Claremont Graduate University

Course: Drucker on Management 343

Analysis of Edward Jones

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What assumptions does it appear that Edward Jones is making about its environment?

According to the business case, Edward Jones is assuming that it needs to double the number of its single broker offices to 10,000 locations by a certain time period, to make national advertising feasible and to spread technology and overhead costs over a wider base. They are assuming that their existing model of single broker offices is the correct model for the future. This vision is contrasted with that of E*Trade's then CEO Christos Cotsakos, who said to a roomful of brokers, "All those branch offices you all have are going to become fast-food outlets, so you might want to think about your career choices" (Harvard Business School, *Retail Financial Services in 1998*, p. 6).

If national advertising is their goal, they are not taking into account that many "office-less" Internet brokerages like E*Trade and Ameritrade have achieved name recognition in a few short years based on marketing campaigns, not storefronts. Edward Jones is also assuming that Internet stock trading is indeed a commodity, and will not interfere with their legacy full service brokerage services. If Internet stock trading will cannibalize Edward Jones' full service clients, it is better that they are the one which gains that new business.

Finally, Edward Jones has not thought through their theory of the business. They view their brokers as the "informed buyers" for individual investors, and are known for their customer service and customer loyalty. In fact, “40% of Jones’ 3.4 million accounts generate no commission income. ‘Our customers invest for the long term, that's the way to build up wealth,’ Bachmann says” (Los Angeles Times, *One Firm Is Sticking With Traditional Way*, November 28, 1999). But that model may be changing with the proliferation of financial research on the Internet. They are extremely profitable in their industry, with a pre-tax return on equity of 36%, beating the average national full service broker and well known competitors such as Merrill Lynch, A.G. Edwards, and Paine Webber. But their profitability is likely due to a good strategy and an environment where the individual brokers are like a confederation of entrepreneurs. That in itself is motivating, but it is not enough to sustain growth. Previously, Managing Principal John Bachman had to delay an earlier 10,000 office goal due to a rising broker attrition rate. First, we ask — What are their strengths? Certainly the entrepreneurial latitude each broker has, is a strength. They also have a tremendous research department, with their 16 analysts generating 39.5% return on their recommended list of stocks. They also have an extensive training program, and a compensation plan which includes potential partnership in the firm.

Next, what are their most profitable products? Mutual fund commissions — with Edward Jones being the largest distributor of the Putnam and Capital Research & Management mutual fund families. If they are indeed moving to the “bank” model of business, then their 10,000 branches can be justified. Nearly every Edward Jones broker is also licensed to sell insurance. In fact, commissions from security and insurance sales generate almost 75% of the company’s net revenues. What will their revenue sources be in the years to come? Fees for services — like banks — or commissions like brokerages and insurance? How do the demographics of their client base compare with that of society in general? 50% of Edward Jones’ total commission revenue is from retirees age 65 and over. But who isn't their customer? Can Edward Jones afford to ignore the average online trader who is "a college-educated 45-year old male, with a household annual income of $100,000 or more, and more than $343,000 in financial assets" (Harvard Business School, *Retail Financial Services in 1998*, p. 8).

What is the specific strategy or mission of Edward Jones?

Edward Jones serves only individual investors. Its mission is to have their brokers be the "informed buyers" for their clients in the vast investment product universe. Their "customers are concerned with providing for a comfortable retirement, achieving financial independence, and maintaining peace of mind" (Harvard Business School, *Edward Jones*, p. 5). To fulfill this mission, Jones attempts to recruit people who are entrepreneurial minded and self-reliant. They purposely did not court brokers from other firms by refusing to pay upfront bonuses to attract transfers.

What assumptions does it appear that Edward Jones is making about its core competencies?

Edward Jones is making the assumption that having 10,000 locations of single broker offices is the key to leveraging its strength in customer service and fostering customer loyalty. "Demographics drives our business," says Bachmann (Los Angeles Times, *One Firm Is Sticking With Traditional Way*, November 28, 1999). Edward Jones believes that they will gain customers among the vast numbers in all parts of the world who want to invest for retirement and other purposes.

They are assuming that focusing on middle-class customers will carry Jones in the future. By not discounting commissions, Edward Jones takes an old-fashioned approach to financial services. For those commissions, customers get a good deal of “contact, research advice and counseling from their investment representatives” (Los Angeles Times, *One Firm Is Sticking With Traditional Way*, November 28, 1999).

Do the assumptions about the environment, mission, and core competencies of Edward Jones fit reality? Explain.

