative of how well the alternative meets BNS’s framework for success. The last column shows the total score for each option across all the criteria.

**Table 4.2 - Strategic Option and Criteria Fit**

	<b>BNS's Framework for Success</b>	<b>Attract Right Advisors</b>	<b>Attract Right Clients</b>	<b>Value Proposition</b>	<b>Productivity /Capacity</b>	<b>Total</b>
<b>Retain</b>	3	4	4	4	3	18
<b>Merge</b>	4	3	3	3	3	16
<b>Sell</b>	4	3	3	3	4	17
<b>Employee</b>	4	3	3	3	4	17
<b>Employee + Agent</b>	4	4	4	4	3	18
<b>Status Quo</b>	4	3	3	3	4	17
<b>HNW</b>	5	4	4	4	5	22

Regarding the question of what to do with the DWMS brand, the option to retain the brand scored higher across advisors, clients and value, relative to the options to merge/sell. Retaining the DWMS brand in addition to the SM brand offers more choice,

and will appeal to a wider audience of advisors and clients. The option to merge/sell scored higher in BNS' Framework for Success, as there is only one brand to manage and focus on; in addition, the option to sell scored higher in Productivity/Capacity, as capital is made available for reinvestment.

The option to offer only the Employee model to advisors scored higher in productivity, relative to offering both advisor models, as all advisors have more tools to leverage to increase productivity/capacity (e.g. 'Team of Experts', operational support, etc.). The option to offer both the Employee and Independent Agent models scored higher in attracting advisors, clients, and value, as advisors have more freedom to choose which model is best suited to their strengths and business strategy; again, this will appeal to a wider audience of advisors and clients. Advisors who choose the Independent Agent model may be less productive however, as they are not offered the same tools to leverage.

Adopting a HNW strategic focus for SM only, relative to the status quo, scored higher across all criteria. HNW clients own the majority of investable assets and are the fastest growing customer segment. Targeting HNW customers will lead to greater advisor productivity/profitability; and the advisors who are able to meet the needs of HNW customers will generally have more credentials, experience, and better skills.

From Table 4.2, it can be inferred that a HNW focus strategy, a dual advisor model, and retaining the DWMS brand are of importance, and may add significant value. It is expected that strategic alternatives that incorporate more of these options will score higher and warrant closer attention; regardless, several alternatives will be proposed and analysed, as it is unclear of what management's preferences are for the various strategic options, nor was P&L data available for a definitive feasibility analysis.

The following proposed alternatives differ on how they answer the revised questions, and are being put forward based on what BNS should consider in order to exploit identified opportunities and strengths, while mitigating any weaknesses or threats.

#### **4.1 Alternative 1 – Retain DWMS, Employee + Agent Model, Strategy Status Quo**

Keep both the SM and DWMS brands; keep both the Independent Agent and Employee models; and keep SM’s current vision, mission, and strategy.

Under this alternative, advisors and clients may continue to stay with their current brand – If so, a DWMS advisor/client remains a DWMS advisor/client; a SM advisor/client remains a SM advisor/client. On-going marketing efforts would continue under each brand, respectively; as well, both brands could leverage the parent BNS brand. For example, letterhead, business cards, advertising, brochures, and signage, would remain the same under each brand, but both could use the BNS logo/TM.

Depending on existing and new advisors meeting certain criteria (e.g. AUM, revenue, experience, credentials, etc.), and their own business strategy, they will have the freedom to choose which model they wish to operate on – Independent Agent or Employee. Back office functions currently provided by DWMS would be (further) consolidated with SM’s back office for cost savings. The best processes and technology between the two firms would be retained.

In terms of strategy, for SM and DWMS, it’s the status quo – “To be the leader in retaining, attracting, and rewarding the best growing and highest performing advisors, and to be the firm of choice for primary advisors to affluent and HNW clients”; to deliver investment advice, money management, and comprehensive wealth management services (see Section 2.2).

#### **4.2 Alternative 2 – Retain DWMS, Employee + Agent Model, HNW Focus**

Alternative 2 is similar to alternative 1, but SM should narrow its strategic *scope* to HNW clients only, and put more emphasis on the related *means*.

For SM and its advisors, growth bonus, advisor training, and experienced recruiting should be targeted towards attracting the HNW client (preferably age 40-60). SM should strive to be the leader in planning services and/or fee-based solutions (including discretionary portfolio management); and should strengthen the ‘Team of Experts’ for advisors to leverage. Existing SM advisors/clients that don’t conform to the new strategy should be transitioned to the bank branches or to DWMS.

