

Excerpt from the 2012 World Wealth Report
Wealth Management Firms Look to Scalable
Business Models to Drive Profitable Growth and
Bolster Client-Advisor Relationships

WORLD WEALTH REPORT 2012



RBC Wealth Management

Wealth Management Firms Look to Scalable Business Models to Drive Profitable AuM Growth and Bolster Client-Advisor Relationships

- **While wealth management has fundamental strengths as a business, costs have risen faster than the growth in revenues in recent years**, so the imperative for wealth management firms now is to chart a course to profitable AuM growth, while bolstering the client-advisor relationships that are the lynchpin of their business.
- **Challenges other than costs are also converging to reshape the wealth management industry.** Firms have a degree of control over some of these developments, such as diminished client and advisor loyalty, but less control over more systemic and structural trends, including the post-crisis backlash against the financial services industry, rising competition, greater regulatory scrutiny, heightened market volatility, and increasing diversity in the world's HNWI population.
- **Many firms will need to rethink their business models to deal effectively with the new industry landscape, and overcome constraints imposed by previous decisions and assumptions.** In the process, firms will need to re-focus on core competencies, shore up client trust, bolster client-advisor relationships, improve client-segmentation models, and analyze new market opportunities through the prism of changed external realities. This will also require senior management to be focused and proactive, yet flexible, in steering the firm's re-orientation, which is likely to include numerous other imperatives, from executing digital-technology strategies to managing an ageing advisor workforce.
- **Firms that can identify, leverage, and embed scalability levers in their business models** will be better able to drive client AuM growth at relatively lower cost, while maintaining high levels of client satisfaction. Different firms will prioritize different scalability levers, depending on factors such as core competencies and overall business strategy, but critical for most will be levers around client segmentation and true scalability-driven acquisitions.

ELEVATED COST-TO-INCOME RATIO TOPS LIST OF FUNDAMENTAL CHALLENGES TO WEALTH MANAGEMENT BUSINESS MODELS TODAY

Wealth management is an inherently attractive business, largely because it is a stable generator of cash, and requires relatively little capital. Its client and asset bases also seem to expand naturally and continually, given rising levels of global prosperity. For some firms, wealth management can also be an important “door-opener” to other business lines (such as investment banking¹⁴). And the client pool is seen as relatively resilient, because HNWIIs have deeper pockets and access to more sophisticated and timely advice than the average investor, so they are theoretically armed better to ride out market fluctuations.

That said, these favorable dynamics have yet to fully deliver the benefits many firms have envisaged. For example, while capital requirements are relatively low in wealth management, the recent returns on equity are also low—estimated to be in the single digits globally. Also, firms have found it harder than expected to achieve and leverage scale in their operations, as evidenced in recent years by the pull-out of large firms from sub-scale operations, especially in emerging markets.

These setbacks are also a reflection, though, of the challenging operating conditions. Widespread and significant changes are under way in the wealth management industry. These shifts include the post-crisis tendency of investors to opt for products that minimize risk and preserve capital, and the persistent weakness in economic growth in mature markets. Slow growth has kept interest rates low in many markets as governments seek to offset the effects of the global slowdown. Regulation has also become more stringent, making risk management

¹⁴ See World Wealth Report 2011 Spotlight, “Wealth Management Firms Can Leverage Enterprise Value to Better Address HNWIIs’ Complex Post-Crisis Needs”

even more complex, and potentially jeopardizing the future of certain revenue streams for some financial services firms.

As these forces coalesce, many wealth management business models are buckling under the pressure, unable to adapt quickly or effectively enough to position firms for sustained success.

The issue of profitable AuM growth is a critical case in point. Industry estimates suggest that while total AuM has grown since 2008 (after a significant decline that year), the costs associated with managing those assets have risen faster than the growth in income. The cost-to-income ratio of the global wealth management industry stood at 79.8% in 2010, up from 63.7% in 2007¹⁵ (see Figure 15), reflecting a consistently rising cost trend. And that trend is clearly exacerbated by the inability of firms to generate significant fees when interest rates are low and investors are favoring capital-preservation products. To improve overall profitability, then, firms need to find new and sustainable ways to control and reduce their costs while growing AuM.

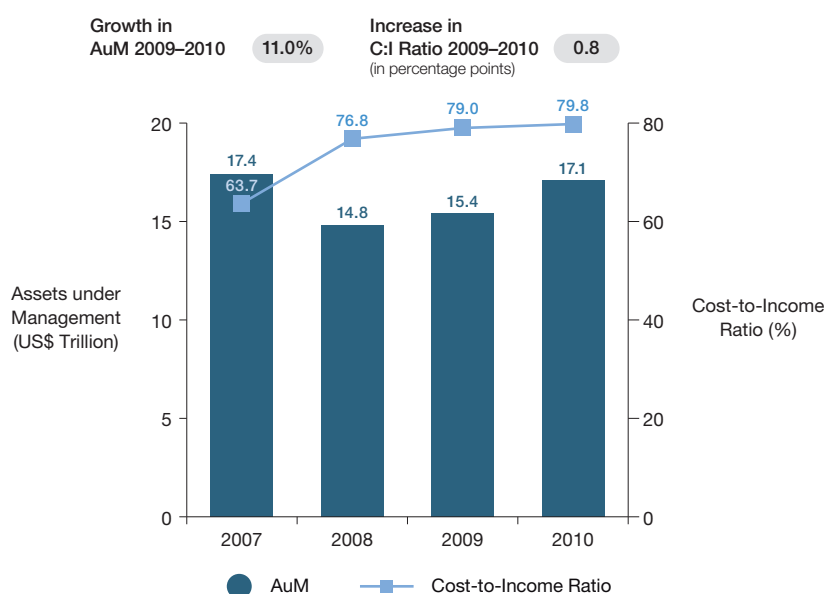
Gains in total AuM at some firms also reflect another industry trend—bringing brokerage and insurance businesses under the wealth management brand umbrella. These strategies aim to provide a more comprehensive and holistic proposition for clients, but have pooled AuM

without necessarily rationalizing the underlying costs. Similarly, private banking now offers many mainstream retail banking products, such as time deposits, which boost industry AuM but rarely generate much margin.

