IBM Institute for Business Value

Matching customers with capabilities: Three wealth management strategies

As firms enter the wealth management arena, they will have to answer important questions about the methods used to deliver their unique value proposition to their chosen customers, the role of technology in serving those customers profitably and their strategy for differentiating themselves in a fiercely competitive market.

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Introduction

Opportunities to increase revenue are scarce in the current economic environment, leading many financial institutions to contemplate forays into wealth management as a way to generate new top-line growth. Some firms already have an affluent customer base that they assume can be easily converted to a wealth management offering, while others recognize that they'll have to attract new clients to their institutions. Whether firms choose to set their sights on traditional or new customer segments, creating a robust wealth management offering isn't a simple matter. Successful firms will carefully analyze their target customer segments, realistically assess their own strengths and weaknesses, and monitor and respond to actions of their competitors. Firms must also consider how technology can lower the cost to serve previously unprofitable segments.

High profits, high stakes

The number of wealthy Americans increased substantially during the 1990s. At the end of the decade, over 2.5 million individuals possessed liquid assets of at least US $1 million dollars.[1] The recent market downturn notwithstanding, a substantial amount of old and new wealth needs managing. Factors like increased volatility and uncertainty, the growing number and complexity of financial products available, and increased personal responsibility for retirement planning have made many previously confident investors realize that they do, in fact, need advice. This demand, along with attractive industry returns, has many firms considering entering the wealth management space. However, a history of impressive returns in the wealth management market does not mean that every firm can play in it profitably.

Entry into the wealth management arena holds no guarantee of high returns. If wealth management firms have traditionally targeted only the wealthiest customer segments, it is because only the wealthy can afford the high level of service traditionally provided. High net worth (HNW) clients demand a superior level of customer service and expect their advisors to have specific and extensive expertise; experienced advisors, in turn, expect their compensation to reflect their abilities. For firms looking to tap the existing wealth management client base, this level of service creates customer brand loyalty that can be difficult for even the most competitive firms to surmount.

If price were no object, everyone would welcome a financial advisor. In reality, however, the cost to provide comprehensive financial planning and the expected level of customer service that accompanies it is high. Firms must balance the customer value proposition with profitability, delivering the right offering to the right client segment at the right price. Technology helps in two ways: it enables the advisor to be more efficient and serve more clients, and it makes self-service more plausible, offering firms an opportunity to expand the wealth management market by reducing the cost of providing quality advice and service.

Before embarking on an ambitious and expensive wealth management effort, firms should carefully consider the needs of the customer segment they are trying to target. Designing an offering that matches the competencies that attractive segments value to the firm's capabilities is the key to successful wealth management.

Beyond products and services: Five competencies, five chances to differentiate

Many financial institutions currently view wealth management as an integrated set of products: cash management, asset management, protection, credit, retirement and estate planning, and tax planning. While a product-centric approach to wealth management is sensible in some respects (because products drive profit), this approach fails to address a large portion of clients' needs. Given that most wealth management products are roughly equivalent regardless of who offers them, clients are less interested in product specifics – assuming they meet certain basic requirements – than in the elements of service that surround the products.

Indeed, while firms target customers with a range of products as solutions to individual wealth management needs, customers see their personal wealth management strategy as a lifelong endeavor that influences every financial and practical decision they will make from the immediate to distant future. Even customers who fail to grasp their bigger financial picture are driven by the need to plan for specific monetary events that will impact their lives. In both of these contexts, superior customer service, sound advice and an advisory relationship are valued features not easily copied by competitors.

The following five competencies address customer needs that enable firms to create sustainable competitive advantage in attractive customer segments.

Advisory relationship

The core of any successful wealth management offering is the relationship developed between the advisor and the client. Successful advisors develop a relationship with clients by demonstrating that the clients' interests are the advisor's paramount concern. In the context of an advisory relationship, the wealth management firm can work with the client to develop, implement and monitor a comprehensive wealth management strategy.

