Prospering in Uncertain Times

GLOBAL WEALTH 2002

The Boston Consulting Group
After we published *Richer Prospects in Wealth Management*, our 2001 report on global wealth, several of our clients asked us for additional analysis of their operational performance and the economics of the wealth management business. More than 60 private-banking and wealth-management institutions—with collective funds under management of more than $3 trillion and many different business models—subsequently participated in a benchmarking exercise led and administered by The Boston Consulting Group.¹ The participants, which were split almost evenly among North America, Europe, and the Asia-Pacific region, included seven of the world’s top ten wealth-management institutions. (See Exhibit 1.)

The result of this benchmarking exercise was the BCG Wealth Manager Performance Survey. The survey aimed to achieve a better understanding of the economic and operational performance of wealth management institutions globally throughout 2001 and of their strategies for the future.

Benchmarking participants were asked to complete an extensive quantitative questionnaire capturing data on the economics and operations of their businesses during 2000 and 2001. In addition to the survey, individual qualitative interviews were completed with senior wealth executives to frame each institution’s short- and long-term strategic responses to changes in the competitive landscape and evolving client behavior.

We analyzed the survey’s results to draw out regional differences and insights on wealth manager performance during 2001. We established benchmarks for provider performance by business model, region, target client profile, product set, and key activities.

As in last year’s report, we define *wealth* as net investment assets, which include the net of listed securities held directly or indirectly through managed funds, administrative platforms, cash deposits, and nonlisted investments (such as equity in family businesses), minus all personally held debt (such as mortgages and personal loans). Net investment assets exclude the value of a household’s primary residence but include other real estate investments. (For details of this report’s approach to market sizing, see the Methodology, page 30.)

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1. We collected benchmarking data until May 21, 2002. All dollar figures in the report are U.S. dollars.
More Than 60 Leading Institutions Participated in the Benchmarking Survey

Regional Summary of Participants

- **North America**
  - Survey participants: 21
  - CAL¹ of participants: $1.7 trillion

- **Europe**
  - Survey participants: 21
  - CAL¹ of participants: $1.2 trillion

- **Asia-Pacific**
  - Survey participants: 19
  - CAL¹ of participants: $119 billion

**Source:** BCG wealth manager performance database.

¹Client assets and liabilities (CAL) of participants in the survey; CAL = wealthy clients’ assets under management, assets under custody, and outstanding loans.
There was worldwide destruction of private wealth in 2001 as investors—from the mass affluent to the richest—saw the value of their equity holdings tumble.

- The declining markets cost all investors an estimated $2.9 trillion, or 4.4 percent of the total value of global investment assets. More than 2 million households slipped below our wealth threshold of $250,000 in net investment assets.

- Global wealth is forecast to grow more slowly than previously foreseen—at an average 6.9 percent annual rate through 2006 compared with the five-year average annual growth rate of 9 percent predicted just a year ago. The decline in equity markets has had a severe impact on the profitability of wealth managers—especially on brokerages that rely on commissions.

The BCG Wealth Manager Performance Survey revealed very different declines in profitability from region to region.

- In the United States, profitability fell 69 percent, with commission-based brokerage firms reporting significant losses while fee-based wealth managers in the survey recorded a more modest 6 percent decline in profitability.

- In Europe, profitability declined by an average of 34 percent as private banks in our survey saw their revenues tumble by 14 percent.

- In Asia-Pacific, profitability at the institutions we examined—which included several top performers—grew by 15 percent.

Most wealth managers have so far done surprisingly little to address costs, given their reduced revenues in 2001.

- Our survey indicated that, on average, costs have risen. Moreover, cost reductions have usually not matched revenue declines.

- Some institutions that participated in our survey were unable to provide the cost breakdowns requested. The costs section was invariably the least complete portion of a participant’s survey.

Nervous investors—particularly those with more moderate holdings—are becoming more conservative.

- They are shifting to cash and money market funds and increasing their holding times for investments, while cutting their margin debt substantially.