We would argue that they do not fit reality, because Edward Jones, like many other financial institutions, are converging into an area that requires distinct, and sometimes opposite strengths. By trying to solve all their growth issues with single broker offices, they are neglecting the Internet trading market. Certainly if they move to banking and insurance markets, those branches will prove to be strong points. But it doesn’t address the fact that their most profitable areas are commission based, and that model may not be best served by branch offices. “...by offering all Schwab customers the ability to trade stocks online for just $29.95. Many feared the move would cannibalize, even destroy, the discount broker's traditional and lucrative businesses of catering one-on-one to do-it-yourself investors and to independent investment advisors who serve the let-someone-else-do-it class of investor. It had just the opposite effect. The company, by leveraging both the power of the Internet and its network of 340 brick-and-mortar customer centers, has brought in client assets faster than any other discount or full-service brokerage in America” (Los Angeles Times, *Schwab, Merrill Plans Blur Industry's Lines*, November 28, 1999).

We are aware that the typical Edward Jones client does want that close contact service. But as Drucker says, "One cannot manage change. One can only be ahead of it" (*Management Challenges for the 21st Century*, p. 73). If discount brokerages and Internet trading is growing substantially, then Edward Jones must address that issue. Perhaps "performance" for Jones clients will switch from trusted advice and frequent customer contact, to conducting their own research (based on Jones' analysts reports) and online trading.

Also, in branching out to more advanced financial products, Edward Jones risks losing out on the performance they were known for — trusted service and trusted advice. "A major commercial bank decided that the way to improve performance in its branches was to offer new and more advanced financial 'products,' ... but when the bank introduced [them], it rapidly lost customers. Only then did the bank find out that to customers, performance of a bank branch means not having to wait in line for routine transactions" (*Management Challenges for the 21st Century*, p. 81).

Do these assumptions fit one another? Are they consistent?

As we mentioned before, there are assumptions for the bank and insurance model, and assumptions for full-service brokerage models. Seemingly at first, all the models appear to thrive with branch offices. But this does not take into account the changing nature of the brokerage business. Edward Jones may want to apply its 10,000 office "strength" to the insurance, bank, and full-service brokerage industries. But we would also suggest that they focus on an in-house discount brokerage as part of a consolidation of the back office.

How can these assumptions be communicated through Edward Jones during this period of rapid expansion?

The assumptions can be communicated both through training and their in-house mentoring program. "After passing both the Series 7 and the history and culture exams, trainees came to St. Louis for a five day session covering the industry's 'know your customer' rules... Trainees then spent three weeks in three different offices observing customers, developing client contact skills, studying office administration, and meeting other IRs" (Harvard Business School, *Edward Jones*, p. 10).

It is significant to note that this is also a control systems issue too. The downside to their rapid expansion and the very nature of their "confederate" nature is that there is no set infrastructure in place for communications. In addition to communicating these assumptions, Edward Jones needs structure to also focus on MBO. According to Drucker, this structure is crucial for MBO to succeed. "It requires policy and structure. It requires that management by objectives be purposefully organized and be made the living law of the entire management group" (*Management: Tasks, Responsibilities, Practices*, p. 431).

How can Edward Jones test their "Theory of the Business" periodically?

Edward Jones' "strategy converts this Theory of the Business into performance. It's purpose is to enable an organization to achieve its desired results in an unpredictable environment" (*Management Challenges for the 21st Century*, p. 43). Failure of the strategy to produce the expected results is the first indication that the theory of the business needs to be thought through. We would argue that their 1995 failure of expansion was a warning sign that a rapid increase in size is not the correct path for them. "A theory of the business always becomes obsolete when an organization attains its original objectives" (*On The Profession of Management*, p. 14).

What early warning signals can Edward Jones devise to test their "Theory of the Business" periodically?

If Edward Jones is correct, customers are proving far more loyal than conventional wisdom would suggest. "Over the years, fewer than 100 customers departed Jones for discount brokers" (Los Angeles Times, *One Firm Is Sticking With Traditional Way*, November 28, 1999). Accordingly, if Jones sees a rapid decrease in their 2.9 million retail accounts, they can take that as a warning signal. Or perhaps more importantly (because clients may keep their Jones' account and open a second account with a discount brokerage), Edward Jones can monitor their retail clients $144 billion in assets to see if they decrease significantly. A third warning signal could be an increased turnover rate in brokers, who might be having problems attracting new full-service brokerage clients. Edward Jones must continually ask the question, "What value is this job supposed to add?" (*On The Profession of Management*, p. 150). If the marketplace changes so that the only "value" that customers want is to purchase or sell securities, then Edward Jones theory is likely no longer correct.