Integrated information

Very few clients maintain all of their accounts with a single provider; an integrated view of their overall financial picture is critical if clients are to be able to make informed decisions. Advisors, too, should be able to access and analyze customer data efficiently. When information is automatically integrated across accounts and across institutions, advisors can concentrate on helping customers make fact-based and insightful wealth management decisions, rather than focusing on more mundane tasks like assembling statements from multiple sources.

Multichannel access

Customers want the ability to access their account information when they want, how they want and where they want. The combination of integrated information and multichannel access empowers clients by enabling them to access constantly updated, accurate information, whether in person, over the telephone or online.

Perception

To win new customers and retain existing ones, wealth management firms must be perceived as competent, dependable and empathetic. Clients must also perceive that they are paying a justified price for the value that they are receiving. Client opinion is formed through a combination of personal experience, word of mouth and marketing. To compete effectively, the firm must have a brand that is firmly associated with the qualities demanded of a wealth management institution.

Personal touch

A major component of successful wealth management offerings is human touch. Clients respond to charismatic guidance and a high level of attention; they feel valued when their queries are addressed promptly and personally. Firms that go above and beyond expected levels of service will reap substantial rewards. The key consideration as firms extend wealth management offerings to customer segments with fewer assets is balancing the cost to serve with the revenue opportunities associated with a particular client.

Targeting growth: New groups, new channels

Wealth management firms have traditionally targeted the ultra high net worth (UHNW) and high net worth (HNW) customer segments. This is not surprising, because these segments collectively represent almost fourteen times the financial opportunity of the next largest customer segment on a yearly basis.[2,3,4]

However, an examination of the remaining population on a lifetime basis rather than an annual basis yields two new customer segments with promising revenue opportunity: the affluent and young affluent (see Figure 1). These groups represent significant returns for the right wealth management firm and offer the opportunity for firms to take their offerings down market with the help of new technologies.

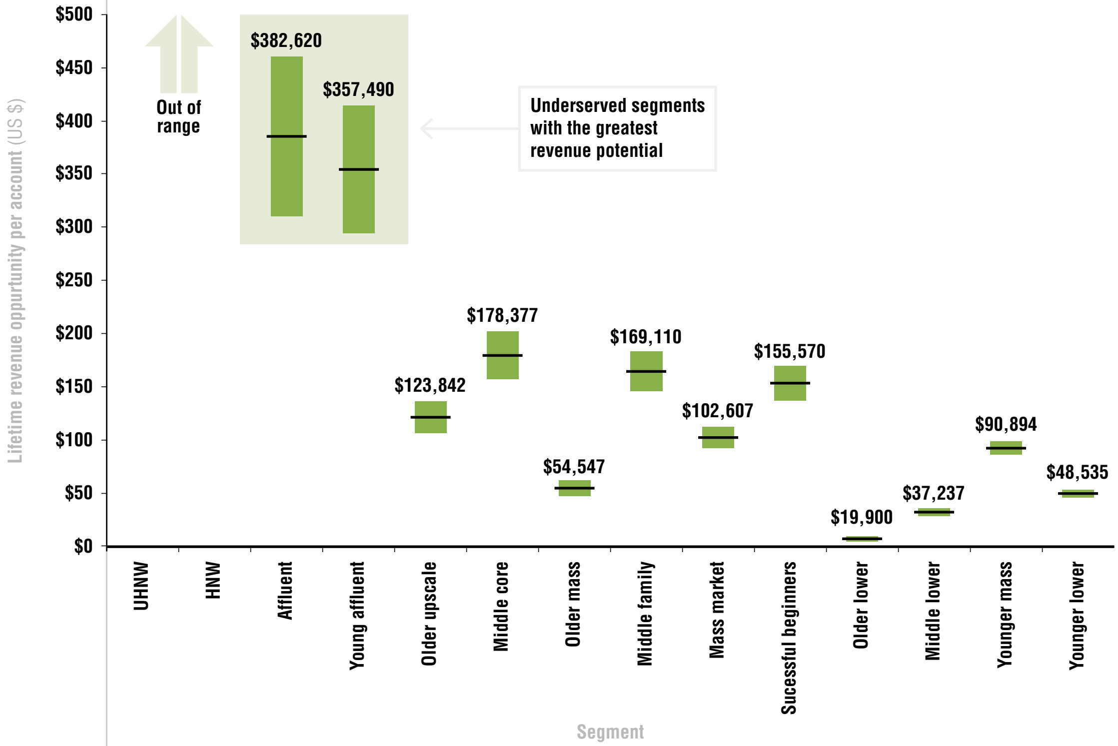

Figure 1. Lifetime financial services institution revenue opportunity per household by segment.

