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WHITE PAPER

Outperform - Beat the Average

Key Levers for Top Performers in Wealth Management

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White Paper

Outperform - Beat the Average

Key Levers for Top Performers in Wealth Management

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FOREWORD

For much of the last ten years, wealth managers have been able to reap the benefits from the rise in personal financial wealth, resulting from strong asset appreciation and economic growth in rapidly developing economies. A temporary halt in growth at the end of 2018 exposed the underlying fragility of the industry, leaving managers with lower revenues, higher costs and reduced profits.

As we enter the new decade, being average is no longer an option. To be prepared for possible future lower growth rates in global personal financial wealth, managers must focus on opportunities to excel in the face of unfavorable market conditions. This paper aims to understand what differentiates top-performing wealth managers from the average and identify the key strategic levers wealth managers can use to stand out from the crowd.

We do this by identifying the crucial characteristics of successful wealth managers in relation to various strategic profiles: their size, organizational set-up, relative strength in growth or mature markets, their target client segment, and whether they focus more on domestic or cross-border business. While there are better options within each strategic area, there is no one-size-fits-all model that guarantees success. Indeed, we will show that top-performing wealth managers employ five key levers that enable them to outperform their peers, regardless of their fundamental strategic choices. These levers are optimized price realization, rigorous sales force management, client centricity, digital advantage and end-to-end efficiency.

The insights in this paper result from discussions with the wealth management leaders we work with. Our conclusions are supported by data from our benchmarking study which covers more than 140 wealth managers of different sizes and business models from all over the world. Our goal is to present a clear and complete illustration of today's competitive landscape in the wealth management industry. We will also offer some perspectives on issues that will affect all types of wealth managers as they pursue their ambitions for growth and profitability in the years to come.

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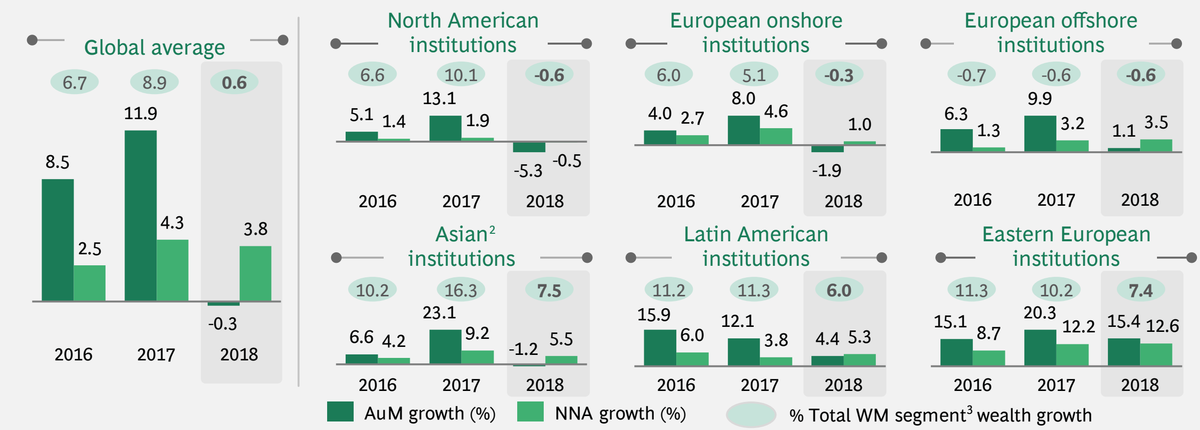
An uncertain environment for wealth managers

Blame it on the markets –wealth managers' dependency on asset appreciation to achieve growth

Increased market volatility, low interest rates, trade tensions and political uncertainties are affecting the growth of personal financial wealth. While markets have rebounded and taken personal wealth to new heights since the turbulence in the fourth quarter of 2018, the fall in assets under management (AuM) experienced by the wealth management industry in 2018, both globally and within many regions, was significant (See Exhibit 1).