And even as profit margins are being eroded, rising levels of advisor remuneration make it expensive to acquire and retain successful advisors (who, of course, are key to bringing in and managing clients and assets). Other costs are also high, with expensive real estate locations, and high technology and regulatory compliance costs all taking their toll on the bottom line.

While many firms face rising cost-to-income ratios, they must also manage numerous other forces at play. For instance, both client trust and advisor loyalty have been undermined by the financial crisis and its effects. HNWIs' faith in advisors and firms is slowly being restored,¹⁶ but trust and confidence in regulatory bodies and institutions remains shaken, especially as politicians and governments prevaricate over tax and other market-related policies. And client trust in advisors and firms remains fragile, as it depends so heavily on investment performance—and performance is far from assured in the currently challenging and volatile macroeconomic and market conditions. Advisors could also be in danger of defecting in current conditions given there is high demand for successful advisors.

FIGURE 15. Assets under Management (AuM) and Cost-to-Income (C:I) Ratio, 2007 – 2010



Source: Capgemini Analysis, 2012; The Scorpio Partnership Private Banking Benchmark, 2009 and 2011

¹⁵ The Scorpio Partnership Private Banking Benchmark, 2009 and 2011

¹⁶ See World Wealth Report 2011 Spotlight, "Wealth Management Firms Can Leverage Enterprise Value to Better Address HNWIs' Complex Post-Crisis Needs"

The good news is that firms have some degree of control over how they address AuM, client, and advisor issues. More difficult to tackle are the systemic and structural transformational trends in the wealth management landscape, especially in the post-crisis years.

First of all, wealth management firms are operating amid a widespread public backlash against the entire financial services industry. The loudest criticism centers on taxpayer-funded bailouts, and industry practices such as perceived conflicts of interest and executive bonuses. Still, all firms have to work harder to drive client and advisor loyalty amid perceptions that the financial industry puts profits before clients.

This backlash has been coupled with greater regulatory oversight and scrutiny. The aim of regulators has been to reduce systemic risk, and protect individual investors. The result for firms, however, has been higher costs—in the form of both increased compliance and indirect economic effects. For example, some regulatory measures have affected funding costs, and some are even targeting business models. The U.K.'s Retail Distribution Review, for one, is designed to improve transparency and reduce fees, but essentially shifts the industry income structure from a primarily commission-based approach to a more fee-based approach.

At the same time, the markets themselves have been highly volatile since the financial crisis, and uncertain economic and political conditions have complicated investor strategies even more. With heightened volatility even in traditional safe-haven investments such as gold, and a high level of correlation between asset classes, it has become especially difficult since the crisis for wealth management firms to develop effective diversification strategies, and provide appropriate holistic wealth management advice to HNW clients.

Even before the financial crisis, however, financial markets had started to display far shorter cycles than had been typical before the year 2000 (see Figure 16). This suggests wealth management firms must be able—as the rule, and not the exception—to guide their clients successfully through more periods of higher volatility, and short, unpredictable bull and bear cycles. This could be a particular challenge for firms that have built business models directly tied to market performance (especially in commission-based systems). These models assume up-cycles will occur consistently, thus providing firms with an extended period in which to accumulate the trust

of HNW clients, along with greater incomes, when times are good. Firms now need to adjust to a 'new normal' in which they must find ways to add value to the client relationship even when market conditions are persistently difficult.

The challenges just described show how the convergence of shifts in the economic and business environment are affecting the fundamental economics of wealth management. But these are not the only changes affecting individual firms and the industry as a whole.

For one thing, corporate structure and brand reputation can help or hinder any wealth management business today. For instance, scandals or financial losses incurred by any part of an integrated financial services firm can reflect badly on the reputation of a wealth management business. In an integrated firm, senior management may also become distracted from the wealth-management business by problems in other areas of the firm.