- U.S. equity-fund holdings dropped $550 billion in 2001 while money market holdings increased $440 billion.

- Despite this increase in investor conservatism, alternative investments are growing and have a long-term role in the wealth management industry.

In the United States and to a lesser degree in Europe, increasing regulation has precipitated a shift to onshore investing. Nevertheless, the offshore market continues to grow.

- The onshore market is growing faster than the offshore market. Still, the offshore market remains very large, totaling at least $5 trillion.
• The offshore market offers better margins than the onshore market, but it is highly fragmented among many different wealth managers.

Regulatory and legislative investigations have focused attention on the importance of truly independent research and advice.

• A series of corporate scandals in recent months has undermined investor confidence in earnings reports and in the markets in general. This strengthens the case for separating investment advice from transactions.

• Clients, meanwhile, are demanding higher-quality, broader, and more personalized investment advice from wealth managers.

The new wealth-management agenda demands that wealth managers address their costs. That alone, however, is not sufficient for success. Leading competitors also need to attract and retain the most valuable customers and ensure the effectiveness of their sales forces. Innovative, competitive products—including alternative investments—are critical to maintaining and improving the yield on client assets.

• Many competitors are still assuming unrealistic levels of growth. To create sustainable, successful franchises, institutions must actively manage their costs instead of focusing too narrowly on revenue and asset growth. They need to understand their cross-subsidies and transfer pricing to manage their costs better.

• To gain competitive advantage, wealth managers must deal with unprofitable customer groups within their businesses by ensuring that investors really do meet their standard account minimums.

• In particular, they must align their business models to focus on their target markets, investing in their sweet spots—where their brands, skills, and costs to serve best fit their chosen customers—and ensuring that their offerings are sufficiently segmented and appropriately matched to their core customers.

• Institutions should review the effectiveness of their sales forces, ensuring that they match their service models, compensation, and management structures with their priorities.

• Most players will want to consider how innovative investments—including funds of funds—fit into their product and service offerings.

There are substantial rewards for those institutions that get the new wealth-management agenda right.

• Today’s uncertain markets provide wealth managers with a rare opportunity to push through tough decisions and changes.

• Wealth managers that exploit that opportunity will build competitive advantage—improving their P/E ratios and increasing their market capitalization.
Providers of wealth management services and investors alike face challenging trends in today’s difficult market environment. For providers, costs remain stubbornly high, particularly given the relatively slow projected growth for the industry. For investors, the task has been to find safer, high-return products; to that end, they are embracing fixed-income and other investments that they often neglected in the boom years of the late 1990s.

The Challenges for Providers

The task ahead for providers is to get a firm grip on costs while exploiting the benefits of scale.

Despite Cuts, Costs Remain High

During 2001, wealth managers attempted to reduce costs to offset declining revenues. Financial services companies, and particularly the hard-hit U.S. brokerages, cut staff in core markets, froze or reduced salaries (largely by lowering bonuses or commission payouts), deferred IT and infrastructure investments, made belt-tightening operational cuts, and retreated from overseas markets. Merrill Lynch, Charles Schwab, and Credit Suisse, for example, all withdrew from the Australian market. Merrill and Schwab also left Canada. Merrill is closing 20 of its 28 branches in Japan. Indeed, Merrill went further than its competitors in its effort to cut costs. And because of its dramatic cost reduction, it managed to maintain better margins than many competitors.

Ten of the largest financial institutions announced global cuts of 26,000 jobs and $4 billion in annual operating expenses in 2001. (Outside the brokerage market, few wealth managers have taken such draconian cost measures.) Many of these planned cuts, however, fall outside the institutions’ core wealth-management franchises. And they aren’t likely to be enough. In 2001, costs for the institutions in our survey rose an average of 2 percent, and head count actually grew at many institutions. One exception to the retrenchment in private banking in the United States is Citigroup, which is growing its overall wealth business. (See the insert “Citigroup Personalizes Client Relationships with Separately Managed Accounts.”)

