Third Party Distribution

Banks need a clear strategy for managing the broker channel

Love them or hate them, commercial brokers are a growing and increasingly entrenched and sophisticated part of the market and banks need to have a clear strategy to effectively manage and optimise the channel. In East & Partners' latest SME Banking Markets Report, a massive 38 percent of SMEs said they had sourced a business banking product through a broker over the past six months.

Five years ago this figure was closer to six percent. Commercial brokers have quickly become an important dynamic in Australia's business banking markets because they (and regional banks) have successfully filled a void created by the major domestic banks. In their drive for productivity and savings, major banks continued to lift the revenue threshold of companies they would relationship manage to the extent that RMs ended up with portfolios of many hundreds of SME customers and the term 'relationship manager' become a misnomer.

This created the opportunity for regional banks and brokers to take ownership of a significant tranche of neglected small to medium sized business customers who wanted service and a more personal relationship with their banks. But banking is nothing if not cyclical and having purposefully relinquished the space, banks are now attempting to reclaim it.

In the case of third party distribution, banks continue to adopt a "front end" approach to engaging with the broker channel. Rather than being designed, structured, and resourced as a channel in its own right, the broker strategy is essentially driven informally by Relationship Managers through a number of ad hoc relationships with brokers.

There are two key issues here: Firstly, why pay an RM to originate when they are simply contacting brokers they know to provide customers?

Most of the work gets carried out by the broker, but this is generally not differentiated in banks' internal systems. Furthermore, who owns the end customer in this scenario and where are the opportunities for banks to increase product penetration with that customer?

It is not easy to cross sell into broker originated customers when the broker considers that the customer is theirs and they naturally want to "clip the ticket".

Secondly, if the bank structures its operations including the credit function to treat the broker channel as a discrete channel and manages it accordingly, the channel becomes a much more efficient and effective one for the bank.

There are essentially three categories of brokers currently operating in the Australian market: Mortgage brokers moving across to commercial lending; ex-commercial bankers who have set up broking operations; and Equipment Finance brokers moving their expertise into term debt.

All have a role to play and East expects to see some convergence between these three groups and further aggregation, which of course creates margin issues for banks.

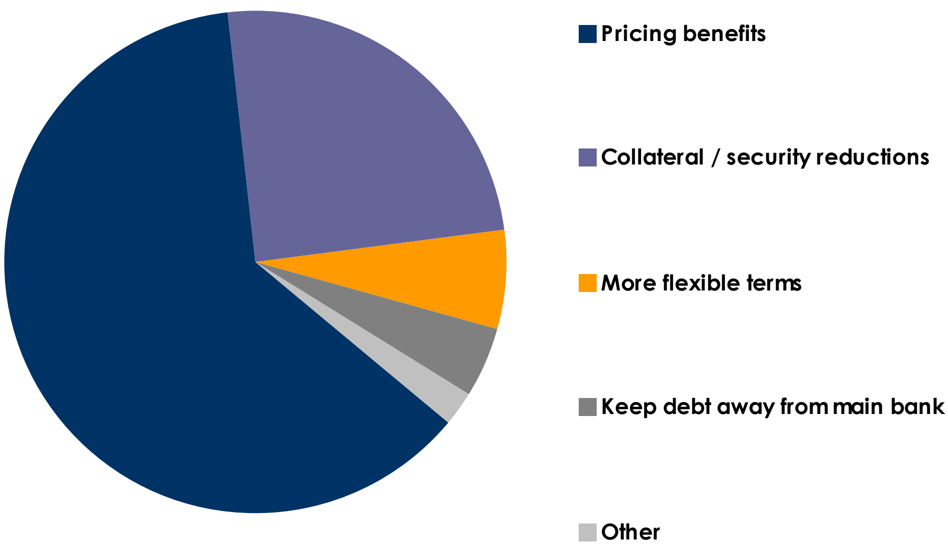
Cash flow products on brokers' radars

As SMEs move away from bricks and mortar secured financing, brokers are progressively starting to offer working capital products, with some 30 percent of SME customers engaging cash flow products such as invoice discounting, receivables financing, payables financing and inventory financing in the latest SME Banking Markets Report.

Brokers tend to be quite entrepreneurial in nature and look to identify opportunities where they can further entrench themselves within the customer. Working capital does not have the scale that other debt products and Equipment Finance has but it is starting to develop, driven by SME requirements for those types of products.

Banks have become very good and attuned at using brokers to originate mortgages but they are not managing commercial brokers as effectively. The problem is that whereas the RM channel is well understood and established, banks' strategy for managing the commercial broker channel is not currently built from the ground up.

Key Reasons for Using a Broker in the SME Segment – April 2007
Percent of Enterprises (N: 1461)



Banks need to identify and manage non-direct channels for what they are and to the extent that they wish to utilise them.

Of course, the best channel is the one that works best for the customer. But whilst two businesses may appear identical in appearance, one of them might be happy to self-service via the internet and an annual RM visit might suffice; whereas the other business might require high touch service and quarterly visits from their RM.

Banks need to adopt a multi-channel strategy that correlates with the wishes of different categories of customers.

To effectively engage with third party originators, banks must deploy a separate channel that sits beside the RM channel with clear rules of engagement to minimise any potential channel conflict.