BCG

REPORT

Wealth Markets in China

Delivering the Right Value Proposition for China's Wealthy

THE BOSTON CONSULTING GROUP

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CHINA BANKING INSTITUTE

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BCG Financial Institutions in China

The Boston Consulting Group (BCG) is pleased to present this report which constitutes the most recent in a series of publications produced on the dynamics of China's financial services industry, and the implications for local and overseas players.

BCG is a general management consulting firm that is a global leader in business strategy and that has helped companies in every major industry and market achieve competitive advantage by developing and implementing winning strategies. Founded in 1963, the firm now operates 66 offices in 38 countries.

BCG started operations in China about 26 years ago, with projects for multinational companies entering the country. Soon afterwards, BCG began serving Chinese enterprises and Government entities. In 1993, BCG opened its first office in China—located in Shanghai—well ahead of other major international management consulting firms.

Financial Institutions has been a cornerstone of BCG's business portfolio in China for many years. BCG serves a select number of leading foreign multinational and domestic Chinese clients in the banking, insurance and securities sectors. In particular, the firm has assisted, and continues to advise, several large state- and privately-owned banks in their wide-ranging reform and commercialization efforts.

Cooperation with these and other clients typically start from enterprise-wide strategic themes such as understanding customer needs by segment, corporate and business strategy, and competitive differentiation. Subsequently, BCG teams, assisted by a global network of experts and advisers, have also been instrumental in helping our clients build deep professional capabilities in key areas such as capital strategy, risk management, information technology, marketing, and sales force effectiveness.

Consequently, BCG China sees itself as a bridge between Chinese and foreign business cultures and practices. BCG leadership firmly believes that success in China requires a deep understanding of both business perspectives and the ability to meld them into a unique way of doing business in China.

Preface

Global wealth declined by 11.7 percent from 2007 to 2008, as assets under management (AuM) were weighed down by the financial crisis and the economic downturn.[1] The crisis took a heavy toll on wealthier households—the number of millionaire households fell from 11 million in 2007 to about 9 million in 2008. The damage was most pronounced in larger, more developed markets such as North America, while Asia as a whole was less affected. AuM declined by only 6.2 percent in Asia-Pacific (excluding Japan), but the impact of the turmoil—as well as the outlook for the timing and strength of a recovery—varies by country.

Although China's economy has suffered significant reductions in production, its GDP is expected to grow by about 8 percent in 2009. China's wealth market remains strong—it declined by only 2.3 percent in 2008 and is expected to exceed its precrisis level in 2009. China's strong economic growth, rising incomes, and high savings rate will continue to create wealth at a phenomenal rate. We expect the wealth market in China to grow at an average annual rate of 17.2 percent between 2008 and 2013, to reach $7.6 trillion.

On the demand side, China's wealth market remains immature. The penetration of private banking is low, and many high-net-worth individuals (HNWIs) do not fully appreciate the value that private banking can offer.[2] This creates challenges for both local and foreign banks, but it also presents unique opportunities. To introduce private banking products and services to Chinese HNWIs, banks will need to understand their existing and potential customers—they have distinct needs and investment behaviors—and take time to build trust and good relationships. It will be crucial for banks to develop targeted value propositions that appeal to specific customer segments.

Cultivating relationships requires substantial time and effort, but the rewards can be significant. If a bank can make a connection with a client just as he or she is becoming more interested and active in wealth management, the bank will be in an advantageous position to become the client's main wealth manager. And as the client's wealth and financial sophistication grow, this relationship will become increasingly valuable.

On the supply side, China's private banking market is also at an early stage of development. Bank of China, the first local mover, launched its private-banking business in 2007, and was followed by a number of players. No one has established a dominant position yet.

Local banks have been using different approaches to organize their private banks. The options include establishing a private bank as an independent business unit, integrating it into retail banking network, or adopting a hybrid approach. Most Chinese banks, however, are still searching for the right balance between leveraging their existing HNWI resources in the retail network and developing a differentiated and professional private-banking operation. Many are also developing the necessary capabilities and addressing a range of organization issues. At the same time, foreign banks have been actively developing their private-banking businesses in China. While they

1. BCG's global wealth model covers 62 countries and includes AuM owned by all households (not just wealthy households). AuM includes cash deposits, money market funds, listed securities held directly or indirectly through managed investments, and onshore and offshore assets. It excludes wealth attributed to investors' own businesses, residences, or luxury goods.

2. HNWIs are defined as individuals from households that have a minimum of $1 million in AuM.

have deep private-banking expertise in international markets, many are not able to deploy their full global capabilities and advantages in the local market.

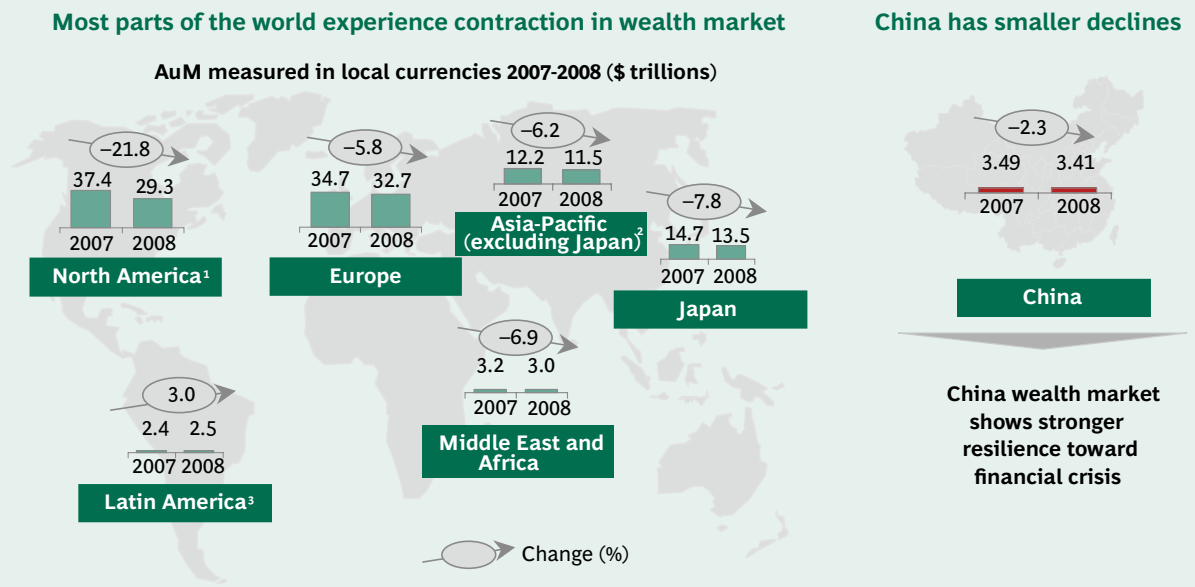
The race to build a strong wealth-management business in China is still in its early stage. We believe that China's wealth market will develop rapidly over the next couple of years, offering a window of opportunity for banks to establish competitive positions—but they need to act quickly, before others take an unassailable lead in the most attractive segments and geographies. The winners will be the ones that have defined a clear goal, developed a deep understanding of their customers, invested in a tailored and differentiated business model (backed by the requisite capabilities), and mobilized the organization to take advantage of this attractive opportunity.

China's Wealth Market: Poised to Resume Strong Growth

China's wealth market maintained relatively strong momentum despite the financial crisis. While global wealth declined by 11.7 percent in 2008, wealth in China fell by only 2.3 percent to $3.41 trillion. (See Exhibit 1.) From 2003 through 2008, China's wealth grew at an average annual rate of 28.2 percent. It was the largest and fastest-growing wealth market in Asia-Pacific (excluding Japan) and arguably the most explosive wealth market in the world. (See Exhibit 2.) For both local and foreign banks, China's wealth market provides an unparalleled opportunity for growth.

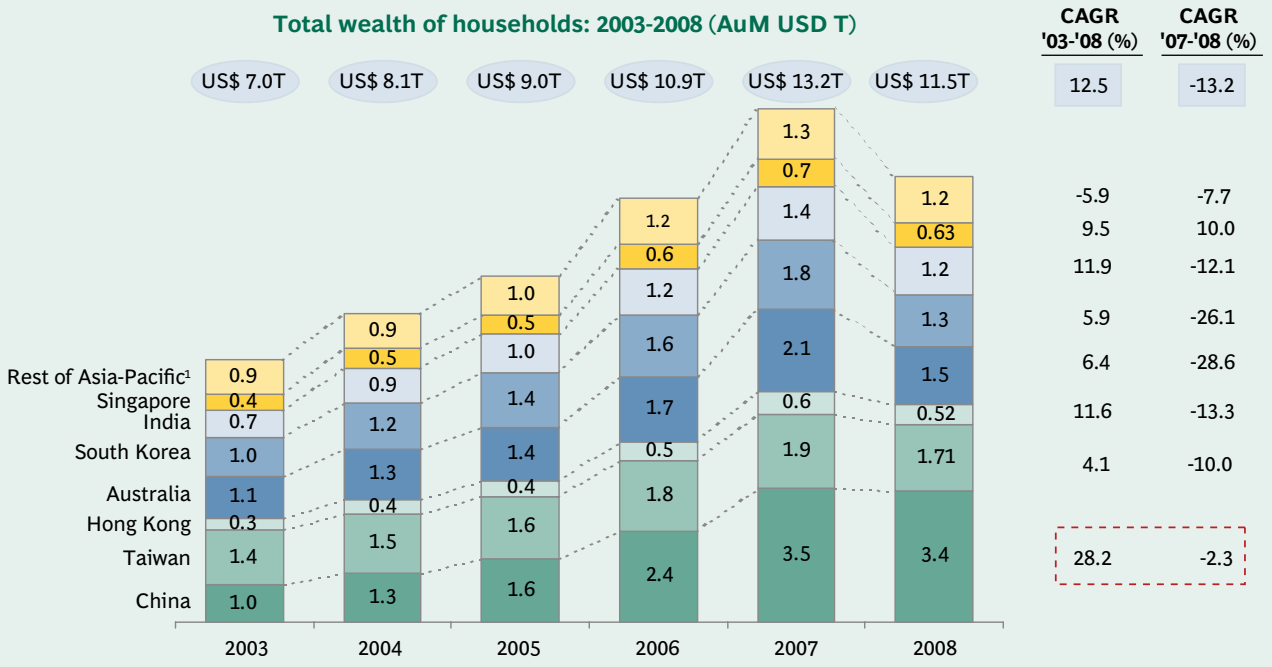
China was not immune to the financial crisis (few markets were). Since the crisis began, the country has witnessed high volatility in the A-share market, declining export volumes, and fluctuations in real estate prices. Still, the overall market sentiment remains positive, for good reason. The government implemented a substantial stimulus package, and the economy has

Exhibit 1. China's Wealth Market Declined Slightly in 2008



Source: BCG Global Wealth Market-Sizing Database, 2009.
Note: Percentage changes and global totals of AuM are based on complete, not rounded, numbers. AuM levels for 2007 vary slightly from last year's report because of changes in the underlying macroeconomic data and the exclusion of defined-benefits pensions from U.S. household wealth. Global wealth is measured by AuM across all households; growth rates are measured in local currencies. AuM in 2007 was calculated using 2008 U.S. dollar exchange rates, so that growth rates exclude the effects of currency movements.
[1]United States and Canada.
[2]Includes Australia and New Zealand.
[3]South America, Central America, and Mexico.