Our performance survey showed that in 2001, European private banks saw costs fall by a mere 1 percent on average. Indeed, several competitors substantially increased sales and back-office staff. This lack of attention to costs led to a profit drop of more than 34 percent at such institutions.

The composition of costs has also remained largely unchanged across the industry globally. (See Exhibit 10.) Many wealth managers have trimmed

**EXHIBIT 10**

Cost Structures Remained Largely Unchanged


<table>
<thead>
<tr>
<th>Costs (% of total costs)</th>
<th>75% quartile</th>
<th>Median</th>
<th>25% quartile</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensation</td>
<td>16%</td>
<td>10%</td>
<td>6%</td>
</tr>
<tr>
<td>Operations</td>
<td>40%</td>
<td>30%</td>
<td>20%</td>
</tr>
<tr>
<td>IT</td>
<td>24%</td>
<td>18%</td>
<td>12%</td>
</tr>
<tr>
<td>Marketing/other</td>
<td>10%</td>
<td>8%</td>
<td>6%</td>
</tr>
</tbody>
</table>

Source: BCG wealth manager performance database.

Note: Select outlier data points were excluded from the analysis.
capacity and variable costs, but few players have begun to remodel their service offerings in response to changed conditions.

**Scale Has Its Place**
Large players can derive some benefits from scale, especially in IT costs and in their processing businesses. Big IT investments require a certain minimum scale to amortize the increasing costs of client service and compliance. Private banks are finding that back-office and processing businesses are increasingly driven by scale. Centralized or shared services can also help competitors reap the benefits of scale. Indeed, our survey found that more competitors are interested in exploring the benefits of scale, although few are actually doing it. An exception is the merger of Sarasin and Rabobank. (See the insert “Sarasin and Rabobank: A Swiss Private Bank Marries a Dutch Heavyweight,” page 20.)

Scale has its limits, however, in sales and service. The client relationship and personal touch are key to private banking. Knowledge of the client and the quality of the client relationship are critical to distribution. That means understanding changing client behaviors and effectively managing relationships.

**The Concerns for Investors**
Investors, nervous about the market, are looking for safe, high-return products.

**Rattled Investors Stop Trading**
The nerve-wracking state of the investment markets is accelerating several long-term changes in investor behavior. Alarmed by the evaporation of much of their wealth at the very time they are striving to build a substantial nest egg for retirement, investors are becoming decidedly more risk averse. This is the first taste of wealth destruction for many investors and wealth managers.

Investor conservatism and inaction—palpable in the markets and present in most debates about investing—are recurring themes in our conversations with clients globally. Data from our survey show that industry practitioners see a marked shift to safer asset-holding patterns in their client bases, even among the wealthiest clients. And investors want more professional advice to guide them through these difficult times. Today the wealthy sometimes expect their bankers to share risks with them—through performance fees, coinvesting, and other partnering arrangements.

The fact is that investors are currently focused more on wealth preservation than on rapid wealth creation. Their thinking is becoming longer term and less ambitious. They are practicing asset allocation more and embracing asset classes that many abandoned in the late 1990s, including fixed-income and balanced investments, and commercial property. Speculative money is now more likely to go to actively managed, noncorrelated products rather than to volatile, long-term growth equities, whose performance has been mixed at best. Holding periods for equities are increasing, too. After dropping an average 8.7 percent a year from 1995 to 2000, average holding times on the New York Stock Exchange rose 16.6 percent, to 257 days, between January 2001 and April 2002. Nasdaq holding times rose 47.9 percent, to 75 days, for the same period.

At the same time, since mid-2000, many investors have traded their equities for money market funds and bond mutual funds have become more popular. Margin debt fell about $130 billion in the United States from its peak in 2000 as investors reduced their leverage and market exposure. (See Exhibit 11.) These changes represent a return to a long-term conservative trend in investor behavior that was interrupted by the “irrational exuberance” of the late 1990s. Meanwhile, the aging population in most wealthy countries and continuing pension reform have spurred employee stock purchases in long-term retirement plans.