#### **4.3 Alternative 3 – Merge DWMS, Employee + Agent Model, Strategy Status Quo**

Keep the SM brand only; offer both the Independent Agent and Employee model; and keep SM’s current strategic scope and means.

Advisors/clients under the DWMS brand would switch to the SM brand, along with all future marketing efforts. All letterhead, business cards, advertising, brochures, and signage, etc. would show the SM/BNS brand, logos, and TM’s.

Depending on existing/new advisors meeting certain criteria (e.g. AUM, revenue, experience, credentials, etc.), and their own business strategy, they will have the freedom to choose which model they wish to operate on – Independent Agent or Employee model. Back office functions currently provided by DWMS would be entirely consolidated with SM’s back office for cost savings. The best processes and technology between the two firms would be retained.

#### **4.4 Alternative 4 – Merge DWMS, Employee + Agent Model, HNW Focus**

Alternative 4 is similar to alternative 3, but SM should narrow its strategic *scope* to HNW clients only, and put more emphasis on the related *means*.

#### **4.5 Alternative 5 – Merge DWMS, Employee Model, Strategy Status Quo**

Keep the SM brand and the Employee model only, and keep SM's current strategic scope and means.

DWM Securities advisors would switch over to SM's compensation and business model, where top-end pay-out is reduced, but all/most operational and marketing functions and decisions are standardized and covered by SM. Back office functions currently provided by DWMS would be entirely consolidated with SM's back office for cost savings. The best processes and technology between the two firms would be retained.

#### **4.6 Alternative 6 – Merge DWMS, Employee Model, HNW Focus**

Alternative 5, but narrow SM's strategic *scope* to HNW clients only, and put more emphasis on the related *means*.

#### **4.7 Alternative 7 – Sell DWMS, Employee Model, Strategy Status Quo**

Sell DWMS and use proceeds to build out Alternative 5.

#### **4.8 Alternative 8 – Sell DWMS, Employee Model, HNW Focus**

Sell DWMS and use proceeds to build out Alternative 6.

The following table summarizes how each alternative answers the three new questions posed at the start of the section.

**Table 4.3 - Summary of Strategic Alternatives vs. Strategic Options**

	DWMS			Advisor Model		Scope & Means	
	Retain	Merge	Sell	Employee	Agent	Status Quo	HNW
<b>Alt 1</b>	X			X	X	X	
<b>Alt 2</b>	X			X	X		X
<b>Alt 3</b>		X		X	X	X	
<b>Alt 4</b>		X		X	X		X
<b>Alt 5</b>		X		X		X	
<b>Alt 6</b>		X		X			X
<b>Alt 7</b>			X	X		X	
<b>Alt 8</b>			X	X			X

#### 4.9 Evaluation of Alternatives

Table 4.4 takes the total scores for each strategic option in Table 4.2, and matches to the corresponding alternatives (see Table 4.3). For example, Alternative 1 is comprised of the following options: Retain; Employee + Agent; and Status Quo. The total score for each option is added up for each criterion, and these in turn are added up to produce a final score for each alternative. In the following table, the 11 corresponding to Alternative 1 and BNS’s Framework for Success is the sum of 3 (Retain), 4 (Employee + Agent), and 4 (Status Quo) under the Framework column in Table 4.2. The process is repeated across each row to get a final score for each alternative.

**Table 4.4 - Alternative and Criteria Fit**

	<b>BNS's Framework for Success</b>	<b>Attract Right Advisors</b>	<b>Attract Right Clients</b>	<b>Value Proposition</b>	<b>Productivity /Capacity</b>	<b>Total</b>
<b>Alt 1</b>	11	11	11	11	10	54
<b>Alt 2</b>	12	12	12	12	11	59
<b>Alt 3</b>	12	10	10	10	10	52
<b>Alt 4</b>	13	11	11	11	11	57
<b>Alt 5</b>	12	9	9	9	11	50
<b>Alt 6</b>	13	10	10	10	12	55
<b>Alt 7</b>	12	9	9	9	12	51
<b>Alt 8</b>	13	10	10	10	13	56

Based on Table 4.4, the following alternatives scored higher and will be considered for feasibility:

- Alternative 2 – Retain DWMS, Employee + Agent Model, HNW Focus
- Alternative 4 – Merge DWMS, Employee + Agent Model, HNW Focus

## 5 Alternative Feasibility Analysis

For each of the alternatives selected for further consideration, feasibility will be based on whether SM/DWMS' internal capabilities are sufficient, or could be made sufficient, to implement. For each alternative, for each capability, an assessment is made based on:

- What is required;
- Whether there are gaps;
- What gap-bridging solution is required; and
- What the cost(s) of the solution may be.