Exhibit 2. China Has a Fast-growing, Resilient Wealth Market



Source: BCG Wealth Market Sizing Database, 2009.
[1]Rest of Asia-Pacific includes Indonesia, Thailand, Malaysia, New Zealand, Philippines and Pakistan.

started showing signs of a recovery. Both industrial added-value growth and GDP growth have picked up this year, and stock markets have rallied. Stock trading value reached a record high in July 2009, exceeding its previous high, set in 2007. (See Exhibit 3.) Although the stock markets experienced a recent correction, investors still have considerable confidence in the economy.

The vitality of China's wealth market was reaffirmed by a recent industry survey conducted by BCG. Nearly 40 percent of the respondents (mainly private bankers or functional heads in private banking) think the impact of the financial crisis on China's private banking industry is minimal. Only around 10 percent believe the impact is significant or severe. Ms. Anna Zhu, Chief Investment Officer of Minsheng Banking Corp. and CEO of CMBC Private Banking, indicated that "The number of HNWIs is increasing very quickly, even during and after financial crisis." Mr. James Wang, Senior Vice-President and Head of Wealth Management, BNP Paribas (China) Ltd, commented in an interview that "the global financial crisis had no significant impact on the onshore private banking business in China. I see great potential going forward. Hence, China market is very important for us."

Core Drivers of Growth

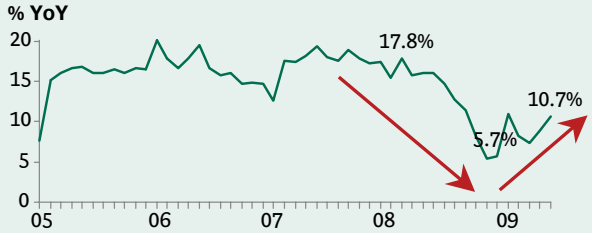
The Chinese economy is expected to rebound in 2009, and its rapid expansion will continue to create wealth. China's diversified, manufacturing, and real estate industries continue to spawn the largest entrepreneurial wealth. (See Exhibit 4.) The country's sustained economic development has led to rising income—per capita income has been growing at an average annual rate of more than 10 percent over the past few years. Additionally, China's national saving rate, at 51 percent[3], is the highest in Asia-Pacific. Both factors—rising income and a high savings rate—will continue to spur the development of the wealth market.

3. Source: PBOC, measured at savings divided by national disposable income.

Exhibit 3. China's Economy Is Recovering and Stock Trading Value Reached a Record High in 2009

Monthly industrial added-value and quarterly GDP growth both show an uptick in 2009

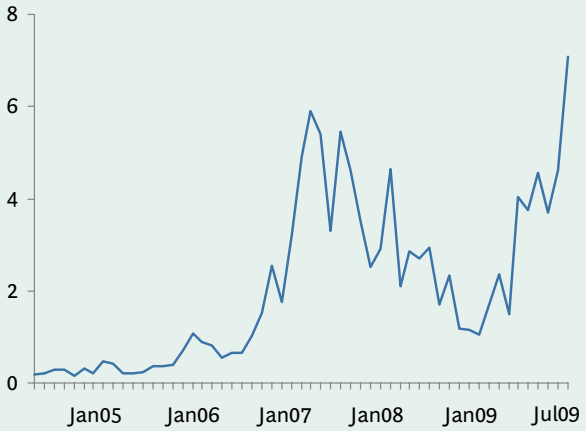
China monthly industrial added-value growth rate



China quarterly GDP growth rate

Trading activity reached new record level

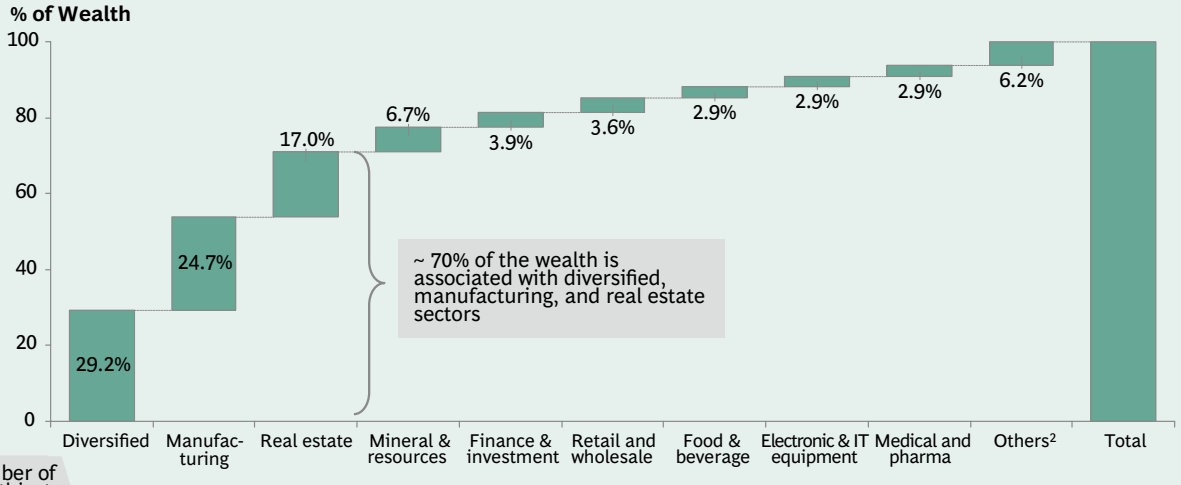
Stock trading value (RMB T)



Source: CEIC, GS Global ECS research, lit search, Statistics Bureau; BCG analysis.

Exhibit 4. China's Diversified, Manufacturing, and Real Estate Sectors Created the Most Wealthy Individuals

Industry sector sources of wealth for China's wealthiest individuals, 2008[1]



Number of wealthiest Chinese per industry	Diversified	Manufac-turing	Real estate	Mineral & resources	Finance & investment	Retail and wholesale	Food & beverage	Electronic & IT equipment	Medical and pharma	Others[2]	Total
	232	303	125	69	41	30	38	28	43	90	999

Source: 2008 China Hurun Rich List and BCG Global Wealth analysis.
[1]The AuM of China's wealthiest 999 individuals.
[2]The other category includes environment and infrastructure, transportation and tourism, agriculture, education and other service industries.

China's economic recovery is reflected in key wealth indicators. By the end of 2009, the number of millionaire households—those with at least $1 million in AuM—is expected to reach 453,000, and millionaire household AuM will reach $1.73 trillion. On both measures, the 2009 totals will exceed the precrisis levels. Moreover, we expect the number of millionaire households to grow at an average annual rate of 13.6 percent from 2008 through 2013, to reach 788,000. (See Exhibit 5.) We expect China's wealth of millionaire household to grow at an average annual rate of 17.5 percent over the same period, to reach $3.49 trillion. (See Exhibit 6.)

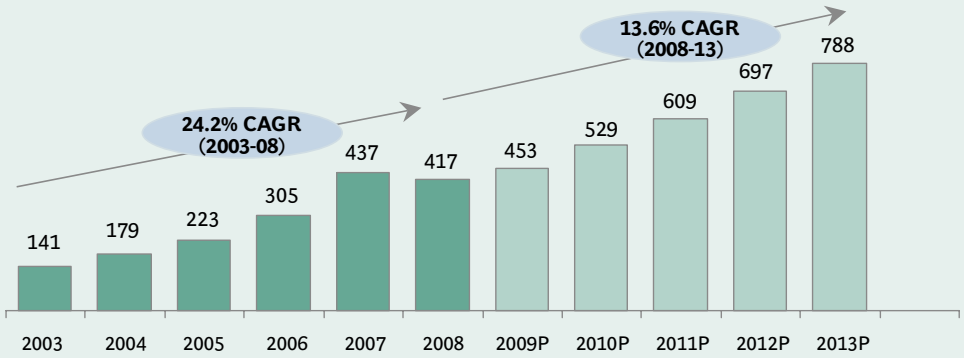
Concentrations of Wealth

Millionaire households represented only about 0.1 percent of all households in China but held 45.8 percent of the total wealth in 2008. During the crisis, however, wealth became slightly less concentrated. The percentage of wealth owned by these households was higher in 2007, at 47.4 percent. (See Exhibit 7.) However, we expect millionaire households to become wealthier during the eventual economic upturn, and the concentration of wealth will increase again. (See Exhibit 8.)

Wealth in China is also concentrated geographically. Six regions accounted for more than half of the wealth owned by millionaire households: Guangdong, Shanghai, Zhejiang, Beijing, Jiangsu, and Shandong. (See Exhibit 9.) These areas each have more than 20,000 millionaire households. Guangdong has by far the highest number.

We believe China will continue to be one of the most attractive wealth-management markets, considering its fast growth and high potential. In addition, the concentration of wealth makes it easier for players to tap into the market. A presence in key locations is sufficient to capture a large portion of the opportunity.