It is worth noting that there are important regional differences in these changes in investor behavior. U.S. investors are becoming more sophisticated about risk and how they manage it by increasing their diversification through hedging and alternative investments. They have, however, become conditioned to expect higher than average returns. In Europe, pension and tax reform on generational transfers is increasing the wealth pool and the need for advice. In some markets in the Asia-Pacific region, there is a growing sophistication about and awareness of tax issues, spurring the rise of tax-advantaged products, such as master trust products and tax wraps.
The Holy Grail: Investors Want Safe, High-Return Alternatives

Savvy investors who want to limit their exposure have rushed to find investments that aren’t correlated with the equity markets. This mounting trend has led to an enormous growth in private investors’ holdings of alternative investments. There are now more than $580 billion of such investments in the United States, including $132 billion in private equity, $106 billion in real estate investments, and $342 billion in hedge funds. Although alternative investments comprise only about 3 percent of the investment assets held by wealthy households in the United States, they represent an attractive opportunity for wealthy retail investors. Meanwhile, financial institutions—hungry for high-margin, fast-growing products—have embraced alternative asset classes, packaging them for investors right down to Main Street.

Secure-return investments that meet growing needs for performance and safety are also increasingly popular with investors, especially in Asia. They include guaranteed-return products, such as UBS Warburg’s Guarantee Certificates, which are tailored to client needs, and ABN AMRO’s capital-protected funds. After the recent equity-market decline, retirement funds that include insurance features have sold well, as have other products that offer protection against risk.
Implications for Providers

Competition for wealthy clients is increasing. And investors, stung by the downturn, are more open to switching to new providers. It is therefore imperative for companies to control their costs and devote more resources to attracting and retaining profitable clients. Strong brands and objective investment advice are likely to be powerful draws for valuable customers.

Managing Revenues

To manage their revenues successfully, competitors need to focus carefully on understanding and improving the productivity of their relationship managers—that is, their sales forces. They also need to be more disciplined about pricing.

To better manage their sales teams, companies should follow three measures: their yield on client assets and liabilities (CAL) managed, CAL per client, and the number of clients per relationship manager. (See Exhibit 12.) There are, of course, many different service models available to wealth management businesses. Some firms prefer their relationship managers to work separately and take an individual approach to managing clients. Others prefer a team approach, integrating several relationship managers and product specialists into a group that works together to serve clients. Each team member’s skills should complement those of their team colleagues. Our experience is that team size is key to productivity and that complementary teams of about four to six relationship managers actually improve productivity.

Whatever the configuration of the sales force, there is usually substantial opportunity to enhance revenues by improving pricing discipline. (See Exhibit 13, page 24.) Often, accounts of similar size pay quite different fees. There are clear opportunities for providers to establish greater pricing discipline simply by standardizing fees.

Hitting the Sweet Spot

The challenge for providers is to align their service models with their most promising potential markets—their sweet spots—where they can deliver excellent service to clients with specified levels of investment assets and at the same time get good returns. (See the insert “MLP Builds Lifelong Relationships with Wealthy Professionals,” page 24.) There are too many wealthy investors who are either underserved or overserved by their private bankers. Few institutions get this right—often because they don’t stick to their own service models. Even when wealth managers do find their sweet spot, they don’t adhere to their own target markets. (See Exhibit 14, page 25.) Our survey confirmed that it is common for more than 50 percent of clients to hold assets below the stated account minimum.

One leading global player found that, in its European operations, it was using one service model to meet the needs of two distinct types of customers: the mass affluent and the wealthy. Because it was using a one-size-fits-all service model, the institution was not properly aligning its costs to serve with its customers’ economics. Its business consisted of two customer groups. The first was made up of a few thousand highly profitable investors with average balances of about $5 million who generated a 35 percent margin. The second group represented a disappointingly unprofitable side of the business, where thousands of customers with accounts close to or below the bank’s stated account minimum generated annual net losses of tens of millions of dollars. In response, the wealth manager is now tiering its service offering, creating a lower-cost self-service model for its mass affluent customers.
Tackling Costs

As the survey shows, cutting costs is essential. Although the short-term cost cuts of recent months were critical for survival, those who wish to build long-term competitive advantage need to become leaders in cost management. Our survey found that top performers generally enjoyed both a revenue and a cost advantage. (See Exhibit 15, page 25.)