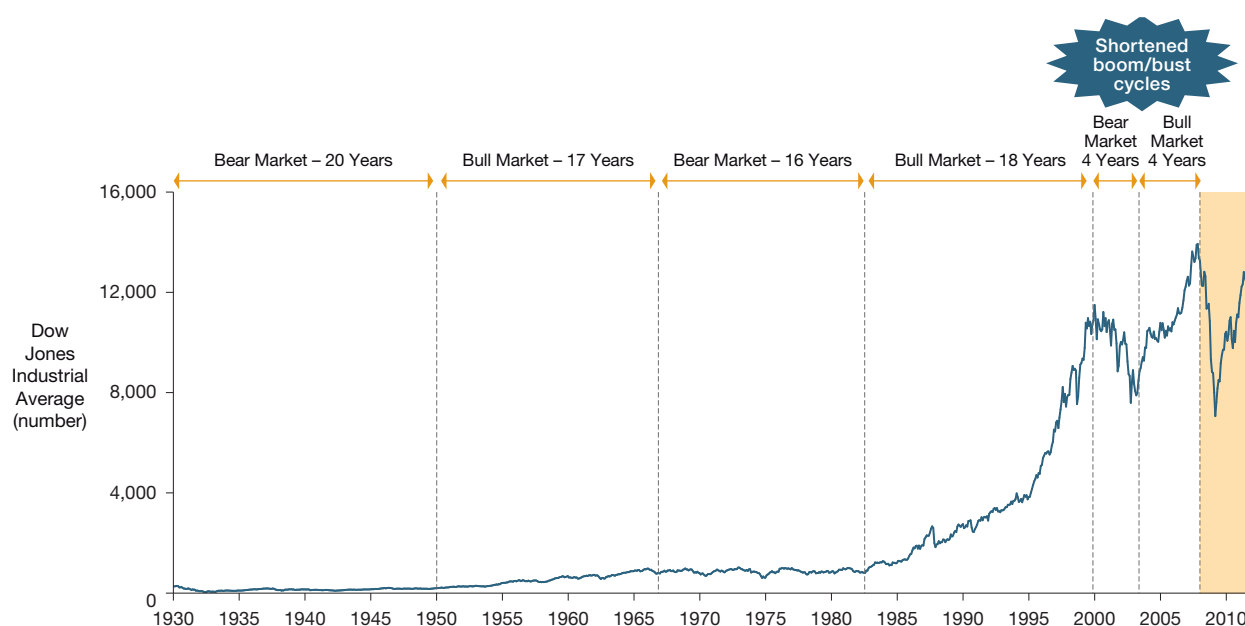
Parental structure can also influence the types of products a wealth management firm makes available to its clients. For example, a wealth management firm with investment bank ownership might favor more institutional products (the parent's specialty). A retail bank legacy might produce a greater focus on products linked to the parent's retail banking offerings.

The wealth management industry as a whole is also facing both consolidation and new competition, as players jockey to capture relatively dependable, fee-based revenue streams. These revenues offer a critical boost to pre-tax margins, which have been declining gradually for the past few years, though they have been more resilient and dependable in wealth management than in activities such as investment banking.¹⁷ Each player also needs enough AuM to operate profitably, and it can be especially difficult for new entrants to accumulate adequate AuM when they are often battling large and established incumbents, and less-than-friendly regulatory environments.

In emerging markets, it is especially critical for firms to make a reliable assessment of how much AuM is really targetable, given the stiff competition, and the fact that many of the assets are in illiquid or unmanaged pools. And increasing wallet share creates yet another imperative for firms: understanding the cultural and behavioral specifics of each market in which they operate.

¹⁷ See World Wealth Report 2011 Spotlight, "Wealth Management Firms Can Leverage Enterprise Value to Better Address HNWIs' Complex Post-Crisis Needs"

FIGURE 16. History of Bull and Bear Markets in the U.S., 1930 – 2012



Source: Capgemini Analysis, 2012; Yahoo Finance, 2012

The world's population of HNWI is increasingly diverse, and firms can no longer hope to simply take a business model that works in one market and replicate it in another. Rather, firms have to make deliberate adjustments to their business models to achieve sustained success in multiple locations. This means choosing which processes, products, and services to standardize across the firm, and which are differentiators that need to be customized to individual market requirements—even if it increases operational costs and complexity.

FIRMS NEED TO FIND RELEVANT WAYS TO MODERNIZE LEGACY BUSINESS MODELS

Today's wealth management business models reflect strategic decisions of the past, operational decisions of the present, and the ongoing evolution in markets. The net effect, though, is that many firms have little flexibility to adapt to changing business conditions quickly or effectively enough. Next-generation business models will need to overcome that weakness.

Firms May Need to Rethink Prior Strategic Decisions

In looking for ways to improve future performance, many firms will need to look first at how to undo the impact of prior strategic decisions. Those effects include:

- Diluted brand proposition.** Many firms, pursuing ambitious growth targets, moved away from core competencies in the recent past, and ended up diluting service levels and brand value. Ironically, this is a problem firms have faced many times over the last few decades as they have sought to adapt to changing market conditions. So yet again, they will now need to re-focus on core competencies to drive client satisfaction, and must consider other approaches, such as adopting an open architecture, to provide clients with access to non-core services.
- Fragile client trust.** Many firms focused excessively on investment performance in the past, without tightening risk management practices, especially in the ebullient pre-crisis years. As the financial crisis unfolded, it quickly became clear this strategy had contributed to the contagion in markets, compounding losses for

clients, confounding regulators, and causing the widely publicized demise of counterparties and firms. The fallout weakened client trust, and reduced the commitment (and wallet share) of clients. If firms are to grow the AuM of existing clients, and attract client referrals, they will need to work on reinforcing client trust and making it less vulnerable to market cycles. This will also bolster the ability of firms to attract net new money, which is critical to growing revenues while keeping costs low.

- **Diminished client-advisor interaction.** In the past, many firms urged advisors to expand their client lists, assuming that more clients would mean more profits. In reality, when advisors focus aggressively on bringing in new clients, they invariably reduce the time spent with existing clients—possibly to a point where clients become dissatisfied or mistrustful. Firms will need to discern and maintain the optimum level of client-advisor face time (an amount that will differ by client), especially as they seek to develop an integrated channel strategy.
- **Inadequate focus by top management on key issues.** At many firms, a number of issues have detracted from the focus of top management on key business issues. Some firms have been distracted from long-term strategy by short-term investment and other metrics. Others have increasingly hired executives from segments other than wealth management, where the key strategic issues may be very different. To chart and pursue a course to sustainable growth, firms will need a stable and experienced top management team, which understands the fundamental changes under way in the industry, and who can execute the kind of operating decisions needed to succeed in a margin-squeezed environment.
- **Vulnerability to an ageing advisor workforce.** While the average age of HNWI is getting younger, the same cannot be said of advisors. Older, successful advisors play a crucial role in maintaining and growing the existing client base, and grooming young advisors. However, if these tenured advisors favor advisory methods (and technology) that do not resonate with younger HNWI, important client needs could go unmet. Firms will therefore need to map advisors to the appropriate category of clients to ensure the relationships are well-matched, and perhaps develop a younger advisor workforce for younger HNWI to relate to.