Exhibit 1 | AuM and NNA[1] growth affected by global challenges



Source: Global Wealth Manager Benchmarking and Market Sizing Database 2017-2019
Note: Definitions explained in text
[1]AuM is assets under management. NNA is net new assets [2]Excluding China and Japan [3]The Wealth Management Segment is defined by individuals with a financial wealth above USD 250k

The unrelenting profit squeeze

Revenue margin under stress

During the last ten years, revenue margins have been on a declining trend. Although they have stabilized in the last two years, there are no signs of a renewed increase.

We believe there are six reasons for this: (1) low interest rates; (2) more fee transparency as mandated by regulators; (3) increased investor preference for lower-margin products such as passive funds; (4) political uncertainty, both globally and in certain countries, creating a greater demand for lower-margin fixed income and cash-alternative solutions; (5) increasing competition from non-traditional companies in the FinTech space as well as from other finance sector players who have started to focus more on wealth management due to its attractiveness compared to other banking segments; and (6) a growing (ultra-) high-net-worth segment which now has greater bargaining power and therefore has forced prices down.

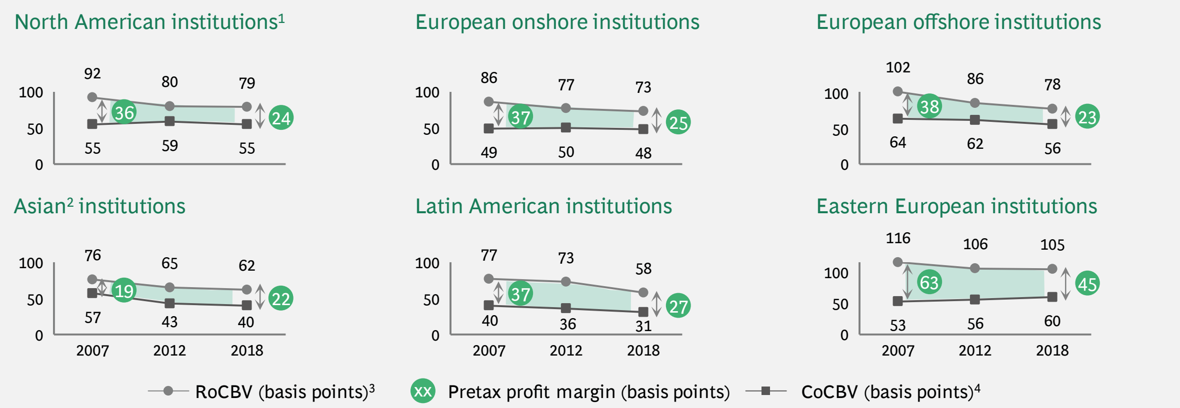
There are regional forces at play too. In the United States, scale-focused players are waging a price war for standard products. For example, they are driving online trading commissions to zero in order to win over clients who are then targeted with more profitable solutions. In the more developed financial centers of Asia, margins have been shrinking as customers start to transact less and move to a buy and hold strategy.

Looming cost increases

Many firms have stringently managed costs in order to help them maintain profit levels. As a result, some wealth managers have foregone necessary investments in systems and new technologies. This will ultimately lead to higher operating costs and a loss of competitiveness unless such investments are forthcoming soon.

Companies that have not invested enough in growth-enabling or efficiency-boosting areas, such as segmentation by behavioral factors and by life events that trigger behaviors, or front-to-back digital capabilities or data and analytics, may feel the need in subsequent years to increase their investments in order not to fall further behind.

EXHIBIT 2 | Margin and cost pressure squeezing profitability



Source: Global Wealth Manager Benchmarking Database 2008-2019
[1]Sample excludes full-service and discount brokers [2]Excluding China and Japan [3]RoCBV = Revenues over average client business volume (assets and liabilities under management) [4]CoCBV = Cost over average client business volume (assets and liabilities under management). Cost excludes depreciation, amortization, provisions, and losses

However, there are still players that manage to grow and remain profitable despite these challenging circumstances. This paper will look at five different strategic decisions that wealth managers make, while also seeking to understand the crucial elements within each such decision. We will then identify the common traits of top-performing players, and illustrate that some players simply do things better than others irrespective of their business model.

Strategic options for wealth managers and their different outcomes

We identified five key strategic profiles for wealth managers. These relate to size, organizational set-up, market presence, client focus, and geographical focus. Although players can select any combination of choices for these five areas, we will look at each of them independently to understand which strategic options tend to yield the best results in the current environment. The result of our analysis along several key metrics is shown in Exhibit 3, in which we have highlighted the most successful option for each strategic profile.