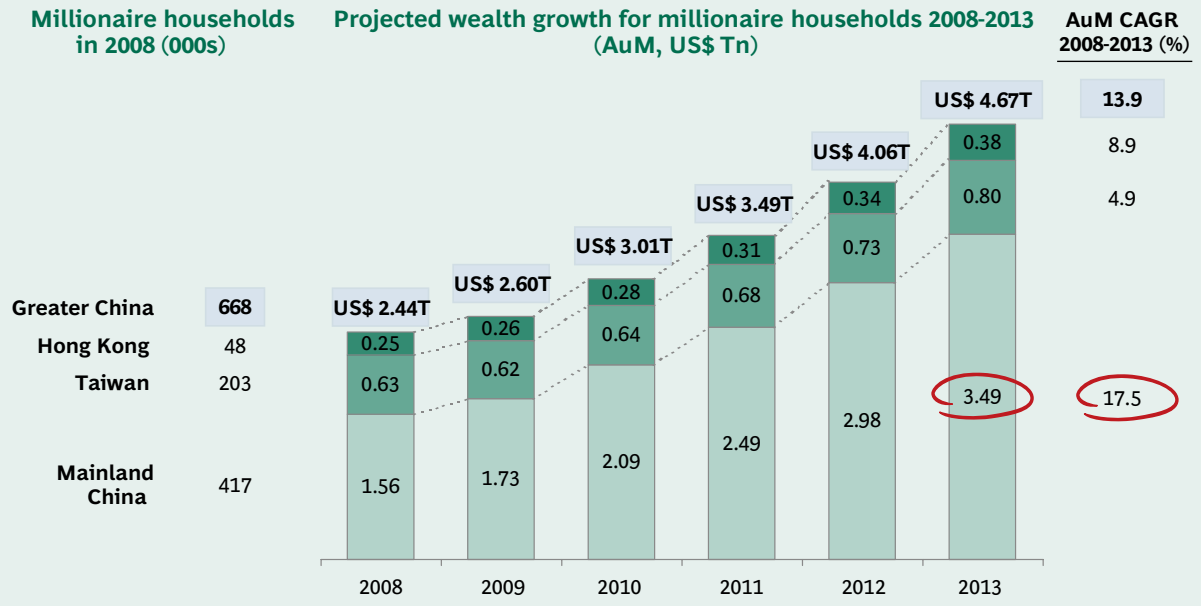
Exhibit 5. The Number of Millionaire Households Is Expected to Nearly Double from 2008 to 2013



	2003	2004	2005	2006	2007	2008	2009P	2010P	2011P	2012P	2013P
Total millionaire HH AuM (US$ Tn)	0.45	0.58	0.76	1.07	1.62	1.56	1.73	2.09	2.49	2.98	3.49
Average AuM per millionaire HH (US$ Mn)	3.19	3.25	3.30	3.52	3.78	3.75	3.80	3.95	4.10	4.27	4.43

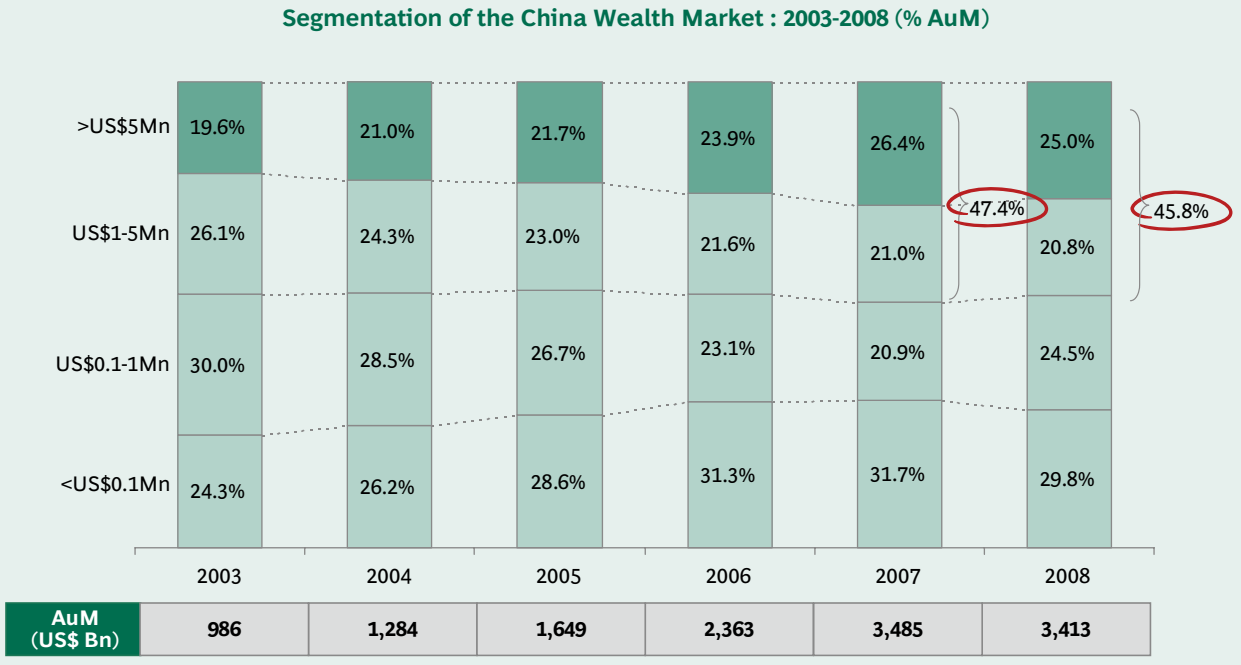
Source: BCG Wealth Market Sizing Database, 2009.

Exhibit 6. Wealth in Mainland China Will Grow at an Exceptional Rate



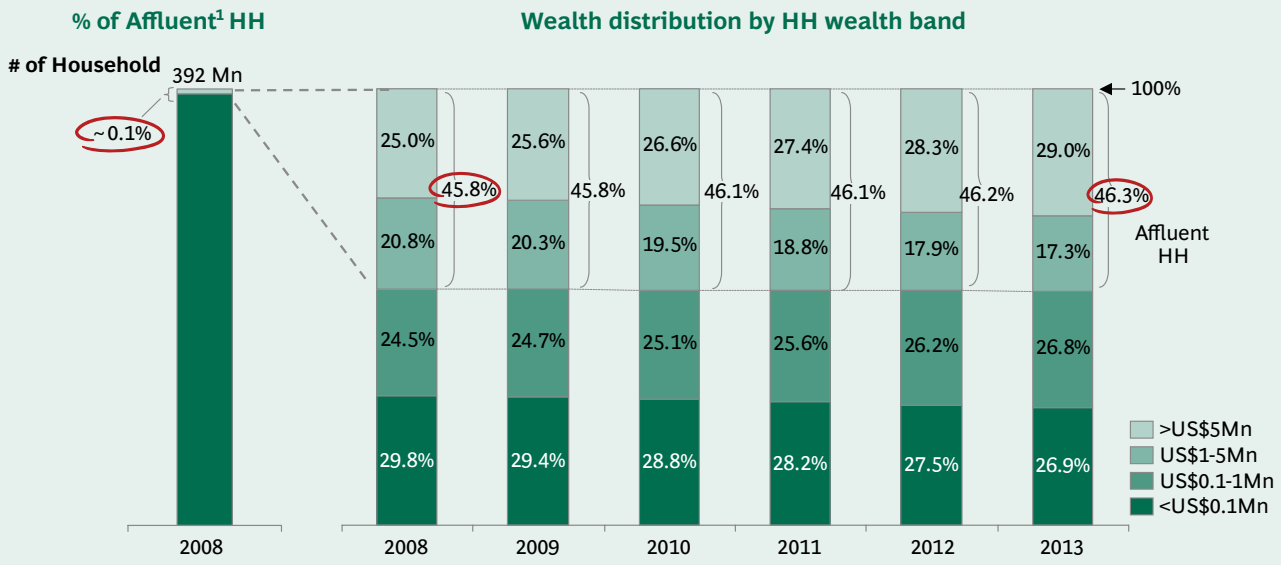
Source: BCG Wealth Market Sizing Database, 2009.

Exhibit 7. Wealth Became Slightly Less Concentrated in 2008



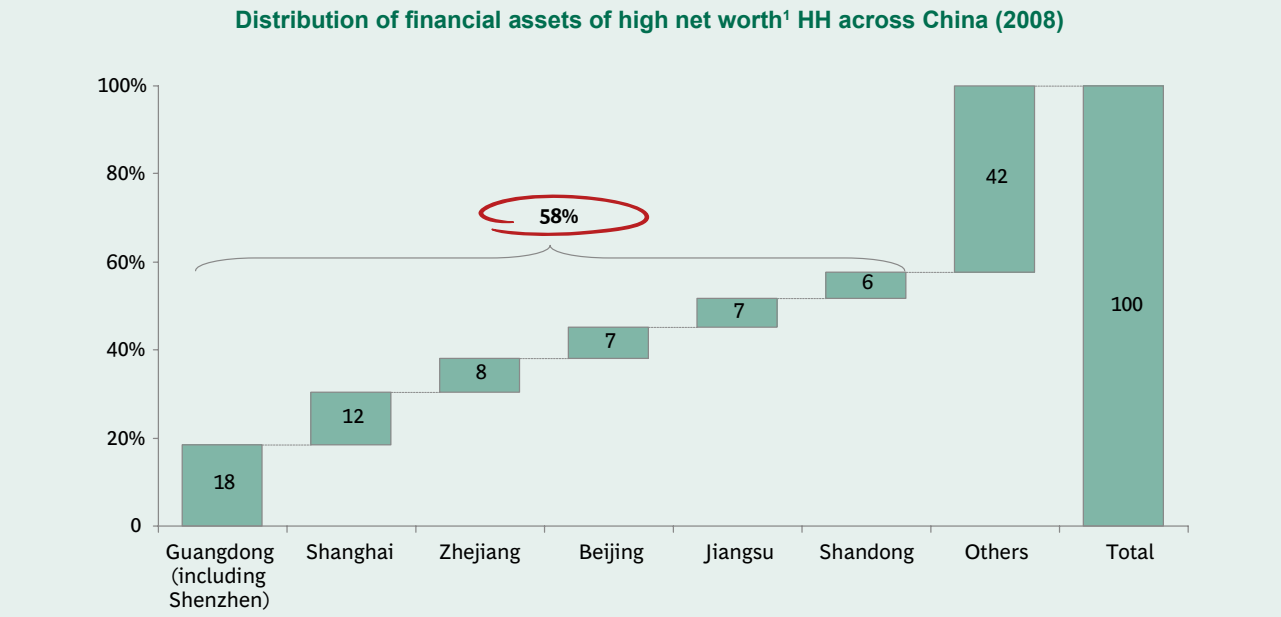
Source: BCG Wealth Market Sizing Database, 2009.