There is a dramatic variation in profitability among wealth managers, with full-service brokerages facing the stiffest challenges working down their cost-to-income ratios. But if financial services providers don’t reengineer their cost structures, they are likely to return to the business-as-usual model of the 1990s when traded volumes on the major securities markets do recover. That would mean built-up staffs and ballooning costs.

The current environment offers institutions the opportunity to make tough changes that will position them for profitable growth in a recovery or a climate of continued uncertainty. These changes start with a reexamination of client needs, behaviors, and value for the organization. Institutions

**EXHIBIT 12**

Focus on the Drivers of Revenue

<table>
<thead>
<tr>
<th>Revenue Driver Tree of Survey Participants (2001)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Clients per Relationship Manager</strong></td>
</tr>
<tr>
<td><strong>Revenue per Relationship Manager ($ thousands)</strong></td>
</tr>
<tr>
<td><strong>CAL per Client ($ thousands)</strong></td>
</tr>
<tr>
<td><strong>Revenue per CAL (basis points/$CAL)</strong></td>
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</table>

**Source:** BCG wealth manager performance database.

**Note:** Select outlier data points were excluded from the analysis; each variable is ranked from top to bottom performer.
EXHIBIT 13
There Is Widespread Potential for Pricing Discipline

Fee Structure Across Discretionary Equity Accounts

Sources: BCG wealth manager performance database; BCG analysis.

*Dots represent fees on individual discretionary equity accounts at a global wealth-management firm.*
must then optimize their service models to answer the needs of their target customers profitably.

Wealth management costs are spread across back, middle, and front offices. (See Exhibit 16.) But cost control is particularly critical to improving profitability in the sales force where most wealth managers’ costs are concentrated. The salespeople who power wealth management firms have in recent years been able to claim a larger share of the spoils. The danger for providers is that their sales forces walk off with too much of the pie.

**Meeting the Needs of Nervous Investors**

Increased investor conservatism creates opportunities and threats for wealth managers. For those that

**EXHIBIT 14**  
Companies Are Failing to Hit Their Sweet Spots

<table>
<thead>
<tr>
<th>Institutions</th>
<th>100</th>
<th>80</th>
<th>60</th>
<th>40</th>
<th>20</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clients below target level (%)</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Average = 67</td>
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</thead>
<tbody>
<tr>
<td>Clients below account minimum (%)</td>
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<tr>
<td>Average = 50</td>
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</tbody>
</table>

**EXHIBIT 15**  
Providers Must Manage Both Revenues and Costs

**EXHIBIT 16**  
Managing Costs Across Front and Back Offices Is Critical

**EXHIBIT 17**  
Managing Costs Across Front and Back Offices Is Critical

SOURCES: BCG wealth manager performance database; BCG analysis.

**EXHIBIT 18**  
Managing Costs Across Front and Back Offices Is Critical

SOURCES: BCG wealth manager performance database.

**EXHIBIT 19**  
Managing Costs Across Front and Back Offices Is Critical

SOURCES: BCG wealth manager performance database.

Note: Select outlier data points were excluded from the analysis.

1Includes overhead, funds management, product manufacturing, and back- and middle-office processing.
offer a broad advisory relationship, there is an opportunity to capture market share and assets, and provide broader services. (See the insert “Credit Suisse Uses Technology to Offer Global Private Banking from Singapore.”) Providers that can’t offer such a broad approach face the prospect of losing significant market share, as hungry competitors woo disgruntled clients.

For the moment at least, large wealth-management providers have to acquire client balances (CAL) in an environment where four key drivers of new liquid wealth—IPOs, sales of family businesses, the exercising of stock options, and rapid market growth—have slowed or disappeared. As a result, competitors have to mine their own clients more successfully, improving internal referrals.