Key Operating Practices, Including Client Segmentation and Digital Strategies, May Also Need to Be Refreshed

Certain legacy operating assumptions have also made it hard for firms to adapt to new market dynamics. A prime example is how client segmentation has remained heavily based on assets—for instance classifying clients as “mass affluent,” “wealthy,” or “ultra-wealthy,” depending on their assets.¹⁸

Segmentation based purely on assets yields sub-optimal results in both product positioning and client service, so firms will need to be more sophisticated in their approaches, taking account of the growing number of factors that shape client aspirations and needs—from age, gender, and location to risk appetite, source of wealth, product preferences, return expectations, and investment objectives.

Segmentation strategies will also need to take a more comprehensive accounting of HNWI assets, including assets held at other institutions, to provide firms with a more thorough understanding of the overall needs of their clients. Without this kind of holistic view, firms could inadvertently be under-serving high-potential HNWI. This is especially true for retail banking-wealth management strategies, but applies equally to the wealth management industry as a whole.

More-relevant segmentation approaches, in helping firms to better understand client investment behavior and biases, can help to improve client experience, optimize channel marketing, service positioning and sales efforts, and rationalize costs.

Firms have also been slow to implement comprehensive digital-transformation strategies, despite rising demand from both clients and advisors, who want more freedom to transact, interact, collaborate, and access information in different ways.

Many firms could be more aggressively pursuing digital adoption and transformation, but there are hurdles in terms of initiating and executing such strategies, and managing their governance. Management inertia, security and privacy concerns, and the lack of a proven business case can all stump digital transformation at the planning stage. Execution can be undermined by a lack of skills, IT complexity, and inadequate data/information management. Firms may also be unprepared to manage the impact on job responsibilities when activities are automated and information is widely accessible.

¹⁸ For the purposes of our analysis, we separate the HNWI segment into three discrete wealth bands: those with US\$1 million to US\$5 million in investable assets (so-called “millionaires next door”); those with US\$5 million to US\$30 million (so-called “mid-tier millionaires”) and those with US\$30 million or more (“Ultra-HNWI”)

The governance of digital transformation can also be a problem if there is no real transformative vision, or there is ineffective (or non-existent) coordination across organizational boundaries, business units, functions, or processes.

Firms May Also Have to Re-Think Legacy Assumptions in Sizing New Opportunities

In today's operating environment, wealth management firms will also need to consider carefully whether to target "buzz" markets, which are expected to be the drivers of future HNWI growth. If investable-wealth levels prove to be less than expected, it will be difficult for multiple players to survive.

The experience of some firms in Asia-Pacific may offer important lessons learned. In an effort to garner more AuM, and strengthen their industry positions, many wealth management firms have attempted to expand into key Asia-Pacific markets in recent years, lured by rapid economic growth. However, levels of real investable wealth have often proved to be smaller than expected, and insufficient to sustain multiple global wealth management firms, let alone to power growth.

Some global players have already begun to sell off operations in these smaller markets. Instead, they are focusing on markets in which they can better utilize organizational capabilities so as to add more client and shareholder value. These firms are essentially conceding their attempts to build scalable business models were incompatible with prevailing market conditions or their own DNA. However, it is important to note that other firms may still be able to thrive in these markets (and perhaps acquire disposed assets) by leveraging different competencies and business models.

SCALABILITY IS KEY AS WEALTH MANAGEMENT BUSINESS MODELS EVOLVE, BUT HURDLES EXIST

Given the challenges facing the wealth management industry, many firms are now grappling with how best to achieve revenue growth from new markets or products without adding incremental resources and costs—and while avoiding service degradation during expansion. This type of scalability is likely to be the earmark of 'next-generation' business models, because it better positions firms to navigate the changing landscape profitably, and offers more flexibility to manage whatever is the next industry shift.

In fact, a well-defined scalable business model can reinforce a virtuous circle of brand building and expansion, providing an important competitive edge to wealth management firms as they identify and pursue growth opportunities. But scalability offers benefits, and presents challenges, at different business levels. For instance:

■ At the wealth management firm level:

- **Business agility** can be enhanced by speeding go-to-market strategies, facilitating market entry/expansion, and ensuring greater responsiveness to other changes in the market environment. This can serve as a competitive differentiator.
- The **profit equation** is improved as fixed costs are kept in check while variable costs increase at a slower pace than the value added (at least over the medium term once investment returns begin). In short, firms can serve more clients, or the same number of clients in more ways, at lower incremental cost. However, it is also a reality for most firms that costs have long grown in lockstep with revenue and asset bases, and many will struggle to make substantive changes to that paradigm.
- **Regulatory hurdles** to expansion may be spotted sooner, allowing firms to take proactive steps to ensure compliance. But scalability may also expose firms to regulatory risk. For instance, attempts to centralize the design of products, or standardize products and processes across regions, may inadvertently create non-compliance. Restoring compliance, or creating regional-specific exceptions to the rules, may ultimately be more costly than a less scalable approach.
- **Client and employee engagement** can get a boost from scalability, which allows more clients and advisors (and other stakeholders) to be closely engaged in the firm's processes and culture, helping to drive their engagement in the brand.
- **Scale economies** are an obvious and much-touted benefit of scalability, but at least one route—acquisition—may not always deliver hoped-for dividends. This is because scalability is not about absolute size, but about the ability to generate returns at a lower incremental cost. Too often, acquisitions end up merging businesses that are not complementary, so process complexity actually increases, and firms struggle to rationalize in a cost-effective way.