Exhibit 8. But Wealth in China Will Remain Highly Concentrated Going Forward



Source: BCG Wealth Marketing Sizing Data, 2009.
[1]Affluent HH refers to HH with financial assets of 0.1 Mn USD or more.

Exhibit 9. Six Regions Accounted for More Than Half of the Wealth Owned by Millionaire Households



Source: BCG Wealth Marketing Sizing Data, 2009.
[1]High net worth HH refers to HH with financial assets of 1 Mn USD or more.

High Net Worth Individuals: A Distinct Segment

The concept of private banking is still new to many wealthy individuals in China, and the penetration of private banking remains extremely low. This was borne out by our interviews and surveys of customers and industry players.

Many HNWIs have not heard of private banking and do not understand what private banks can offer. Some are reluctant to use private banks because they want to keep their true wealth inconspicuous; some cannot distinguish private banking services from retail banking; and some even assume these are "privately-owned" banks and are therefore not reliable. Many domestic private banks in China are trying to attract and build a stronger bond with their customers by offering free add-on services, such as golf club memberships, airport lounge access, art events, or premium outings.

Private banks typically categorize their HNW customers by level of wealth. However, that is far from enough to profile customer segments with unique characteristics and investment behaviors. Our recent customer survey observes several other useful dimensions for private banks to identify distinct customer segments such as source of wealth, investment styles, investment product and service needs. Some global banks already applied these dimensions to get a comprehensive view on who their customers are and what they want from private banks from different angles. As the industry evolves, private banks need to refine their target customer segments through multiple dimensions and provide well-defined and clearly differentiated value propositions tailored to their unique needs and behaviors in order to establish a strong position.

Customer Segments Defined by Sources of Wealth

HNWIs are often segmented by levels of wealth, but their sources of wealth provide a much better indication of their wealth-management characteristics and needs. China's HNWIs can be categorized into four groups based on their sources of wealth: entrepreneurs, executives and professionals, professional investors, and the independently wealthy. Among these four segments, individuals' backgrounds and expectations toward private banking vary widely.

- *Entrepreneurs.* Most HNWIs in China are entrepreneurs and first-generation wealth creators. This segment is expected to have the highest growth potential over the next three years, based on our industry survey. But the needs of customers within this segment vary widely, and often depend on the developmental stage of their businesses. Entrepreneurs whose businesses are in an early stage of development tend to focus on growing their endeavors. They mainly invest in their own businesses, and their banking needs revolve around basic transactional services. Depending on the industries they are in, some entrepreneurs may need cash to operate their business; hence, they prefer very simple and highly liquid products, like money market funds or flexible time-deposits. More established entrepreneurs or those whose businesses are at later stage—the businesses might be listed or the owners may have even cashed out—are likely to have more sophisticated banking and services needs. Some may consider portfolio planning or might use a private bank as an alternative investment channel.

- *Executives and Professionals.* This relatively small group is often better educated and has more of an understanding about private banking. Due to their busy work, they rely on private bankers to follow the market and provide investment advice or financial planning. Many demand high-quality service and advice and are aware of different wealth management products. Some are actually delegators—they ask private banks to manage their assets on their behalf.

- *Professional Investors.* Some HNWIs accumulate their wealth by investing in stocks, real estate, and other opportunities. Such professional investors represent a small portion of the overall private-banking customer pool. They follow the markets diligently and trust their own judgment. Although they do not rely on advice from private bankers, they appreciate having market information. Professional investors are typically well versed in investment instruments; hence, they may regard private banks merely as a way to diversify their investment risks, or they may choose a private bank in order to access sophisticated products.

- *Independently Wealthy.* Some HNWIs gained their wealth through inheritances or endowments from family members. This group includes the children and wives of wealthy individuals. Their backgrounds are very diverse and their needs are disparate, but they generally have more time to manage their assets and have a clear need for advisory services.

Customer Segments Defined by Needs

The needs and behaviors of clients in two segments—executives and professionals and professional investors—are relatively homogenous within each group. There is much more diversity within the entrepreneur and independently wealthy segments.

Across all four segments, we identified distinct groups of customers based on their needs for investment products and advice: traditional, service-oriented, product-oriented, and advanced.

- Customers in the traditional segment only require basic banking services and simple investment products. The majority of private banking customers in China fall under this segment. Many are entrepreneurs whose businesses are at the expansion stage. They have strong business capabilities and confidence in their ability to generate wealth. They invest most of their money in their own endeavors, but they like to hold a significant amount of liquid assets in case they need cash for their business operations. As a result, their banking needs revolve around bank deposits, transactional services, and simple investment products. In terms of their investment style, most are self-directors—they manage their own assets but want constant access to transaction services. (For more on investment behaviors, see the sidebar "Customer Segments Defined by Investment Style.")

- Service-oriented customers are usually established entrepreneurs, senior executives and professionals, and independently wealthy people who manage wealth for their spouses. They rely on private banks for wealth preservation and steady asset growth. They have little need for sophisticated investment products, but they require high-quality advisory services. In terms of their investment style, most are participators—they rely on their RMs to provide good investment advice and proactively identify good investment opportunities.

- Product-oriented customers are usually well-established entrepreneurs and professional investors. They have thorough knowledge of the financial world, along with the time and interest to actively manage their wealth. They aim for superior returns and are usually well informed about market developments. They are constantly looking for innovative products with good returns. They do not place much value on advisory services but they do value timely product information. In terms of investment style, most are self-directors—they make investment decisions by themselves and want constant access to services, along with fast executions of orders.

- Customers in the advanced segment are the most difficult to serve, as they demand both sophisticated investment products and professional advisory services. Many are well-established entrepreneurs or independently wealthy. Most have been using private banking services for years and have an in-depth understanding of the value of this sector. They tend to be participators—they rely on good investment advice and look for their RMs to proactively identify good investment opportunities.

Although most private-banking customers in China have relatively simple demands, it is important to recognize that their needs will likely evolve. Some will gain a better understanding of the value of private banks. Others will reassess their needs as they transition to a new stage in their lives (or their businesses). In addition, their needs will inevitably change as China's wealth market matures and the private banking sector rolls out offerings that

Customer Segments Defined by Investment Styles

Wealth management clients can also be categorized according to how much control they want to have over their investments. This assessment reveals three distinct types of investor. (See the exhibit below.)

- *Self-directors* typically manage their assets by themselves, with limited input from private banks. They want to decide their own investment strategy and asset mix. They usually take full responsibility for the performance of their investments and are generally more loyal to their private banks than to their RMs.

- *Participators* rely on investment advice from their private banks but make the final decision themselves. Their core need is good investment advice. They usually value having an RM they can trust. This is the largest client segment in the global private-banking sector.

- *Delegators* rely heavily on banks and asset managers to manage their wealth, often on a discretionary or mandate basis. They tend to have one overriding priority for their investments: performance. Delegators do not need frequent interactions with their RMs once they set or agree on broad guidelines. They trust their RMs to make the right investments and are typically less sensitive to price compared to other types of investors.

There Are Three Distinct Investing Styles

Self-director

*"I have a clear investment strategy and asset allocation and just **need a bank to execute** my orders"*

Manages the assets by himself

Key characteristics
- Seeks access to broad product range
- Wants competitive pricing package
- Has high online usage and financial expertise
- Values constant accessibility of services and fast execution

Participator

*"I want my bank to **come up with more proactive ideas and customize their advice** to my personal circumstances"*

Relies on good investment advice

Key characteristics
- Seeks good investment advice, but wants final say on where wealth is invested
- Wants proactive identification of investment ideas by bank or relationship manager (RM)
- Values integrity of RM

Delegator

*"All my banks get a certain proportion of my wealth in managed accounts, **the only thing I care** afterwards **is a good performance**"*

Relies heavily on banks and asset managers

Key characteristics
- Seeks solid, risk-adjusted net performance
- Wants only limited interaction with RM or bank, but needs transparent reporting
- Values performance more than any other single factor

Source: BCG Client Discovery; 2006 BCG Global Wealth Report.
Note: The three investing styles were first introduced in 2006 BCG Global Wealth Report. We included it here for easy reference.

are increasingly customized. (For more on the kinds of products and services customers need, see the sidebar "Distinct Investment Behaviors of Wealth Individuals.")

Criteria for Selecting a Private Bank

Many of China's wealthy customers maintain several banking relationships and easily shift assets from one to another depending on their level of satisfaction. They use vastly different criteria for choosing a private bank, but a handful of factors are almost always critical. In our interviews, HNWIs mentioned services, products, and channels as the top selection criteria. Even then, however, different segments of customers had different expectations and requirements across these criteria.

- *Service* was the most-mentioned selection criteria. For traditional customers, quality service mainly means being given priority treatment in transactional services. They tend to visit banking outlets more often, and therefore appreciate having faster and more efficient services. For service-oriented and advanced customers, quality service mainly refers to the sophistication and professionalism of advisory services—these customers expect to receive personalized investment advice, financial planning, and even non-financial services, such as tax and legal advice. To product-oriented customers, quality service mainly refers to having easy access to product or market information, along with fast execution of orders.

- *Products* are also regarded as an important criterion. Traditional and service-oriented customers need a wide range of basic, simple investment products, like mutual funds, time-deposits, or money market funds. On the other hand, product-oriented and advanced

Distinct Investment Behaviors of Wealthy Individuals

China's HNWIs have investment behaviors that are distinct from those in Western countries. For foreign entrants, it is essential to recognize these unique traits and revamp the offering to reflect local needs.