EXHIBIT 3 | Performance of common WM business models varies significantly

Strategic profile	Size			Org set-up		Market presence		Client focus		Geographical focus	
Business Options	Small (<10)	Mid (10-100)	Large (>100)	Universal	Pure-play	Mature	Growth	(U)HNWI	Affluent	Domestic	Cross-border
Net new assets (% of AuM)	0.0	2.7	3.5	1.9	1.8	1.5	5.7	4.4	6.7	2.1	3.7
Service (DPM & adv. share, %)	48.2	47.2	43.8	57.2	65.2	55.3	17.5	34.4	29.9	46.2	34.7
Price Realization (RoCBV, bps)	67.3	71.9	75.1	69.0	73.3	75.5	68.5	66.7	86.0	68.7	72.4
Client Base (CBV/client, $M)	3.0	3.9	4.6	3.6	4.2	2.6	2.5	9.9	0.3	3.0	5.2
RM Book Size (CBV/RM, $M)	177.0	236.9	266.0	232.4	264.5	216.7	318.7	290.4	75.6	221.6	232.2
RM Productivity (Rev/RM, $M)	1.2	1.7	1.9	1.6	1.9	1.7	1.7	1.9	0.7	1.5	1.7
Cost Efficiency (Cost-to-income, %)	83.2	70.2	67.4	65.3	69.7	68.9	63.2	72.3	58.5	66.7	70.6
Cost margin (CoBV, bps)	56.0	50.5	50.6	45.0	51.1	52.0	43.3	48.2	50.3	45.8	51.1
Profitability (Pre-tax profit, bps)	11.3	21.4	24.5	23.9	22.2	23.5	25.3	18.5	35.7	22.9	21.3

Source: Global Wealth Manager Benchmarking Database 2018-2019
Note: Definitions explained in text; CBV is client business volume

SIZE[1]: THE LARGER, THE BETTER

Wealth management is a scale business, and size remains one of the most important contributors to profitability. Cost efficiency increases with size due to economies of scale. We can see the largest effect of an increase in scale in medium-sized players. Subsequently, a combination of complexity and the propensity to make larger investments e.g. in digitalization lead to a flattening of the cost margin, to a global average of approximately 51 basis points (bps) for both medium-sized and large players. However, we expect investments in client experience and operational efficiency to be effective in the future. These investments may therefore result in a faster growth in profitability among the larger players that are investing most heavily in these areas.

Revenue margins also increase in line with company size. Large players have the highest margin at 75 bps on client assets and liabilities, even despite having slightly larger clients on average compared to medium-sized and small players, who earn 72 bps and 67 bps respectively. This suggests that large, well-known brands are able to command a pricing premium or offer fewer discounts. They may also be able to provide clients with a broader range of higher-margin products and services, such as lending and alternative assets.

Better cost-to-income ratios of large players primarily result from superior revenue-generating capabilities rather than from a significant cost advantage.

It is worth noting that currently the better cost-to-income ratios of large players primarily result from superior revenue-generating capabilities rather than from a significant cost advantage.

In general, wealth managers with AuM less than USD 10 billion are at a serious disadvantage due to a lack of economies of scale, and they have the lowest profitability across all the strategic plays we examine. Only those few small players that are employing other approaches, to be discussed later in the paper, stand a chance of being successful.

Organizational set-up[2]: Universal banks are more profitable

Does it make a difference whether a wealth manager is part of a larger banking group or operates as a stand-alone entity? Organizational set-up does indeed have an impact on profitability.

As a result of their cost advantage, wealth management divisions of universal banks tend to be slightly more profitable than standalone players. Increased coordination costs are mitigated by the potential for sharing services, infrastructure and platforms with other business divisions. This offsets the edge pure players have in terms of revenue margins, where they do a better job of offering high-margin services like discretionary portfolio management (DPM) and advisory services, and are also more adept at price realization.