■ **At the distribution level:**

- **Client satisfaction** can certainly be improved through scalability, as systems and processes can be deployed appropriately to maintain high service levels during expansion, even without additional resources.
- **Advisor satisfaction** can also be improved—by streamlining processes and technology to optimize advisor time, while providing clearer direction on the firm’s value proposition.
- However, the **underlying business proposition** is inherently relationship-based and personalized, so it is difficult to standardize in any meaningful way. In fact, standardization attempts could directly counter the increased demand by clients for customized solutions related to their specific requirements.

Ultimately, then, it will probably be difficult for wealth management firms to achieve scalability across the entire wealth management value chain (as illustrated in Figure 17), but firms can still selectively scale up specific activities related to acquiring, retaining, and servicing clients—while employing other tools to improve the proposition in areas that cannot be easily scaled.

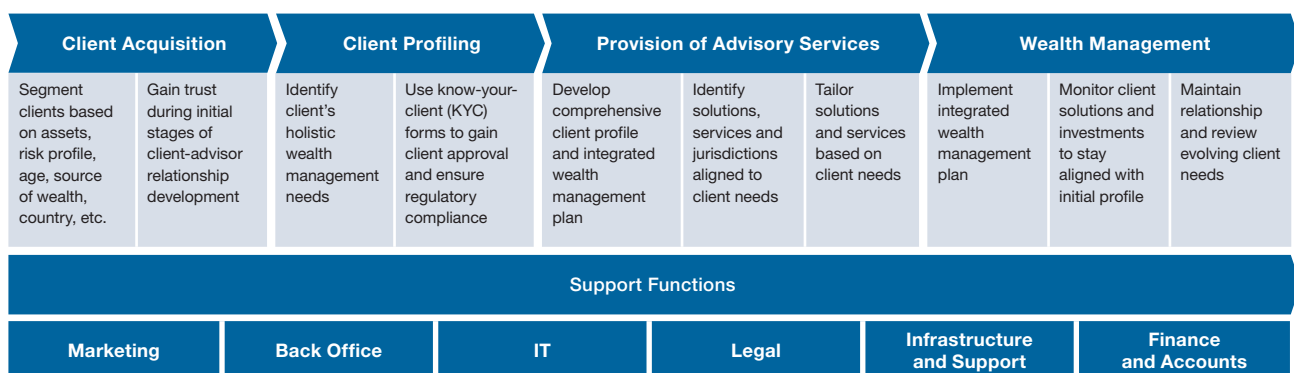
Client Acquisition and Profiling Epitomize the Challenges of Scalability

In general, scalability is much more difficult to achieve in activities related to client acquisition and profiling than in advisory services or wealth management. The nature of the advisory relationship creates a significant challenge in these two activities, as it is difficult to secure client trust in general, let alone on an accelerated basis.

Indeed, the trust required to acquire clients can only be built through multiple interactions that prove to the client that the advisor understands their needs, and can develop and execute a customized wealth management strategy that reflects their priorities. Many of these interactions take place even before the HNW client has committed to the advisor relationship, so the effort is very much a long-term commitment to loyalty from the perspective of both the advisor and the client.

Technology can facilitate the means, speed, and frequency of communications between advisor and client (and thus improve advisor productivity), but it cannot improve the substance of those interactions, or otherwise replace “face time” spent building client relationships.

FIGURE 17. Wealth Management Value Chain



Source: Capgemini Analysis, 2012

As a result, the role of technology-led scalability in client acquisition is likely to be focused most on standardizing advisors' non-core and administrative activities so as to minimize the amount of client-relationship time lost by advisors, and speed their administrative response times.

Client profiling is another area in which scalability is challenging, since the business proposition must recognize a wide range of investing behaviors and cultural preferences to cater to different geographies. These disparities defy standardization, making it difficult for firms to build packaged wealth management solutions that can be successfully leveraged globally.

For example, HNWI in developed economies in Europe and North America have generally become more conservative in current uncertain macroeconomic conditions. Capital preservation is a top priority for these HNWI, while those in Latin America and Asia-Pacific excluding Japan are more likely to consider a relatively higher-risk investment if the potential rewards are high. Tradition also helps to drive different cultural investing norms, such that gold (in the form of jewelry) has long been an asset class of choice for many in Asia-Pacific, while Sharia products (which adhere to Islamic banking principles) are critical in many Middle Eastern markets, and Art and other collectibles remain a popular asset class among European HNWI.

Given the need for customization and the desire for scale, wealth management firms will need to create an effective client segmentation model by identifying the critical elements for each market. Then they can customize their operating practices to cater to various segments. In this way, selective scalability, enabled by technology, can create value for both the firm and the client.

THE WAY FORWARD: LEVERAGING TECHNOLOGY TO ACHIEVE SELECTIVE SCALABILITY

The hurdles to scalability are far lower in providing advisory and wealth management services than in client acquisition and profiling, so wealth management firms will get most value from leveraging technology to achieve scalability in these areas of the value chain. The benefits of scalability in these areas largely relate to automation, and the expanded reach of expertise. Some firms may also have highly developed asset management capabilities that can be used as a foundation and lead-in for building scale.

On the advisory side, firms can be highly effective by creating back-end teams, specialized in financial planning, asset allocation, estate planning, etc., to create customized plans for clients, based on advisor input on the client's profile, segment, aspirations, and so on.