### 5.1 Alternative 2 – Retain DWMS, Employee + Agent Model, HNW Focus

Table 5.1 - Alternative 2 Gap Analysis

Capability	Requirements	Gaps	Gap-bridging	Costs
<b>Management Preferences &amp; Expertise</b>	<ul style="list-style-type: none"> <li>• Maintain two brands and two advisor models</li> <li>• Accept potentially lower profitability ratios from DWM Securities</li> </ul>	<ul style="list-style-type: none"> <li>• Scotiabank looking to simplify/reduce business lines and brands</li> <li>• It is believed that Employee model has higher profitability ratios</li> </ul>	<ul style="list-style-type: none"> <li>• Continue to simplify higher level business lines and brands only</li> <li>• Treat DWM Securities advisors as loss leaders</li> </ul>	<ul style="list-style-type: none"> <li>• More business planning</li> <li>• Potentially lower average profitability ratios</li> <li>• Business line/brand confusion</li> </ul>
<b>Organization</b>	<ul style="list-style-type: none"> <li>• Maintain entrepreneurial freedom for DWM Securities advisors</li> <li>• Must allow advisors to choose their own business strategy and corresponding advisor model</li> </ul>	<ul style="list-style-type: none"> <li>• Scotiabank controls operations</li> <li>• Not enough advisor training and practice management support</li> <li>• Prospective client net is too large</li> </ul>	<ul style="list-style-type: none"> <li>• Maintain two separate full-service broker business lines and leave DWM Securities as is</li> <li>• Maintain middle-management for both ScotiaMcLeod</li> </ul>	<ul style="list-style-type: none"> <li>• More compliance violations</li> </ul>

Capability	Requirements	Gaps	Gap-bridging	Costs
	<ul style="list-style-type: none"> <li>ScotiaMcLeod to target HNW clients exclusively</li> </ul>		<ul style="list-style-type: none"> <li>and DWM Securities</li> <li>Narrow growth bonus to reward HNW client acquisition and fee-based revenue for ScotiaMcLeod advisors only</li> <li>Freedom for advisors to move between brands/advisor model</li> </ul>	
<b>Resources</b>	<ul style="list-style-type: none"> <li>Develop ScotiaMcLeod advisor force to attract HNW clients with leading planning and fee-based services</li> </ul>	<ul style="list-style-type: none"> <li>Current 'Team of Experts' is too small</li> <li>Current technology is somewhat fragmented and doesn't efficiently support discretionary portfolio management</li> <li>Lack of advisor training</li> </ul>	<ul style="list-style-type: none"> <li>Expand 'Team of Experts' to better support ScotiaMcLeod advisors</li> <li>Provide more advisor training and expand practice management group</li> <li>Develop more integrated technology platform with an emphasis on supporting planning related activities and discretionary portfolio management</li> </ul>	<ul style="list-style-type: none"> <li>Increase in ScotiaMcLeod advisor support related costs</li> </ul>