While this analysis highlights a purely demographic segmentation, firms should also consider other types of customer characteristics—such as behavioral or attitudinal characteristics—as they create their own wealth management strategy.

Source: IBM Institute for Business Value analysis, PSI Global data and Putnam Lovell Research data.

Profile of the affluent customer segment

- Level of wealth and average age dictates primary focus is on wealth preservation
- Secondary focus is on distribution of wealth to the next generation
- Adopt technology at an average rate
- Not self-directed.

The affluent and young affluent

The needs of the affluent customer segment are not overly complex. As with other segments, the advisory relationship is essential to the affluent, as is a comprehensive wealth management offering that empowers the customer. Clients in this segment are rapidly approaching retirement age, and deem retirement and estate planning to be critical components of their personal financial strategy; they are concerned about living their postretirement lives in comfort and offering their children and grandchildren a measure of financial security. Perception and personal touch are key with this group, as the affluent require reassurance and have a lower affinity for technology than younger segments.

For the young affluent, asset management is critical. Their primary goal is to grow the wealth they have. The group typically spends significantly, so cash and credit management is key. Integrated information, multichannel access and competent advice are absolutely necessary to serve this segment. The young affluent are technically savvy and confident; for them, the advisory relationship plays an enabling role, rather than one of direction. Young affluent customers want to be able to access services and view aggregated account data to manage their assets in a convenient and timely manner. If firms do not provide these services with a high level of performance, young affluent customers will likely go elsewhere.

Profile of the young affluent customer segment

- Young average age and high average income dictates primary focus on wealth accumulation
- Leaders in adopting new technology
- Largely self-directed
- Do not traditionally qualify for wealth management services but possess a high potential to migrate to the high net worth segment in the future.

Taking your offering down market

While the affluent segment shows the same overall affinity for technology as the rest of the population, research shows that as of 1999, 67 percent of affluent households were online compared to 45 percent of households online in the total U.S. population. In the young affluent group, that chasm widens, with 87 percent of households online. In addition, the number of young affluent customers who would prefer to pay bills and review bank and investment accounts online doubles that of the national percentage. And, 71 percent of young affluent customers not only feel that online transactions are safe, but also agree that technology has improved their lives.[5]

These numbers identify untapped prospects in underserved customer segments. Wealth management firms now have an increasing opportunity to use technology to take their offerings down market. Hiring and retaining the talent to provide the advisory relationship and personal touch are significant cost drivers in the wealth management arena. Technology represents one of the most promising ways to reduce the costs associated with these competencies by enabling the advisor to improve efficiency and increase the number of clients per advisor. Technology can also reduce costs by increasing the effectiveness and rate of adoption for self-service options, although this shouldn't be considered a primary benefit. As firms perfect providing wealth management services at the reduced costs that technology enables, they can move even further down market and tap into the remaining segments in the mass affluent.

Wealth management firms should also consider that the current numbers of prospective customers who are technically adept will only increase as the decade progresses. In addition, as the young affluent inherit wealth from older generations and slowly matriculate to the affluent and HNW customer segments, they will take with them expectations of integrated information, multichannel, realtime access to aggregated data and high service levels as they form their perceptions about which firms are best capable of handling their business. The next generation of young affluent will take their place, possibly with technical knowledge and performance expectations that don't yet exist.

Capability and strategy

Identifying attractive customer segments is just the first step in outlining a viable wealth management strategy. Individual firms' capabilities and constraints must now be added to the mix. Only by matching the needs of target segments against its own capabilities can a firm find a successful role in the wealth management space.