Similarly, firms can leverage technology in executing wealth management activities, without using any high-value advisor time, once the client's integrated wealth management plan has been designed and agreed. Straight-through processing systems can provide prompt notification to clients of trade execution, position, and portfolio updates, etc., preserving advisor time for strategic conversations.

Leading firms are already experimenting with embedding scalability into business models, using process- and strategy-based levers, as well as advisor- and client-based initiatives. The impact of technology-enabled solutions differs by lever, however, making some more critical to success than others.

Multi-Dimensional Client Segmentation Models and Scalability-Driven Acquisition Approaches Are the Most Critical of the Process- and Strategy-Based Levers

Firms will need to focus on core competencies, granular segmentation, and higher automation to drive scalability in wealth management, but most critical (see Figure 18) are: 1) adopting an effective, multi-dimensional HNW client segmentation model based on criteria such as asset size, risk appetite, behaviors, and financial/investment needs and goals, and 2) a more nuanced approach to acquisitions.

The current asset-based approach to segmenting clients yields sub-optimal results, because it does not take account of key drivers of investing behavior, such as risk appetite, and financial aspirations. Using a more multi-dimensional approach, firms will be better positioned to customize their offerings, pitch strategy, and provide touch-points, according to the client's segment. This is likely to generate a higher return on effort, more productive use of advisor time, and higher relationship-conversion and client-acquisition rates—potentially at lower cost.

It will also be critical for firms to view keenly any acquisitions designed to drive scale, since only complementary acquisitions will actually deliver growth while containing incremental costs. It may also be preferable for some firms to opt for acquiring another firm's wealth management team (a "lift-out"), rather than undertaking a fully fledged corporate acquisition.

Other scalability levers offer significant potential, notably optimizing processes by automating back-end operations. Several back-office activities, such as those involving regulatory filings, client reporting, and management information systems, are repetitive and can easily be automated. This will help to optimize cost structures by reducing manpower expenses. Additional benefits include eliminating human error and, most importantly, ensuring timely regulatory compliance. However, it is also important to make sure the outputs are truly standardized as exceptions-handling is time-consuming and costly.

Other process- and strategy-based scalability levers also have potential, including a deliberate focus on markets/operations that can deliver scale for profitability. However, wealth management firms will need to conduct a thorough cost-benefit assessment to identify the point at which the scale of different geographies and operations essentially becomes unprofitable. (This is likely to depend, in part, on the maturity of the prevailing financial system.)

Similarly, firms will need to focus on core business (maximizing the time, energy, and resources devoted to client advisory services), and decide when the business is sub-scale for certain activities. Firms will also need to identify when and how to outsource discrete activities, such as asset management, or repetitive processes that can be more effectively and efficiently handled by a specialist vendor. For some firms, outsourcing will preserve expert resources for core activities, and help to drive cost optimization, though firms with the requisite expertise and AuM may be able to build scale by keeping asset management activities in-house.

Implementing a well-functioning enterprise-wide customer relationship management (CRM) system can also help to ease the flow of information among stakeholders, facilitating quick and efficient decision-making and improved service at the distribution level. However, it is important for the business and technology teams to agree on the usability and functionality of the CRM system at the earliest (design) stage, to ensure the buy-in, success, and ultimate applicability of such initiatives.

Notably, while the client segmentation and acquisition levers are the most widely applicable and critical, each of these scalability initiatives has considerable potential to deliver benefits, especially if firms can combine them to rationalize processes while improving customer experience.

Pooling Product Specialists and Creating Advisor Teams May Be the Most Important Advisor-Based Scalability Levers

There are also several advisor-based initiatives available to wealth management firms hoping to embed scalability in their business models, but the highest priorities are likely to be pooling product specialists and creating advisor teams (see Figure 19).

Pools of product specialists can be responsible for maintaining a knowledge base of various investment products to suit the diverse needs of HNWI's across all client segments. These teams become a central source of knowledge for all advisors, and thus enhance advisor effectiveness and client satisfaction. For the firm, these teams provide another way to share expert resources more efficiently (and cost-effectively). Advisors are more productive, as they have more time to concentrate on core advisory activities. Clients are kept happy, and may even be better served, as they have access (via their advisor) to a wealth of specialized knowledge.

FIGURE 18. Process- and Strategy-Based Scalability Levers

Lever	Critical/Related Success Factors	Criticality
Adopting an effective HNW client segmentation model based on asset size, risk appetite, and financial/investment needs	<ul style="list-style-type: none"> Front-office segmentation on servicing needs requires an ability to drive service development in back office Strong data management capabilities required 	
'Scalability-led' focus on acquisitions	<ul style="list-style-type: none"> Acquisitions may yield increased scalability and returns when complementary 'Lift-outs' (acquiring a team) can be beneficial 	
Optimizing processes through automation of back-end operations (such as regulatory filings, client reporting, and MIS)	<ul style="list-style-type: none"> Standardized outputs are important as handling exceptions can be a time-consuming and costly activity 	
Focusing on markets/operations with potential scale for profitability (and exiting other markets/operations)	<ul style="list-style-type: none"> Firms can look at countries with developed financial systems for relative cost advantages Markets with complementary features are important 	
Choosing 'open-architecture' or 'managed-architecture' platform for scalable growth (depending on firm DNA)	<ul style="list-style-type: none"> Large AUM size is needed to support 'managed-architecture' where asset management is done in-house 	
Implement leading enterprise-wide customer relationship management systems (CRM)	<ul style="list-style-type: none"> Business and technology teams need to agree on the usability and functionality of the CRM system, and co-design for success and future relevance 	

Negligible
 Low
 Medium
 High
 Very High

Source: Capgemini Analysis, 2012

Other team-based models can pull together and leverage advisors of differing experience levels. Most current models assign HNW clients a single, experienced advisor (often because HNW clients demand it), but this approach puts a premium on experienced advisors, and makes it hard for firms to utilize less-experienced advisors. The team approach can help firms to utilize and groom less experienced advisors, without undermining the quality of service to clients.