## 5.2 Alternative 4 – Merge DWMS, Employee + Agent Model, HNW Focus

Table 5.2 - Alternative 4 Gap Analysis

Capability	Requirements	Gaps	Gap-bridging	Costs
<b>Management Preferences &amp; Expertise</b>	<ul style="list-style-type: none"> <li>Maintain two separate advisor models</li> <li>Accept potentially lower profitability ratios from Independent Agent advisors</li> </ul>	<ul style="list-style-type: none"> <li>Scotiabank looking to simplify/reduce business lines and brands</li> <li>It is believed that Employee model has higher profitability ratios</li> </ul>	<ul style="list-style-type: none"> <li>Continue to simplify higher level business lines only</li> <li>Treat Independent Agent model advisors as loss leaders</li> </ul>	<ul style="list-style-type: none"> <li>More business planning</li> <li>Potentially lower average profitability ratios</li> <li>Business line confusion</li> </ul>
<b>Organization</b>	<ul style="list-style-type: none"> <li>Maintain entrepreneurial freedom for Independent Agent model advisors</li> <li>Must allow advisors to choose their own business strategy and corresponding advisor model</li> <li>Employee model advisors to target HNW clients exclusively</li> </ul>	<ul style="list-style-type: none"> <li>Scotiabank controls operations</li> <li>Not enough advisor training and practice management support</li> <li>Prospective client net is too large</li> </ul>	<ul style="list-style-type: none"> <li>Maintain two separate full-service broker business lines and leave Independent Agent model as is</li> <li>Maintain middle-management for both advisor business lines</li> <li>Narrow growth bonus to reward HNW client acquisition and fee-based revenue for Employee model advisors only</li> <li>Freedom for advisors to move between advisor models</li> </ul>	<ul style="list-style-type: none"> <li>More compliance violations</li> </ul>
<b>Resources</b>	<ul style="list-style-type: none"> <li>Develop Employee model advisor force to attract HNW clients with leading planning and fee-based services</li> </ul>	<ul style="list-style-type: none"> <li>Current 'Team of Experts' is too small</li> <li>Current technology is somewhat fragmented and doesn't efficiently</li> </ul>	<ul style="list-style-type: none"> <li>Expand 'Team of Experts' to better support Employee model advisors</li> <li>Provide more advisor training and expand practice</li> </ul>	<ul style="list-style-type: none"> <li>Increase in Employee model advisor support related costs</li> </ul>

Capability	Requirements	Gaps	Gap-bridging	Costs
		support discretionary portfolio management	management group • Develop more integrated technology platform with an emphasis on supporting planning related activities and discretionary portfolio management	

**5.3 Recommended Alternative(s)**

Each of the alternatives analyzed are feasible. There are identifiable costs in retaining the DWMS brand and Independent Agent model, such as, more corporate business planning, potentially lower profitability ratios and the maintenance of more middle management. DWMS advisors would continue to be responsible for all operational and marketing costs; however, back-office operations for SM and DWMS can be further consolidated for cost savings. DWMS and SM should be kept distinct and separate in order to minimize any advisor confusion and cultural conflict, and enable SM to develop its HNW brand.

The Independent Agent model appears ideal/attractive for advisors who have strong operational management capability; are on a lower growth trajectory; want more freedom to choose their business strategy (e.g. target customer, direct delivery of planning, hiring, etc.); and who have roughly \$1 million in gross revenue. The Independent Agent channel effectively gives these advisors the ability to choose how they complete and fill the value channel, which could potentially result in lower (or higher) costs for the advisor relative to the Employee model.

The Employee model appears ideal/attractive for advisors who are focused on a higher/steeper growth trajectory (including new advisors) and need/want to leverage

planning services and the operational management expertise of SM. ScotiaMcLeod should look to establish a leading position in planning and fee-based solutions to HNW clients. This will require a larger ‘Team of Experts’ for ScotiaMcLeod advisors to leverage; and continued investment in more integrated technology.

The HNW client segment is expected to grow at the fastest rate, and HNW clients between the ages of 40 and 60 also stand to benefit from the transfer of wealth. Targeting HNW clients will allow advisors to be more productive, but in order to attract these clients; the value proposition needs to focus on planning and fee-based services and solutions.

Selling DWM Securities and focusing only on the Employee model runs the risk of losing related AUM with Dynamic mutual funds, and it ignores that there are *right* advisors who prefer or are more suited to the Independent Agent model. This will limit AUM and revenue growth.

### **5.3.1 Conclusion**

Based on the evaluation of alternatives, and the alternative feasibility analysis, the recommended alternative is **Alternative 2** – Scotiabank should retain both the DWM Securities and ScotiaMcLeod brands and advisor models, respectively. Scotiabank needs to expand its advisor training and practice management programs as this will enable advisors to better choose their business strategy and corresponding advisor model.

DWM Securities will continue to operate as it currently does, but will have the benefit of being able to leverage the brand name of Scotiabank. ScotiaMcLeod needs to establish a leadership position – it should narrow its focus to HNW clients and the related planning and fee-based services and solutions HNW clients demand. Any advisor or client that doesn’t fit either model should be transitioned to another integrated channel (e.g. branch channel, discount brokerage, etc.).

As a final consideration for further analysis, the exit of HSBC Securities presents an opportunity for ScotiaMcLeod, and to a lesser degree DWM Securities, to leverage the

international brand of Scotiabank, and target related advisors and clients. The expansion of the 'Team of Experts' should include more expertise in servicing new immigrants, and it will require a coordinated effort with Scotiabank's international branches.

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