- *Polarized Asset Allocation.* Chinese HNWIs have very different wealth portfolios compared to their Western counterparts. They tend to hold as much as 60 percent of their assets in cash or liquid assets. This allocation is a result of their tendency to seek security, but it also reflects the impact of the financial crisis. Since the crisis began, the percentage of assets held in cash and deposits has increased. At the same time, however, Chinese customers can still be speculative. They tend to invest a significant portion of their money in stocks, believing that they can make a big fortune, even when markets are volatile.

- *Preference for Tangible Investments.* Our customer interviews found that Chinese entrepreneurs typically had about 30 to 50 percent of their assets invested in real estate or their own businesses. Given China's sustained economic growth, they believe that this is a safer way to guarantee good returns. These individuals generally do not diversify their portfolios to mitigate risk.

- *Desire for Control.* Many wealthy Chinese are entrepreneurs. Having created wealth from scratch, they tend to believe in their own judgment and prefer to control their own investment strategies. They generally appreciate the information that RMs offer, but they want to have a final say in the investment decisions. As one interviewee said: "I don't trust those RMs. They are so much younger and less experienced than me. Even though I lost some money in the stock market last year, I still believe that I have more accurate judgment about the market trend."

- *High Expectations.* The Chinese economy has been growing at an exceptional rate in recent years. Many wealthy Chinese expect this to continue and have very high expectations about their investment returns. In our interviews, many customers who claim to be risk-averse actually expect to achieve 20 percent returns on their investment. The challenge for private banks is to educate customers about the correlation between risk and return and help set more realistic expectations.

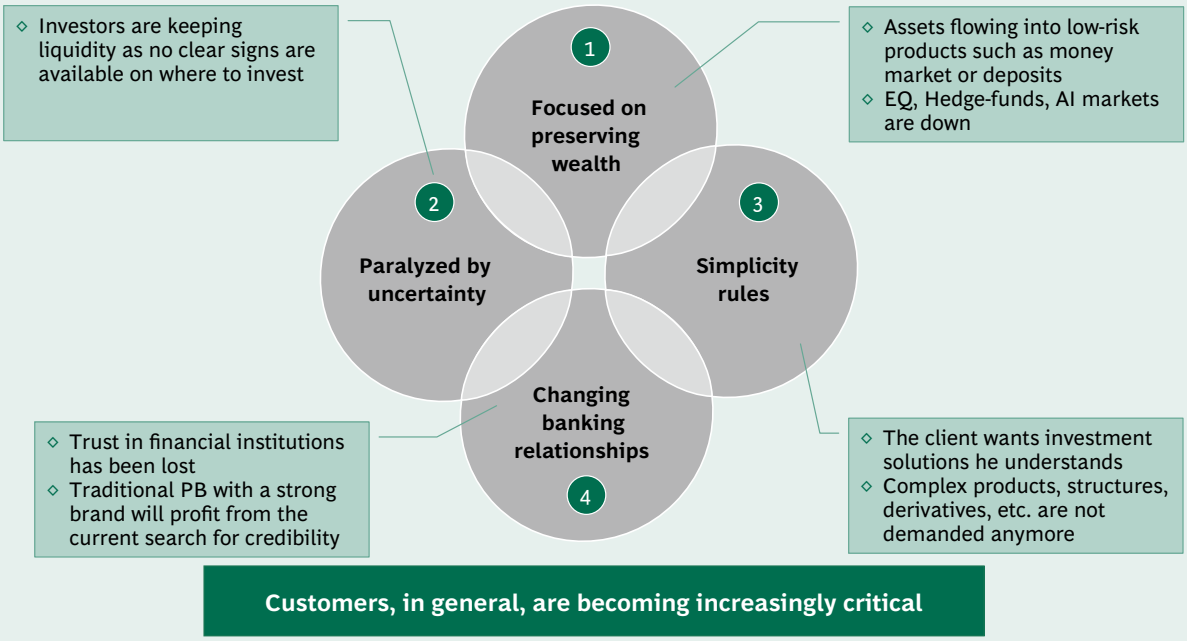
customers have a better understanding of investment vehicles and are looking for more sophisticated or innovative products with good returns.

- *Channels* matter to most customers, but in different ways. Traditional customers value convenience; hence, they like to have access to a broad outlet network, with a "VIP expressway"—even in normal outlets—so that they do not have to wait in line. Such customers are less attracted to foreign banks, given their limited physical presence in China. Product-oriented customers want to access a variety of channels or platforms to help execute their investment decisions. They tend to use online banking more often and prefer to buy investment products via fax or telephone. Service-oriented and advanced customers value channels that connote a premium feel. They prefer to go to private banking centers to access services or have their RMs come to them.

Impact of the Crisis on Customer Behavior

Compared to many wealthy clients in developed markets, who have redefined their wealth-management needs because of the financial turmoil, China's wealthy individuals have been less affected by the crisis. (See Exhibit 10.) More than half of the HNWIs in our survey indicated that their investment styles—self-direct, participate, or delegate—remained unchanged after the onset of the crisis. In some ways, the crisis accentuated investing behaviors. Conservative investors become more conservative, while about one-third of high-risk investors said they would use the crisis as an opportunity to increase their risk exposure. Moreover, three-quarters of the wealth managers and private banks believe that the crisis has not substantially changed HNWIs' risk appetites, but they do expect these customers to become a bit more cautious with their investments.

Exhibit 10. Four General Shifts in Client Behavior Can Be Observed in Developed Markets



Source: BCG expert interviews; BCG analysis.

The financial crisis has, however, led to a noticeable drop in confidence in foreign banks. Many investors have shifted their assets to local banks, which are deemed to be more reliable and safe, given the backing of the Chinese government. And the big four banks are perceived to be safer than joint stock banks. Still, many sophisticated investors remain open to working with foreign banks, but they have become more selective and cautious in choosing a bank. In an interview with BCG, Mr. John Xu, Deputy Director of Private Banking Business in Bank of Communications, commented that "Logically, the financial crisis may potentially open up more opportunities to Chinese banks, as some foreign banks were affected. However, how the competitive landscape will evolve has yet to be observed in the market."

The crisis provides valuable lessons to both the wealth management industry and HNWIs. Before the crisis, many investors were focused primarily on getting higher returns. They paid little attention to downside risk, and some investors were even unaware of the underlying risk of products such as structured derivatives. Investors are now more cautious about both risk and the stability of private banks, and are more aware of compliance. The China Banking Regulatory Commission (CBRC) published a new regulation in 2009 that provides guidance to banks that sell wealth management products. In an interview with BCG, CBRC Director General, Mr. Li Fu An, expressed his opinion that "Commercial banks have high level of responsibility to protect money placed by retail customers, as mass individuals in China have enormous trust in banks. Banks should not provide high-risk products to unqualified customers, and they need to develop an internal capability to ensure compliance."

Private Banking in China: A Rapidly Developing Sector

China's wealth-management sector is relatively young, but it continues to develop and grow. To build a competitive position in this changing environment, banks first need to determine the best way to organize their businesses. They also need to address the challenges that are distinct to local and foreign competitors.

A Changing Landscape

Bank of China, the first local mover, launched its private-banking business in 2007. It was subsequently joined by two of the big-four Chinese banks (Industrial and Commercial Bank of China and China Construction Bank), several joint stock banks (such as China Merchant Bank, Bank of Communications, and China Minsheng Bank), and others. Foreign banks such as Citibank and BNP Paribas also established private banking operations in China in 2007—even earlier than BOC—and were followed by several others. Local banks still dominate the market in terms of customer numbers and AuM, owing to their retail networks and sizable customer bases, but no bank has emerged as a dominant leader.

China's wealth market continues to develop rapidly. Local banks are aggressively expanding their geographic footprints. BOC, for example, has private banking centers in 15 regions. It also established a private bank and institutional asset management arm in Switzerland through its acquisition of Geneva-based Heritage Fund Management in 2008. CMB has eight private-banking centers and has announced plans to have a total of 15 by the end of 2009. [4]

Though many products offered by different banks in China are perceived undifferentiated by many HNWIs, we now observe a wider range of products targeting private banking customers. Apart from upgrading their premium banking products, banks have launched advanced products that have a higher risk and return profile, such as private equity products, to cater to private banking customers.[5] Innovative products such as wine and art investments have also been offered, which suggests that HNWIs have an appetite for more specialized, tailored products. Such products also serve as good advertising for private banking. In addition, local banks are widening their add-on services from basic "upgraded" premium-banking services to professional advisory services and personalized services that cover individual, family, and company needs for their HNW customers. For example, banks can offer a comprehensive suite of services including international wealth-inheritance planning, enterprise financing, IPO planning, art appraisal, and different tailor-made services such as purchasing VIP concert tickets.

Foreign banks have a mature and proven business model, supported by overseas experience, institutional knowledge, and complementary offshore and onshore offerings. Although their presence remains small, many are still rolling out wealth management products and expanding their presence. Mr. Vincent Chan, Head of Private Banking, China, HSBC Bank, mentioned that "Foreign banks can offer both onshore and offshore investment opportunities, which is their advantage to compete in this market. China's HNWIs value the opportunities to diversify their portfolio globally."

Other players such as securities firms, asset management firms, and trust companies are also trying to get a slice of the market. Due to their lack of a distribution network, however, they have focused on playing the role of a partner for, rather than a threat to, banks.

4. Eastern Morning Newspaper, 13 August 2009.

5. Premium banking offerings are geared toward affluent customers, who typically have between $0.1 million to $1 million in AuM.

Organizing for Success

Local banks enter the private banking market to achieve two objectives. The first is to cultivate a base of HNW customers through the existing branch network. It is essential for local banks to leverage their core advantage—their extensive customer base—in order to build a viable private-banking business. The second objective is to develop professional capabilities and a differentiated offering. To this end, the private banking business needs to be given a fair amount of independence. It needs to have its own product development team and a professional, high-quality private banker and advisory team.

To fulfill these two objectives, local banks can follow one of two distinct approaches to organizing and running the business. One is to integrate the private banking business into—and more specifically, under—the retail banking network. While this approach may help a bank leverage its existing customer base, it may impede the development of private banking capabilities. Private bankers may feel restricted in how they run the business, and may lack the necessary initiative or motivation to spur growth.