A more marginal but nevertheless possible source of scalability involves utilizing professional expertise (or vendors) to implement a robust hiring and training plan for new advisors. This approach can help firms to build the technical and "soft" skills needed to engage effectively with potential HNW clients. This training could also occur through mentoring in the team-based environment, but firms could reduce manpower expenses if they use outside specialists and vendors to find and properly train new (and less expensive) hires.

FIGURE 19. Advisor-Based Scalability Levers

Lever	Critical/Related Success Factors	Criticality
Maximizing advisor effectiveness through sophisticated central product specialist teams	<ul style="list-style-type: none"> Smooth flow of information and strong co-ordination between advisors and product teams Team capability and multi-market expertise 	
Creating advisor teams that include a healthy mix of experience to cater to client needs while grooming new talent	<ul style="list-style-type: none"> An effective mentoring plan with well-defined roles is necessary to truly prepare young advisors 	
Utilizing professional expertise (or vendors) to implement a robust hiring and training plan for new advisors	<ul style="list-style-type: none"> Situation-based case studies designed by successful advisors can also be useful for training purposes 	

Negligible
 Low
 Medium
 High
 Very High

Source: Capgemini Analysis, 2012

Options Exist for Pulling Client-Based Scalability Levers

While client acquisition and profiling activities are difficult to scale, there are certain client-based levers that firms can pull to increase the number of HNW clients they serve, at lower costs (see Figure 20).

For example, ‘virtual advisors’ and self-driven investment portals can leverage evolving Internet and mobile channels, meeting demand from clients for greater choice in touch-points and digital interaction. Some leading firms have already started to use virtual advisor platforms, either online or in branches, or through multiple channels to overcome the shortage of experienced advisors. Virtual advisor platforms can enhance collaboration, improve client experience, and help firms to optimize costs and improve productivity.

Similarly, self-driven investment portals both improve client experience and reduce costs. Client demand is strong for real-time insight into portfolio balances and wealth. Some clients also prefer greater control over portfolio management, and Internet-based applications can provide a way for them to feel greater control over their assets, and avoid any sense that certain products are being pushed on them. For firms, self-driven investment portals can help to reduce staffing expenses and free up valuable advisor time.



Importantly, though, several such levers are complementary and inter-dependent. For example, the success of virtual advisors requires the firm to have a sophisticated underlying approach to segmentation. Choosing and combining levers for maximum effect will therefore require firms to evaluate the efficacy of levers given their own DNA and scalability strategies.






Whatever the Scalability Strategy, Strong Client-Advisor Relationships Stay Front and Center

Even as wealth management firms try to pursue selective scalability in growth, their focus remains firmly fixed on establishing and maintaining a robust client-advisor relationship. Some examples:

- **One leading global wealth management firm opted for selective growth, using advanced client segmentation.** One leading firm had successful operations in many regions, but was hoping to tap into the future growth potential of the Asia-Pacific HNW population and its wealth. Recognizing the vast differences in behavioral/cultural issues in different markets, and their differing levels of wealth, the firm charted a selective growth strategy using advanced client-segmentation techniques to decide which markets to enter. The firm also opted to strengthen its presence in emerging offshore banking centers such as Singapore (critical gateways to Asia-Pacific investments) to position the firm better to meet the future needs of clients and serve them profitably.
- **A leading financial services firm in North America built a strong advisor workforce to penetrate the wealth management market.** Wanting to establish a market presence, the firm critically analyzed available data, and identified the importance of a loyal advisor force to sustained firm profitability and client retention. The firm meticulously built its advisor base, understanding the long-term nature of the process, and despite a short-term hit to profitability.
- **One leading pure-play wealth management firm wanted to grow its business by luring successful advisors from other firms.** The CEO of the firm (with more than US\$100 billion AuM) was adamant that many of the industry’s top-notch advisors were

FIGURE 20. Client-Based Scalability Levers

Lever	Critical/Related Success Factors	Criticality
Increasing client satisfaction by creating ‘virtual advisors’ to leverage evolving Internet and mobile channels	<ul style="list-style-type: none"> Capabilities to create the right connection with HNWIs (based on their preferences and value) are crucial to ensure success of virtual advisors 	
Implementing self-driven investment portals to capture non-managed client assets	<ul style="list-style-type: none"> Portals with complete research, execution, and reporting capabilities can help attract new clients 	

 Negligible
  Low
  Medium
  High
  Very High

Source: Capgemini Analysis, 2012

dissatisfied because they lacked the freedom to make independent decisions. The firm therefore attracted advisors from other firms by making them directly and completely responsible for their client relationships, with the help of centralized back-office support, which managed activities that were important but non-core for an advisory role, such as such as compliance administration.

Some Firms Are Scaling Back to Refocus On Core Markets

Other wealth management firms, acknowledging a lack of scale, are ceding some markets in order to refocus their resources on markets they consider to be core. Some examples include:

- **One large bank with Asia-Pacific aspirations focused instead on leveraging its home-country dominance.**

The firm realized it could not successfully enter multiple countries at the same time, or effectively serve all client segments. Nor could it compete against the slew of competitors, as an increasing number of players sought to tap into the growing population of HNWIs in Asia-Pacific. Instead, the bank focused on building a strong client base with roots and relationships in its home country. The firm also specifically targeted corporate employees and entrepreneurs, who would also appreciate the firm's robust banking offering. The firm also acquired advisors with cultural knowledge of its home region to make clients feel more comfortable in their interactions.