Institutions will also have to become more thoughtful and tactical about how they attract clients away from competitors. One big North American bank, for example, successfully targeted star athletes of European origin, contacting coaches and distributing literature in their local languages as well as in English. The bank recognized the importance of family members, targeting the athletes’ parents in addition to the athletes themselves.

Cautious investors, hungry for quality advice, are growing more eager for less transactional, more substantial relationships with their wealth managers. Brokerages and other firms that rely heavily on transactions should therefore monitor and actively migrate their mix of revenues from commissions to fees. (See the insert “Charles Schwab Expands and Improves Its Revenue Mix.”) Many are doing so with pricing options that charge clients a set percentage of assets under management. But to charge on assets, institutions must provide value. That includes offering a credible advice service and administrative platforms that give increasingly value-sensitive and educated clients returns sufficient to warrant fees of 100 to 250 basis points.

Making the transition to an advice model requires enormous organizational change. Brokers accustomed to transactions and commissions have to be replaced or retrained to become true relationship managers. Certain financial institutions in Canada and Australia, for example, found it necessary to replace more than half their client-facing sales staff. Managers also need to realign compensation to reinforce the new desired behavior. Businesses that focus on products have to reorganize around integrated client solutions.

**Developing New High-Performing Investments**

Wealth managers need to innovate rapidly, particularly in the North American market, if they are to prevent their margins from eroding as new financial products become widely available. The profitability of such new products drops off sharply as they become familiar commodities. Leading players continue to force the pace, innovating to drive profits and attract good customers. As more investors realize the power of investment strategies that are not correlated with major markets and of long-short approaches to investing, alternatives will grow rapidly. Recognizing the potential of this market, one top global bank recently decided to increase its alternative investment business more than tenfold over the next five years.

Indeed, the popularity and availability of alternative investments is already growing quickly as many new competitors enter the market and existing players expand their current offerings. As mentioned above, investors have been flocking to buy such products because they have recently offered higher yields. (See Exhibit 17, page 28.)

Hedge funds have provided investors with some of the best returns available in the past two years. Last year, for example, some hedge-fund indexes appreciated by 4 percent or more while most major equity-market indexes declined. Wealthy investors have thus turned to hedge funds in increasing numbers. (See Exhibit 18.) As a result, Credit Suisse puts tens of millions of dollars a month into hedge funds. Many players, including Bear Stearns and Deutsche Bank, already have well over $1 billion in hedge funds in the United States under their purview.

Financial institutions are also successfully marketing more real estate funds as equity returns have slumped. Goldman Sachs, Morgan Stanley, Credit Suisse, Lehman Brothers, and real estate players such as LaSalle and CB Richard Ellis have used the downturn to market new real estate products.
Providers continue to drive top-tier products—such as funds of funds, fund navigators, tax advisory services, and personal administrative platforms—further down into the market for rich retail investors. Wealth managers such as Coutts, the London private-banking group, have also sought to capitalize on investors’ search for better returns by offering a blend of high-performing funds that aim to improve returns and reduce risks.
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- **Sales Force Effectiveness: It’s Not About Playing, It’s About Winning**
  Opportunities for Action in Financial Services, May 2002

- **Hidden Treasure: Finding the Keys to Profitability in Wealth Management**
  Opportunities for Action in Financial Services, April 2002

- **Global Payments 2002**
  A Senior Management Perspective by The Boston Consulting Group, February 2002

- **Strategic Sourcing of Transaction Processing: From the Back Office to the Boardroom**
  A Discussion Paper by The Boston Consulting Group, November 2001

- **Getting More Value from Asset Management in Insurance: The Strategic Agenda**
  A Discussion Paper by The Boston Consulting Group, October 2001

- **E-Commerce in Insurance: The Distribution Advantage**
  A Discussion Paper by The Boston Consulting Group, August 2001

- **Richer Prospects in Wealth Management: Global Wealth 2001**
  A Senior Management Perspective by The Boston Consulting Group, July 2001

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