The second approach is to establish private banking as an independent business unit (BU) fully responsible for its own performance. It would oversee the development of private banking products and would serve private banking customers with an independent team of RMs and specialists. The BU might also have independent channels and operations. Regional private-banking centers would be separate from local branches and would report directly to the private banking BU. This approach is best suited to achieving the second objective—developing professional private-banking capabilities and differentiated offerings—but may create significant challenges when trying to mine the retail network for customers.

Increasingly, Chinese banks are adopting various hybrid models that combine elements of the two approaches and allow them to leverage the existing customer base and develop important capabilities and a distinct offering.

Foreign banks normally establish independent private-banking businesses in China. Similar to their approach in many markets, they run the private banking business separately from the commercial banking business. They focus on acquiring customers in the top tier cities and have a dedicated customer acquisition team. They can leverage an established service model and an industrialized advisory process, and they rely on their own professional private-banker teams, experts, and advisors to deliver comprehensive service.

Challenges Facing Local Banks

Though developing rapidly, many local wealth managers tend to base their value propositions mainly on the provision of dedicated private bankers and private-banking centers that convey a sense of exclusivity. Many offer upgraded premium-banking services, which may be sufficient for many customers now but might require some fine-tuning in order to keep up with the evolving expectations of customers.

Deeper challenges are embedded in the service model. Banks tend to use either an advisory model or a product-push model to serve wealthy customers. The advisory model requires private bankers to build a trust-based relationship with customers by providing holistic solutions that cover the investment portfolio, financial planning, and financial structuring. Under the product-push model, which is more common in retail and premium banking, private bankers are incentivized to pursue certain investment and sales opportunities.

Many local private banks have set out to follow the advisory model, but their offerings tend to bear a closer resemblance to the product-push model, either because the staff has limited skills or because they are not being incentivized appropriately. A product-push model will not help differentiate a private banker's service from a premium banking service—it simply does not project the image of a professional wealth advisor, nor does it cultivate the sense of trust and the close personal relationships that are among the top success factors for private banking. Local private banks need to migrate away from the product-push model.

Ensuring a consistent channel experience is another challenge. Many local banks have invested heavily in building highly polished private-banking centers. It certainly helps to create a sense of privilege and an exclusive image for their wealthy customers. But the customer experience plays out across all touch points, including retail outlets and online banking platforms. And in China, many

HNWIs still prefer to visit retail outlets, which provide more convenient access. Banks therefore need to focus on shaping the private banking customer experience across all touch points.

Banks also face several organizational challenges. Even when private banking is integrated into the retail business, it can be hard to motivate outlets to transfer their valuable customers. In addition, collaboration between retail banking RMs and private banking RMs is critical to delivering quality services to HNWIs. There often is sense of competition between the retail outlet and the private bank which can result in a deterioration of customer experience and ultimately customer churn. Thus, banks must ensure that both RMs are motivated to provide consistent and best quality service.

Challenges Facing Foreign Banks

Equipped with global expertise, foreign banks have been rapidly growing their private-banking businesses in China. But they, too, face a set of challenges besides lack of customer access and retail service network to provide the basic transactional services many Chinese wealthy clients still value the most.

First, most foreign banks have used the advisory model to build strong relationships and manage the full spectrum of clients' investment needs, including individual, family, and company interests. This usually works well for more sophisticated customers. But many Chinese HNWIs come from the traditional segment. They might not fully value this service and may be reluctant to cede control of their wealth to their bankers.

Second, the strengths that most foreign banks have, from a capability standpoint, might be devalued in China. Many foreign banks, for example, have thorough knowledge of investments in global capital markets, but many of these products do not exist in China. In addition, it is difficult for foreign banks, which generally have a limited set of RMB-denominated investment products, to differentiate their onshore offerings and fully leverage their product expertise. However, the situation is likely to change. Ms. Hsiao-Yun Lee, Managing Director, Head of China private banking, Société Générale, commented that "Despite current constraints in foreign banks' product offerings, the market will gradually develop and foreign banks will be able to offer a broader range of products to better serve clients in China, especially as the market stabilizes after the crisis."

Last but not least, the expansion of foreign banks in China is often stifled by the scarcity of talent. To replicate their successful models, foreign banks need to recruit qualified private-banking RMs. This can be a tall challenge in China's relatively young wealth-management market.

Developing a Winning Model for China's Wealth Market

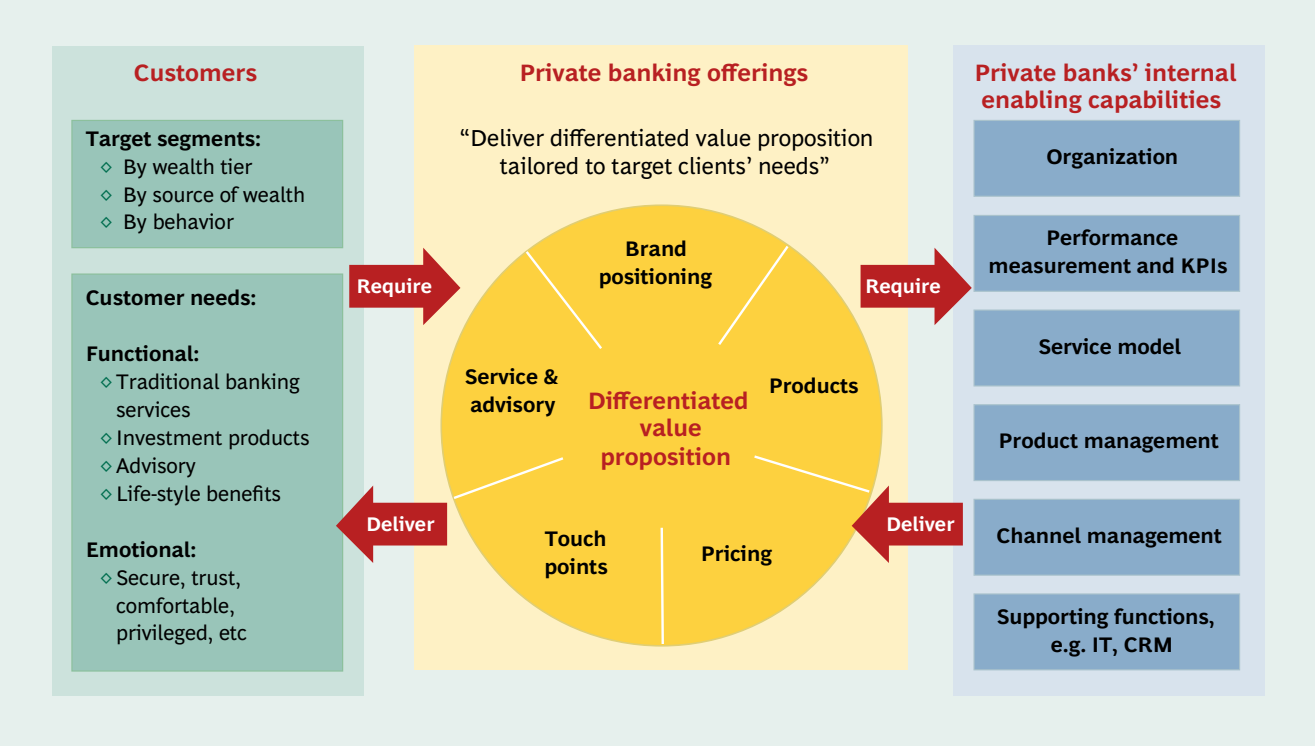
Despite its challenges, China's private-banking market will continue to provide attractive opportunities for wealth managers due to the country's continuous economic expansion, its above-average growth of AuM, and the increasing engagement of HNWIs, who are becoming more aware of the benefits that private banks can provide. To build a presence in this market, private banks should focus on three tightly interlinked components. (See Exhibit 11.)

1. Explore the needs and behaviors of wealthy clients
2. Design a tailored and differentiated value proposition
3. Strengthen internal capabilities to deliver the value proposition

Explore the Needs and Behaviors of Wealthy Clients

As described earlier, Chinese HNWIs have distinct wealth-management needs and behaviors, such as their polarized asset allocation. There are many ways to segment these

Exhibit 11. To Build a Presence in China, Private Banks Should Focus on Three Interlinked Components



customers, and each segment has different criteria for selecting a private bank. These unique traits, coupled with the heterogeneous nature of the customer base, make this market surprisingly complex.

To establish a strong presence in China, private banks must have a deep understanding of their customers. To this end, banks must ask: Who are the right target customers for my bank? How can I best serve them? And what makes my offering unique?

To do this, banks need to examine the business from the perspective of both existing and target customers. First, banks need to perform an internal assessment of their existing customer base. This can involve in-depth analysis of various characteristics, such as age, profession, and risk preference. Banks should also look at customers through a prism of performance factors, such as AuM, revenue, product sales, and profitability. In addition, banks can conduct in-depth interviews to better understand their customers' needs and behaviors, and to gauge their satisfaction with the bank.

Banks also need to develop a view of potential customers. This includes individuals who may be banking with competitors, as well as those who are on the verge of becoming private banking customers. By comparing its existing customer base with the potential base, a private bank can evaluate its market position and identify its strong suit—the types of customers it should be able to attract. Only then can a private bank determine which segments it should target. This view should also be informed by the bank's sources of competitive advantage, as well as its internal capabilities and business economics.

The process of customer discovery is not made easy by the reluctance of Chinese HNWIs to disclose their wealth and share their opinions about private banks. In addition, HNWIs may not be able to articulate what their needs are, as most have little or no experience in dealing with private banks. Thus, banks need systematic and disciplined approaches to gaining insights into these customers and their behavior. Banks can supplement qualitative customer discovery with a quantitative analyses that focuses on demographics, segment size, and a measurable level of satisfaction with private banks.

Design a Tailored and Differentiated Value Proposition

Once they have identified their target customers, private banks can focus on defining a differentiated value proposition. Naturally, the value proposition should align with the specific needs and behaviors of the target segment. The value proposition covers five dimensions, all of which are critical to delivering an excellent customer experience.