In a recent study, the IBM Institute for Business Value assessed the capabilities of seven types of industry players: private banks, independent advisors, mega groups (large financial conglomerates that function in banking, insurance and securities), brokerages, retail banks, insurance companies and asset managers. The assessement of retail banks reveals a strong base on which to build a wealth management program with competencies in product areas like cash management and lending services; yet, retail banks also have substantial gaps with limited competencies in integrated information, perception and personal touch (see Figure 2).

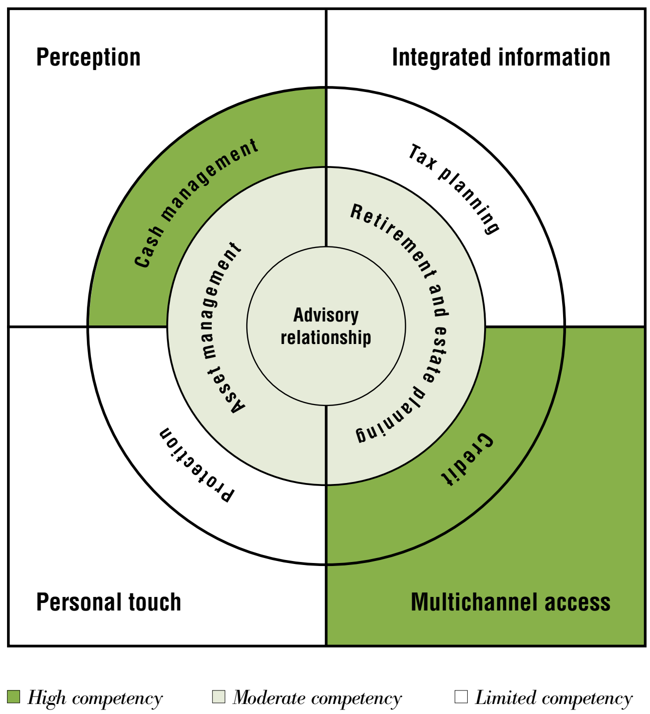

Figure 2. Retail banks have a solid base to build on but need to extend current capabilities.

Source: IBM Institute for Business Value analysis.

The study goes on to show that when the capabilities of retail banks are mapped to customer segment needs, they are most compatible with those of the technologically-adept young affluent customer segment (see Figure 3).

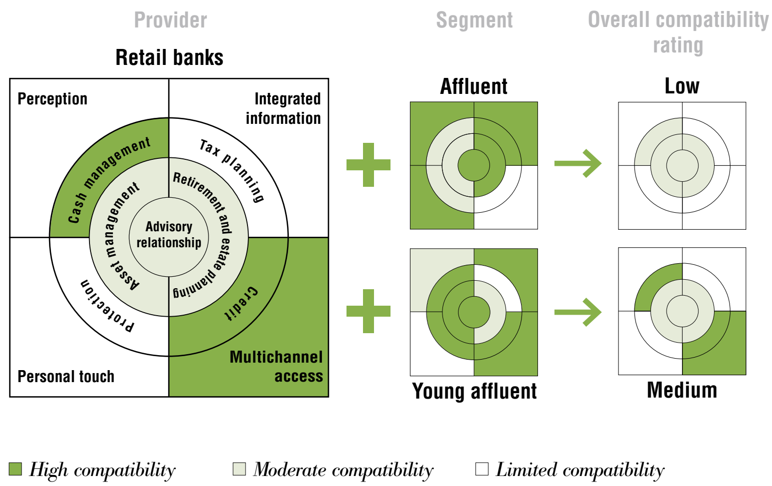

Figure 3. The products and competencies of retail banks are most compatible with the young affluent customer segment.

Source: IBM Institute for Business Value analysis.

The challenges all institutions will face in developing viable wealth management offerings can be grouped into the areas of customer strategy, operational effectiveness, organizational design and technology strategy. While retail banks will face some of the same core challenges as other players, the following challenges are particularly pertinent to banks (see Figure 4).