We have not seen any evidence that those wealth managers embedded in universal banks achieve significantly stronger growth. Net new asset growth in 2018 was nearly identical for universal and standalone players, at 1.9% and 1.8% growth on the previous-year AuM respectively. This indicates that any potential advantage universal banks may derive from their ability to refer clients from retail, corporate and investment banking divisions to their wealth management unit are either poorly utilized or do not offset the advantage which pure players possess through marketing their exclusive wealth management focus to current and prospective clients. Similarly, any advantages stemming from access to investment banking or other wholesale banking services for private clients within the universal bank structure is not reflected in net new assets.

Presence in mature versus growth markets[3]: Growth market players lead on growth

It is clear that those wealth managers operating in markets where personal financial wealth is rapidly increasing will have higher net new asset growth. However, we have also seen that they lag behind mature market players in terms of revenue, if not profit.

If growth market players are able to shift their clients to more holistic and advisory-based services, they are certain to overtake mature market players. These mature market players currently offer more discretionary and advisory services, while growth market players still focus heavily on brokerage. This helps to explain the higher revenue margins realized by mature market players.

Despite higher revenue margins in mature markets, growth market players enjoy lower costs across all functions, leading to a slight advantage in profitability. What sets growth market players apart is their strong organic growth. On average, they gathered four times more net new assets (NNA) than mature market players in 2018. Growth in relationship managers is also much higher for growth market players. The relationship manager (RM) population grew at three times the rate of mature market players in 2018.

Client focus[4]: Various opportunities

Over the last five years, the strategies of many wealth managers have focused on attracting the very wealthiest clients. Dedicated (ultra-) high-net-worth ((U)HNW) units were set up, and exclusive offerings were put together to win over this prestigious clientele. At the other end of the spectrum, the affluent segment was almost overlooked, regarded as unattractive and difficult to serve properly. However, those players who did focus on the affluent segment fared well, although they could do even better.

(U)HNW is the segment with the highest growth in personal financial wealth (with predicted annual growth of approximately 8% in the coming five years, against approximately 6% for the affluent segment)[5]. However, the sheer size of the affluent segment, consisting of 74 million individuals in 2018 and expected to grow to 96 million in 2023, and the fact that this segment has been (and often still is) poorly served, has resulted in higher net new assets for those players focusing on the affluent sector (7% in 2018 against 4% for the players focused on (U)HNWIs).

(U)HNWI is also a more expensive segment to concentrate on. (U)HNW players have a significantly higher cost-to-income ratio in comparison with affluent-focused players (72% against 59%). Given the larger average size of clients, revenue margins are inevitably lower for the (U)HNW segment than for affluent clients. Moreover, due to the nature of the high-touch, tailored service model for higher-net-worth clients, it is difficult for banks serving this segment to keep costs low. (U)HNW-focused companies have a cost margin of 48 bps, against 50 bps for affluent-focused banks.

What this cost analysis really suggests is that the costs that affluent-focused players incur in producing business are far too high, and that they could become even more profitable if they were to increase efficiency. The average affluent-focused relationship manager produces USD 700 thousand in annual revenue, less than half of what a (U)HNWI-focused RM makes. Despite all the advances in technology that can make it possible to produce standard offerings at an industrial scale while personalizing the client experience, banks still seem to be struggling to implement such low-cost models for their affluent client base. Possible reasons could be the investment cost required to digitize offerings, and the difficulty of actually generating actionable insights from big data (as a result of factors and issues such as data silos, talent shortages, ever-changing technology, data quality, data privacy and fraud prevention)[6].

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Geographical focus[7]: Cross-border players not as profitable as in the past

Wealth managers focusing on cross-border business used to be significantly more profitable than those focusing on domestic markets. However, profitability has been converging due to both increasing costs and decreasing revenue for the cross-border model. This has prompted a number of banks previously focused on cross-border business to invest in domestic businesses.

Cross-border players typically serve larger clients. However, they still manage to achieve a higher revenue margin. This is likely to be due to a somewhat higher price point for a more sophisticated product and service offering. Cross-border RMs also manage larger books of business and generate more revenues. However, the cost of running a cross-border model is much higher, resulting in a cost-to-income ratio of 71%, versus 67% for domestic-focused wealth managers.