- **One leading wealth management firm focused on Asia-Pacific opted for an independent asset management role.** As the financial crisis unfolded, the firm realized that HNW clients were suddenly skeptical of proprietary products, and favored third-party products—and wanted to be able to choose custodians for investment purposes. The firm also recognized that the independent (external) asset management model was new to many Asia-Pacific clients (though well-tested in mature financial markets). The firm therefore developed a wealth model that allows its clients to choose products and services from other banks and asset management firms via an open architecture platform, while providing clients with a simple fee-based cost model built on a holistic advisory relationship.

- **One leading global financial services firm cut back operations in markets that lacked scale.** At one time, this firm had expanded to establish operations across multiple countries, but the strategy diluted the firm's strategic focus on core operational areas, and led to its operating in many unprofitable businesses. Under regulatory pressure to raise capital ratios and under shareholder pressure to improve profitability, the bank opted to exit more than 15 countries where it lacked scalability in its offerings. The decision will help the bank to reduce costs and meet capital adequacy standards. The firm even exited private banking in larger economies such as Japan so as to focus on high-growth markets when solidifying its Asia-Pacific footprint.

CONCLUSION

A range of firm-specific and industry-wide trends are converging to undermine the profitability of wealth management operations today. When combined, these trends are clearly creating stress on wealth management business models. For instance, firms are faced with market volatility and gun-shy investors, so need to create products that appropriately cater to client needs and risk profiles, while generating margins.

Similarly, given increasingly competitive conditions, firms have to decide when and how to pursue selective growth strategies or prepare for consolidation—at the same time that increased regulation may be creating new hurdles to profitable entry/expansion in some markets, especially perhaps for smaller players.

Scalability—growing AuM at lower incremental cost, not simply expanding in outright size—will be an important lever of sustained profitable growth for many firms. To leverage scalability, however, firms cannot just tighten their belts. Rather, they will need to reassess many of the costs they once considered to be fixed or “sunk,” and explore new options for rationalization. In short, firms need to find ways to recover revenues needlessly lost to costs, thereby reducing their cost-to-income ratios, and ultimately boosting profitable AuM.

For firms to plot their growth strategies, and evaluate the potential for leveraging scalability in that growth, they must first assess their starting point.

Broadly speaking, by assessing the current state of their operations, firms could characterize themselves in one of the following four ways:

- The **“blank slate” firm** is operating successfully in its home market, but considering how to expand. It will need to perform a gap analysis on available vs. required skill sets to excel in target markets, and identify how its core strengths (which also drive brand value) can be leveraged. By leveraging whatever in their DNA made them successful at home to effectively target clients in new markets, these firms can decide whether and how to offer non-core services (e.g., via joint ventures, partnerships), and identify ways in which technology can help to embed scalability in that existing model. These firms have significant potential to get scalability right the first time, assuming they have the requisite capabilities and commitment.
- The **“limited success expander”** has spread beyond its home market, but has been only partially successful. This type of firm will need to ascertain what constrained its success. Common issues include excessive competition for meager asset pools, lack of a sophisticated client segmentation model, and inadequate use of digital tools to improve client experience and advisor productivity. Such firms will need to consider how behavioral and cultural issues vary by market, and whether those differences are properly accounted for in the firm’s value proposition. They may also need to fortify client-advisor relationships. To embed scalability, these firms will need to identify how technology can help target and exploit synergies between operations across regions, and evaluate whether acquisitions have been (and could be) complementary enough to deliver the desired benefits.
- The **“successful expander”** is already reaping rewards from profitable operations in multiple regions. In the process, it will have been exposed to myriad challenges, from evolving regulations to market-specific dynamics such as norms in cultural and investing behavior. To continue growing profitably and maintain existing dominant market positions, these firms will need to analyze exactly what has driven their success, and how they managed to expand without incurring undue

additional costs. They will need to keep rationalizing costs and activities by, for example, leveraging digital tools as widely as possible to enhance client experience. These firms will also need to stay ahead of ongoing regulatory and other market trends that could change the economics of their business—a capability they have probably employed in prior expansion initiatives.

- The **“re-focuser”** is not using scalability primarily to facilitate their growth agenda. Rather, they see scalability as a way to be more responsive to market conditions, even if business is contracting. The challenge for these firms will be to preserve core operations and minimize costs “stranded” in operations that have been de-scaled. One example of a “re-focuser” might be a “limited success expander” that is in a contraction phase. Such a firm could undertake scalability-related investments while contracting, thereby becoming more like a “blank slate firm” when it ultimately pursues growth opportunities at some point in the future.

Whatever the starting point, the path to next-generation business models essentially begins with identifying the effects of legacy business models, and re-focusing on core competencies to expand the business. But the end-game—achieving a robust scalable business model that also reinforces client-advisor relationships—will involve systematic decisions and precise execution.

To identify and prioritize scalability levers, firms will need to decide which processes and activities need to be centralized or decentralized, what types of products and solutions are crucial to growth and whether they need to be centrally and/or consistently designed, whether the technology is in place to leverage the chosen scalability levers and support strategic business priorities, and whether stakeholders (across business, technology, and operations teams) are aligned—and senior management is committed—to leveraging scalability initiatives to achieve profitable AuM growth.

And all the while, firms will need to remain focused on whether their decisions will bolster the satisfaction and loyalty of both clients and advisors.

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