Service and Advisory. Customers often cite "service and advisory" as one of the most important criteria for choosing a private bank. In general, the services offered to private banking customers range from traditional—such as settlement, payments, and cashing—to investment advice and add-on services. Industry experts in advanced markets expect the private banks need to redesign the service offering, moving to an advisory centric and holistic direction to suit the postcrisis world. (See Exhibit 12.) In China, it will take time for significant numbers of HNWIs to develop an appreciation of advisory services, but private banks should not wait to move toward such a model—it is essential to building trust and deepening relationships. Mr. Yufang Mei, Deputy General Manager of Wealth Management and Private Banking Department, China Construction Bank, commented in an interview that "Ability to provide good advisory service is essential for a private bank. This is what more experienced wealthy customers value most". Typically, different customer segments place different value on the types and levels of service. It is therefore critical for banks to fully understand the different service needs of their target customer segments in order to define a service offering that is clearly differentiated from the competition. Service requirements, in turn, will help the bank determine the necessary RM capabilities and qualifications, the advisory team structure, and the RM-to-client ratio.

Banks should also consider providing add-on services—such as airport VIP lounges, priority medical treatment, and heritage and tax planning, to further improve the customer experience. But they need to consider these options carefully—such services require large investments. In developed markets, the availability of add-on services is predicated on client size. (See Exhibit 13.)

Products. Although some of the more sophisticated HNWIs look for tailored and innovative products that pro-

Exhibit 12. Experts Expect the Service Offering to Move to an Advisory Model

Source: BCG expert interviews.

vide better returns, most wealthy customers in China do not necessarily require complex investment products—at least not at this stage. Most of the existing private-banking products in the market are simply enhanced versions of premium banking products. It will be challenging for wealth mangers to truly differentiate their offerings by focusing on products. However, maintaining a competitive product portfolio is still important to serving clients well.

Pricing. Although HNWIs, in general, are less price-sensitive, a differentiated pricing strategy—coupled with the right mix of products and services—will help improve the customer experience. Many wealth managers are already providing volume-based discounts or discounts on basic services. The key is to set up a pricing structure that is attractive to customers and yet delivers satisfactory economics.

Touch Points. Many private banks offer multiple touch points to serve their customers. (See Exhibit 14.) These touch points, which play a critical role in shaping the private banking experience, should comprise a range of channels—customers may have different preferences for certain channels. Variety is important, but banks must work hard to set a clear and consistent standard across all touch points. Many HNWIs in China expect to receive VIP treatment and high-quality service when they step into an outlet. Local banks will need to leverage their broad networks of retail outlets while providing the requisite level of service for private banking customers.

Brand Positioning. An appropriately positioned brand is vital. Banks need to establish strong private-banking brands that are distinct from both their own retail operations and other private-banking brands. Branding is more than just an image. It needs to relate to both the client experience and the marketing messages—banks should establish a clear brand promise that is tightly linked to the target customer's functional and emotional desires, and then deliver the desired customer experience throughout all client interactions.

Exhibit 13. In Developed Markets, Add-on Services Are Determined by Client Size

Additional service offerings with increasing client size →

Offering category	Minimum USD 20 M	Minimum USD 50 M	Minimum USD 100 M
Family philanthropy		◇ Foundation administration	◇ Philanthropic mission ◇ Family foundation management
Family continuity		◇ Client education	◇ Family governance ◇ Family meetings
Lifestyle management		◇ Cash flow management ◇ Private travel management ◇ Bill paying & payroll	◇ Collectibles management ◇ Property/airplane management ◇ Liability management
Trusteeship		◇ Corporate trust selection ◇ Trust accounting & reporting	◇ Agent for the trustee ◇ Estate administration ◇ Private trust service
Record-keeping and reporting	◇ Custody ◇ Performance reporting ◇ Tax statements	◇ Consolidated statements ◇ Partnership accounting	◇ Consolidated statements and analysis
Integrated planning	◇ Financial and estate plans ◇ Tax plans ◇ Retirement plans	◇ Fee analysis ◇ Tax compliance ◇ Insurance oversight	
Investment	◇ Investment policy ◇ Asset allocation ◇ In-house management	◇ External manager for alternative products (orchestration) ◇ Internal core managers	◇ External manager selection

■ Main focus of offering

Source: BCG project experience.

Strengthen Internal Capabilities to Deliver the Value Proposition

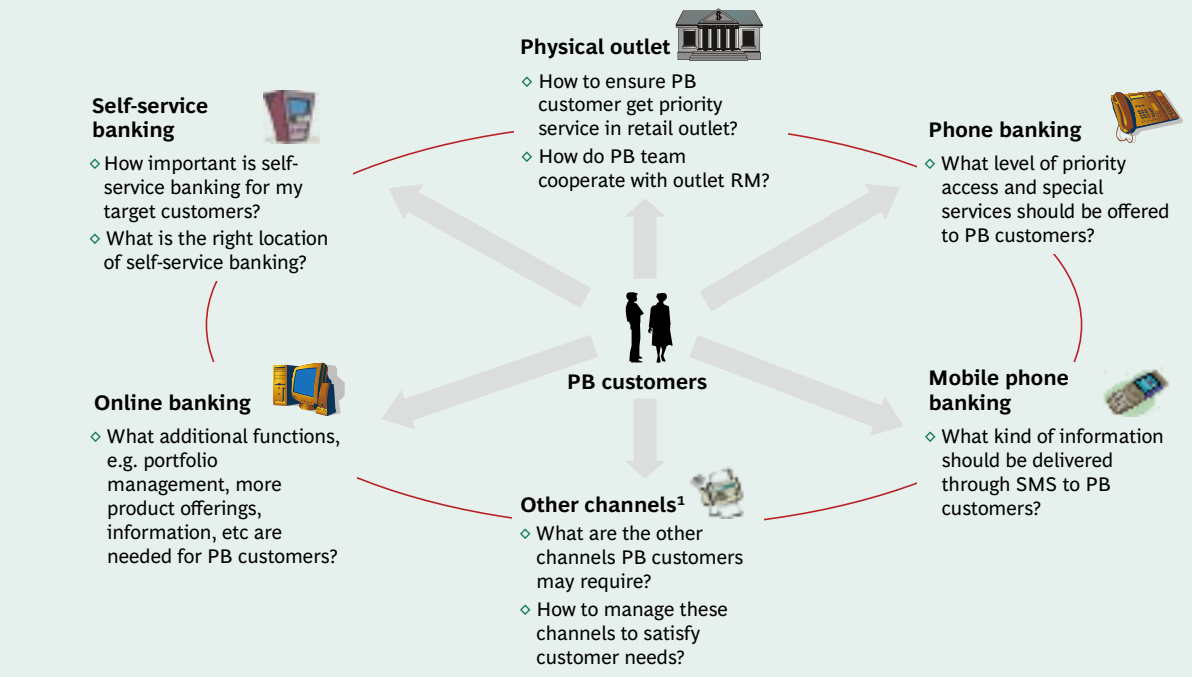
To support the delivery of differentiated value propositions, private banks need to have the right set of internal capabilities and resources. Six capabilities are essential to building a successful private-banking model.

Organization. To deliver on the value proposition, local banks must develop an organization model that leverages the structure and platforms of the retail bank but still preserves the independence of the private banking unit. Globally, there are four organization models that have been adopted by universal banks, but there is no single solution. (See Exhibit 15.)

Instead of searching for a single best-practice model, banks in China should study the different options, understanding the pros and cons of each one and deciding which tradeoffs to make. An effective organization model tailored to a bank's situation in China may be different from models that are common in more advanced markets. The target model will vary across banks, and some banks may need a transitional plan to move from the status quo to the target model. In order for banks to scrutinize the organization model, they should keep the following questions in mind:

- What is the vision for the private banking business? And what are the short- and long-term goals and strategy for achieving it?
- Which organization model options (both at HQ and branch level) are viable?
- What are the pros and cons of each model, and the tradeoffs among the various models?
- How should the bank define the accountabilities, the roles and responsibilities, and the incentive scheme to ensure that the organization is fully mobilized to deliver the best private-banking services?

Exhibit 14. A Multichannel Offering Is Essential



[1]Include fax, express and video conference etc.

- What else is required to ensure cooperation within the bank and fully leverage existing resources and advantages?

Performance Management and KPIs. Banks need to align the performance measurement scheme with the strategic goal for the private bank. KPIs should be set for the main levers of the business—such as the product mix, market share by product, and the costs per transaction—as well as for aspects of commercial effectiveness including net increase in assets, ROA, and share of wallet. The approach toward performance management should be simple and intuitive. If KPIs are too complicated, they will not be effective in driving the desirable behavior.