When we compare cross-border players in mature market financial centers, such as Switzerland, to those in growth regions, such as Singapore and Hong Kong, we find that many of the characteristics previously discussed in the market presence section still apply, except that Switzerland (still) has an advantage on profitability.

In Singapore and Hong Kong, clients are on average larger and margins are lower in comparison to Switzerland. In Switzerland, meanwhile, RMs manage more clients. These effects cancel each other out, leading to similar book sizes and revenue per RM. Revenue margins are higher in the Swiss model at 80 bps versus 66 bps for Singapore and Hong Kong. Although costs are also higher for Switzerland versus for Singapore and Hong Kong, Switzerland still leads on profitability due to its stronger revenue generation capability.

Smaller player in a mature market? How you play matters more than where you play

It is not just about where you play as a wealth manager, but how you play. In our analysis of top-performing wealth managers, defined as the top quartile in profitability among their peers, it was interesting to note that a number of players did not necessarily fit into the most successful categories of strategic options pursued. (See Exhibit 4).

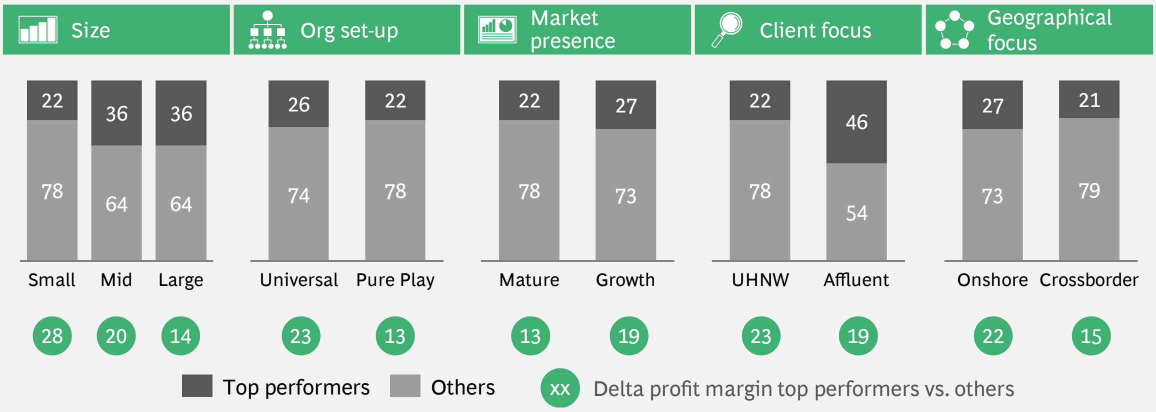
What therefore are these players doing to come out on top despite their apparent disadvantage? We have identified five levers that successful wealth managers all benefit from, regardless of business model or strategic profile: optimized pricing, sales force effectiveness, client centricity, digital advantage and efficiency (summarized in Exhibit 5).

Turn pricing into a core capability

The leading wealth managers of today didn't outperform their peers by being better at cutting costs, but by posting stronger revenue growth. Smart pricing is an important contributor to revenue uplift, and top performers do a better job of aligning pricing to the value proposition and optimizing price structure and execution.

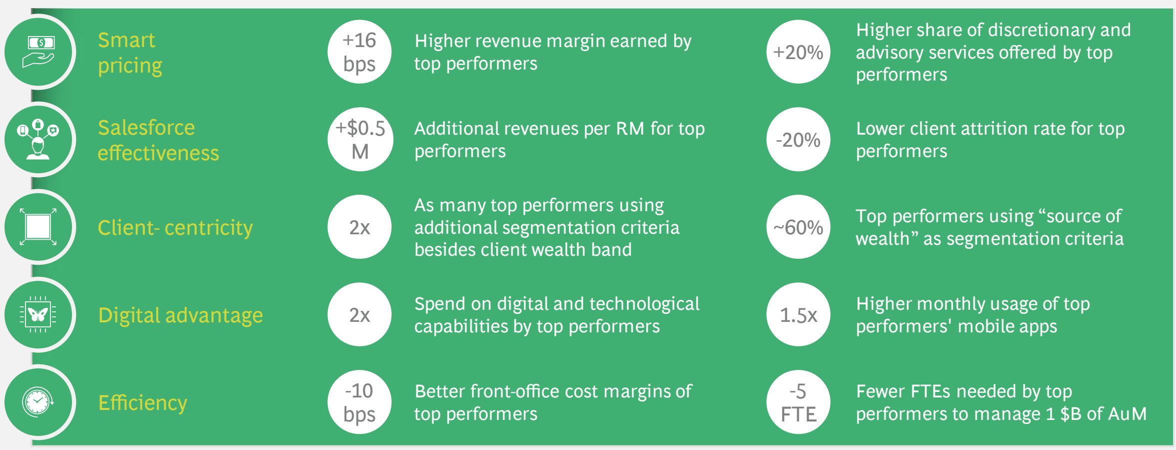
EXHIBIT 4 | There are top performers across all plays

Share of top-performers across strategic options



Source: Global Wealth Manager Benchmarking Database 2018-2019
Note: Definitions explained in text; Top performers refer to top-quartile sample with highest pre-tax profit margin

EXHIBIT | 5 Five common strengths across top performers



Source: Global Wealth Manager Benchmarking Database 2019
Note: Top performers refer to top-quartile sample with highest pre-tax profit margin

Our experience from working with our wealth management clients suggests that an optimized pricing strategy can yield a revenue uplift of between 8% and 12%. Looking at the top performers in our sample, we can see evidence of this significant advantage:

- The price realization of top performers is much stronger. Their return on assets (RoA) is significantly (16bps) higher.

- Top performers have higher margins for all client wealth bands and service models.

- Top performers also have better price variation across client wealth bands. That is to say, we can see top performers maximizing margins for the affluent segment and pricing more competitively in the upper segments.

- The service mix of top performers maximizes revenue, with a higher share of discretionary portfolio management and fee-based advisory business.

Successful pricing is about more than the price itself. Top performers approach pricing as a capability, making the necessary adjustments to their business models, technology, and competency frameworks to reap maximum advantage. Although these changes require considerable effort, they are not necessarily expensive. Moreover, they can make the difference between winning and losing in the years ahead[8].

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Apply rigorous sales force management

Top performers demonstrate above-average sales force effectiveness. This means that the RM has enough time available for acquisition and servicing, spends time with the right clients, and has all the necessary tools and knowledge to provide excellent client service. In order to increase net new assets and revenue, top performers not only focus on RM activities. They also utilize other underlying levers, including product mix enhancement.

Improving sales effectiveness can lead to a significant competitive advantage, as we see from the top performing group:

- Revenue per RM for top performers is on average USD 500 thousand higher than for average players in 2018.

- Top-performer RMs acquire 8% more NNA than average performers.

- Client attrition rates for top performers are 20% lower, meaning that acquisition costs can be kept lower.

- On the compensation side, top performers don't necessarily pay RMs more, but to reward better performance, the ratio of variable compensation as a percentage of overall compensation is higher.

Embrace client centricity

To serve client needs in the best possible way, top performers tend to employ much broader segmentation criteria than average performers, which typically focus on level of wealth. The needs and behaviors of clients should also be considered. While in some cases, these are correlated with level of wealth, often they are not.

For example, 63% of top performers use "source of wealth" to segment clients, whereas only 29% of average performers do this. 'Client life stage' is taken into consideration by 25% of top performers, compared to 10% of average performers.

With modern tools available, such as advanced data analytics and ethnographic research, banks are in a better position than ever to understand clients, not only according to their segment but on an individual level too. This presents an opportunity for all banks, including our top performers, to truly understand what their clients want and why. They can then use this information to improve the overall client experience through measures such as personalized communication via the right channels, meaningful prompts for action and tailored offers[9].

Become a digital leader

Top performers spend nearly double on digital and technological capabilities relative to AuM than average performers. Their client-facing technology has a higher take-up, with 26% of clients of top performers using their wealth manager's mobile application at least monthly, compared to 18% of clients of average performers. A very high number (70%) of clients of average performers don't use the application at all.

Top performers not only invest in client-facing technology, where average players invest more than 40% of their digital investment budget, but holistically divide the expenditure between front, middle and back-office functions, including data and analytics. They have also prioritized cybersecurity, as they understand that protecting client data and bank systems is of the utmost importance in avoiding reputational and financial losses. Top performers score better in all respects in our assessment of cyber-readiness.