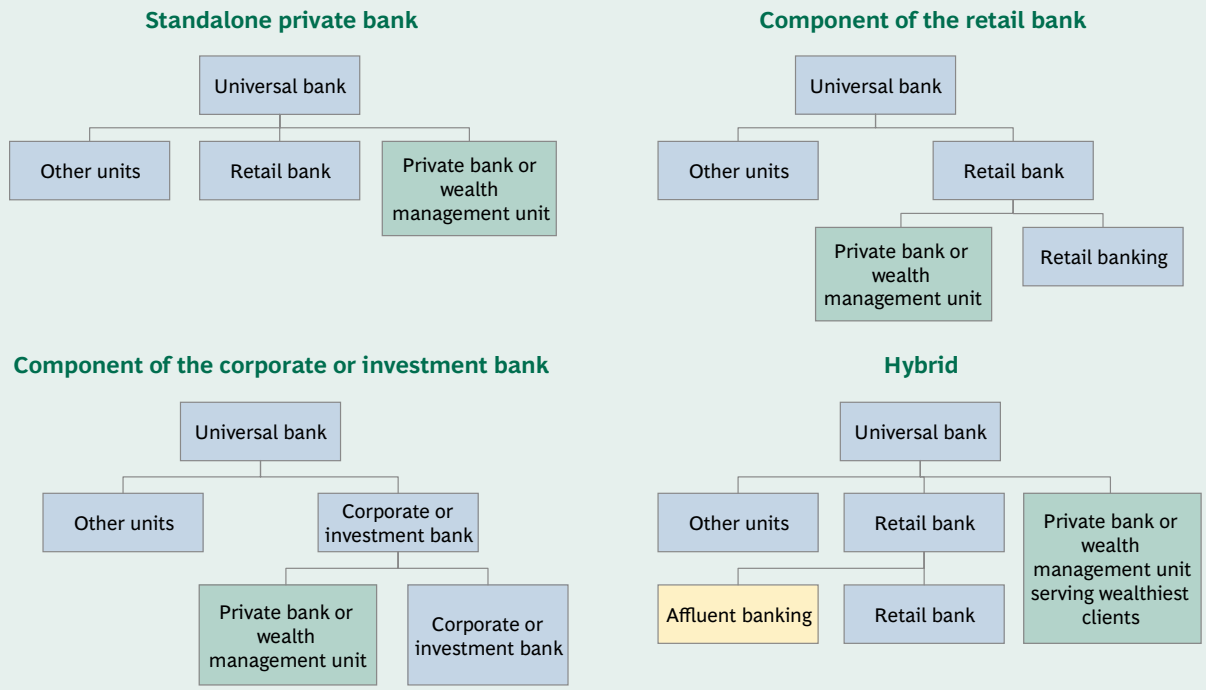
A bank needs to address several questions when designing the performance measurement scheme:

- What is the top priority of the business? What are the KPIs associated with the goal?
- What are the right business targets? How should the targets be cascaded from HQ to the front-line staff?
- What incentive scheme will best motivate the individual private banker to achieve the targets?
- What KPIs and performance mechanisms can be used to ensure proper cooperation between private bankers and retail banking RMs, if they both serve the same customers?

Service Model. The service model is critical to delivering the right experience to private banking customers. Leading wealth managers vary their service based on client size, with more attentive service provided to wealthier segments. (See Exhibit 16.)

The service model needs to be adapted to the needs of each target segment. There are two key elements to be considered when banks design the service model: What

Exhibit 15. Universal Banks Typically Adopt One of Four Private Banking Models



Source: Global wealth interviews, 2008; BCG analysis and experience.

are the roles of the RM? And how will the bank deliver the advisory service? The roles of the RM can be a combination of maintaining client relationships and delivering financial planning and advisory service. Advisory services can also be done through an expert team. Two examples of distinct service models reflect different considerations of the two elements. (See Exhibit 17.) In practice, Chinese banks also leverage their retail-banking platforms to deliver transactional services for private banking customers, rather than relying on assistants in the private bank.

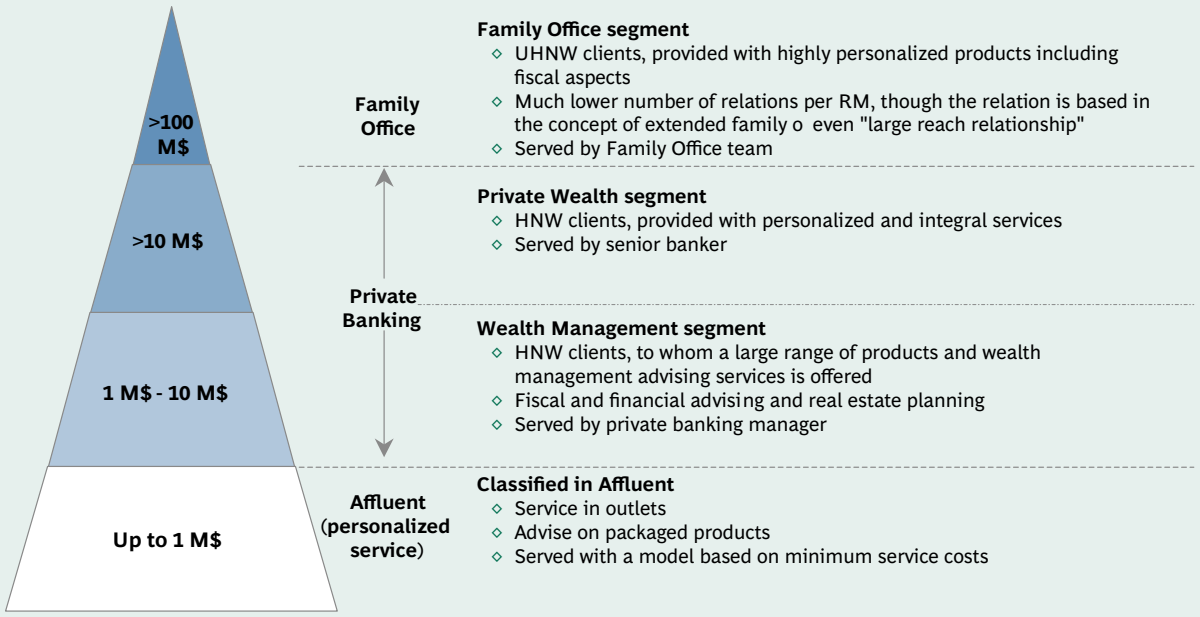
Regardless of the service model, it is essential for banks to recruit sufficient numbers of talented and qualified private bankers—this is perhaps the greatest impediment to developing an effective service model (not to mention a competitive private bank).

Compensation is an important factor in attracting and retaining talent. A well-designed career path should provide an incentive for private bankers to stay with the bank. In addition, a recruiting strategy, an on-boarding and training program, and performance management are all essential to developing the right skill sets among private bankers.

The size of the private banking team is also important. The service level should help determine the private banker coverage ratio, which is an input to determining the team size. A few important questions can help banks think through the development of a service model:

- What are the target customer segments and what is the best service model for each?
- What are the required capabilities or qualifications for private bankers, and what is the required team size?
- What else would be essential to attracting and retaining talent (for example, talent recruiting, compensation model, career planning, and internal training)?

Exhibit 16. Leading Wealth Managers Vary Their Service Based on Client Size



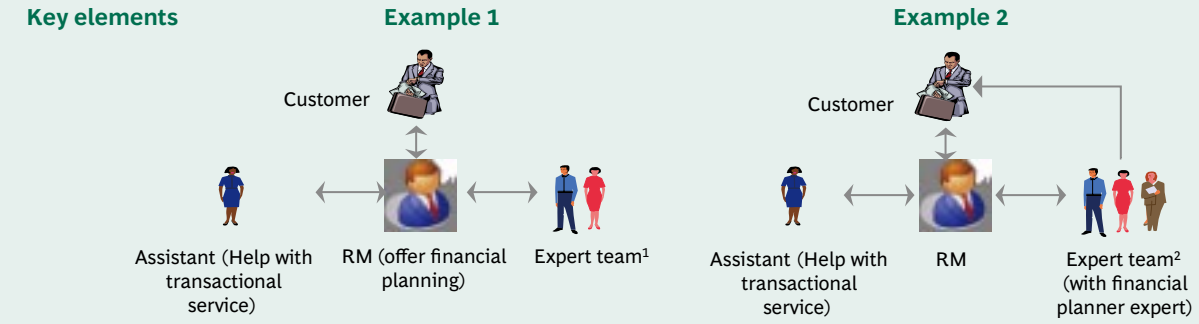
Source: BCG experience (international benchmark).

Product Management. Once China's wealth market becomes mature and customer needs grow more sophisticated, product capabilities will become a key source of competitive advantage. In the recent industry survey, 77 percent of participants believe that product diversity is one of the top five drivers of growth, second only to professional advice from RMs. Sharpening product development capabilities involves a range of actions, such as improving innovation, accelerating the launch process, and expanding third-party partnerships. The actual improvement initiatives may involve some that are not directly linked to the product itself, such as aligning the interests of different departments involved in the process and proposing a more efficient product-approval mechanism. Typically, the following questions need to be answered in order to refine a bank's product management capabilities:

- What kinds of product development capabilities are required to deliver the right products to the target customers?
- What kinds of product approval processes and mechanisms are needed to support these capabilities?
- What is the right organizational linkage and incentivation for the product departments to ensure fast-paced development and execution?

Channel Management. Private banking customers can use multiple channels to conduct transactions and receive services, and they expect excellent experience across all channels. It is therefore critical for banks to integrate and optimize their channels. Private banking centers—the dedicated physical network for private banking customers—have to be planned carefully, as each center requires a large upfront investment. Some HNWIs also demand VIP features in online banking, in addition to having fast, convenient, and secure online transactions. Banks will have to figure out how to manage multiple channels in order to provide a satisfying and convenient customer ex-

Exhibit 17. Two Examples of Distinct Service Models



	Example 1	Example 2
Role of RM	◇ Own client relationship ◇ Provide financial planning ◇ Single point of contact between client and experts[1]	◇ Maintain relationship ◇ Communicates the client questions to the expert and the complex solutions are answered directly by the experts[2] ◇ Do not offer financial planning
Delivery of Advice	◇ RM delivers regular financial planning advice ◇ RM delivery advisory service of specific topic after consult experts	◇ Dedicated portfolio manager deliver product portfolio planning to customer directly ◇ Experts provide advisory service of specific topics

[1]Include Asset Management, Credit, Insurances and Legal except financial planning expert.
[2]Include financial planning experts.

perience while ensuring that the channel strategy is economically viable.

Supporting Functions. Banks need to establish effective supporting functions, such as IT, CRM, and operations, in order to build a successful private-banking business. For example, a good CRM system will capture a broad range of relevant customer information and attributes, which will provide the basis for intelligent segmentation. It can also provide a holistic picture of the customer's entire portfolio with the bank, which helps private bankers better understand the customer's needs and provide customized advice. While established system solutions can be found in overseas markets, Chinese banks should avoid the temptation of buying an existing solution and hoping it will resolve their support function requirements, which are often very complex and different for each bank.

China's wealth management market has tremendous potential and a promising future. It is, however, still in an early stage of development. No clear leaders have emerged to dominate the market, either in its entirety or in terms of attractive geographies and specific customer segments.

This is a critical moment. Both local and foreign banks are ramping up their efforts to build capabilities and establish a strong position. The successful banks will be the ones that have defined a clear goal, developed a deep understanding of the customer, invested in a tailored and differentiated business model, and mobilized the organization's capabilities to take advantage of this window of opportunity.

Note to the Reader

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