Unlike average players, top performers not only invest in client-facing technology, but holistically divide the expenditure between front, middle and back-office functions, including data and analytics.

Focus on efficiency

Top performers have a relentless focus on efficiency. While overall cost margins may not be significantly lower for top performers than for average performers, there are large differences in where these expenses are incurred.

Top performers have significantly better cost margins in the front office as a result of their sales effectiveness. There is a difference of approximately 10 bps between top performers and average players in front-office cost margins. As far as the back office is concerned, top performers are investing in technology and analytics. We note that most IT costs for top performers are almost double the average due to the associated expenditure on capability building that they believe to be so important.

As they have been investing in sales effectiveness and process automation, top performers demonstrate higher efficiency per full-time employee (FTE) – top performers manage USD 1 B in AuM with 23 FTEs, whereas average players need 5 FTEs more.

Moreover, we have observed that leading wealth managers use agile principles to address low end-user satisfaction, employee engagement and process inefficiencies. Along with implementing agile organizational principles and ways of working, they also instill a culture that emphasizes empowerment rather than command and control.

The wealth management market is becoming tougher due to economic uncertainty, tightened regulations, increased competition and changing client needs. Some players might be in a position to consider the most successful strategic options we identified among the most common business models. However, everyone can benefit by focusing on the five key levers in which top performers typically excel.

Notes

1. We define size in terms of client assets and liabilities (business volume) of a wealth manager. Large managers are classified as having a business volume > USD 100 B, medium managers as having USD 10-100 B and small ones with a business volume < USD 10 B.

2. Organizational set-up refers to how a wealth manager is structured. Pure play managers refer to those having a dedicated, stand-alone wealth management business. Universal banks refer to wealth management businesses that are a part of a broader banking organization typically providing retail, corporate and investment banking services.

3. We define market presence by looking at which core domestic market(s) a wealth manager is focused on. We compare mature market players, meaning those with a majority of their business in markets such as North America and Western Europe, to growth market players, which are those that primarily operate in developing markets such as Asia, Latin America and Eastern Europe.

4. We look at the primary client segment addressed by a wealth manager. We focus on two extremes – wealth managers focusing on (U)HNW clients, in which we include wealth managers with a 50%+ share of client assets and liabilities (business volume) in the segment > USD 20 million, and those focusing on the affluent end of the AuM spectrum, which is defined as wealth managers with a 50%+ share of business volume coming from clients with < USD 1 million in AuM.

5. According to BCG Global Wealth Market Sizing 2019, UHNW is defined as individuals with personal financial assets in excess of USD 20 million, while affluent individuals' personal financial wealth amounts to between USD 250 thousand and 1 million.

6. See also BCG's report "Global Wealth 2019 - Reigniting Radical Growth" for more insights on how to seize the affluent opportunity.

7. We define domestic focus as players having the majority of their business in a local market (onshore profile), while the cross-border model refers to players that place a large focus on clients whose assets are booked outside of their domicile.

8. For more information on BCG's Smart Pricing approach, see our report "Solving the Pricing Puzzle in Wealth Management".

9. For more insights on how to understand your clients, see also BCG's white paper "Decoding the Human - Truly Understanding Clients in Wealth Management".

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Further reading

Boston Consulting Group has published other reports and articles that may be of interest to senior financial executives in Asset and Wealth Management. Recent examples include those listed below.

Decoding the Human – Truly Understanding Clients in Wealth Management
A white paper by Boston Consulting Group, October 2019

Solving the Pricing Puzzle in Wealth Management
A focus report by Boston Consulting Group, September 2019

How Asset Managers Can Seize the Lead in Sustainable Investing
An article by Boston Consulting Group, July 2019

Global Wealth 2019: Reigniting Radical Growth
A report by Boston Consulting Group, June 2019

What Does Personalization in Banking Really Mean?
An article by Boston Consulting Group, March 2019

Global Wealth 2018: Seizing the Analytics Advantage
A report by Boston Consulting Group, June 2018

Digital Wealth Management and the China Opportunity
A report by Boston Consulting Group, May 2018