Business and customer strategy	Organizational design	Operational effectiveness	Technology strategy
• Identifying and migrating appropriate customers from banking services to more lucrative wealth management services • Overcoming negative image in advisory capabilities and ability to provide best-of-breed investment products • Assessing the viability of providing a wealth management offering to the mass affluent	• Breaking out of silos to transition from a product-centric to a customer-centric organization • Integrating different components of offering to provide a single point of contact for clients • Creating an environment that is focused on customer service	• Building or partnering to offer more complete asset management, retirement and estate planning and protection capabilities • Leveraging physical footprint • Ensuring more rigorous adoption of "know your customer rules"	• Improving customer relationship management (CRM) implementation to enable the identification of potential wealth-management clients and provide an integrated view of customer information across all product groups • Using technology as a platform for serving the mass affluent • Improving information and data exchange to share information across silos • Integrating legacy and new systems

Figure 4. Challenges for retail banks developing wealth management offerings.

The affinities found between the capabilities of each individual company and the needs of various customer segments suggest one of three strategic alternatives: remaining a traditional wealth management provider, becoming an expanded wealth management provider or refocusing to become a best of breed product manufacturer.

The traditional wealth management provider

The capabilities of private banks and trust companies and independent advisors match up well with the needs of the traditional wealth-management client base. These providers are characterized by strong personal touch and perception competencies, complemented by robust advisory and retirement and estate planning skills. To remain competitive, these firms should align their strategy to that of a traditional wealth management provider. Such firms employ proven means to offer comprehensive wealth management services to the top-tier customer segments, the UHNW and HNW.

Firms already operating in this space have a distinct and well-established lead over potential new entrants. By continuing to focus on the wealthiest customers, they take full advantage of their established reputations and relationships and reduce the degree of organizational and infrastructure change necessary to stay competitive. By deciding not to go down market, they avoid diluting their brands. That said, many established firms will face declining margins as new competitors enter the marketplace and will need to attract the new generation of wealthy as the traditional wealthy client group transfers wealth to younger generations.

Firms considering entry into this already crowded market must carefully consider what it will take to be successful. Not only must new entrants create a comprehensive suite of wealth management products, they must package these around the rare talent that can build a core advisory relationship with a demanding customer segment and supply a new level of customer service that most established firms are unaccustomed to providing.

The expanded wealth management provider

Mega groups, brokerages and retail banks, match up well against the needs of the affluent and young affluent. The affluent particularly value the wide breadth of product offerings of the mega groups and their relative strength in planning for retirement; the young affluent value the strength in multichannel access displayed by retail banks and the leadership role brokerages have taken in adopting new technologies.

The role of expanded wealth management provider represents the best route for most mega groups, retail banks and brokerages. While these firms typically have a wide client base overall, they lack an existing wealth-management offering dedicated to the client base in the HNW and UHNW customer segments. By using technology to expand down market to serve the needs of the affluent and young affluent, these firms have the potential not only to increase their potential customer base by a factor of four,[6,7,8] they can also establish important relationships with potential HNW customers before they are targeted by traditional wealth management providers.

However, these firms face a range of challenges specific to their individual capabilities. Brokerages will have to broaden their product offerings, mega groups will be forced to address significant gaps that exist in integrated information and tax planning, and retail banks, especially, face an uphill battle. They must significantly improve the competencies of perception and personal touch, as well as offer stronger protection and tax planning products to successfully provide a comprehensive wealth management solution.

While there are clearly opportunities and profits to unearth with down market offerings, the challenge is how to serve the corresponding customer segments profitably. Because no one has yet done it well, expanding down market is a high-risk strategy. On the other hand, a down market strategy specifically highlights and attacks the critical competencies that make this business costly for traditional providers.

The best of breed manufacturer

A narrow focus on specific products and a lack of strong competencies limit the strategic options for all but the largest and most client-focused insurers and asset managers. Building an entirely new set of capabilities and competencies is risky, and firms might be better served by focusing on their core manufacturing competency. A best of breed manufacturer strategy provides the greatest chance of success to the bulk of asset managers and insurers.

For these firms, competition in the wealth management space should center on the design of new and innovative products and distribution through the firms that own the primary advisory relationship. Insurers and asset managers can choose to compete on the basis of scale or by distinguishing their products with value-added services. Either way, forming partnerships with primary advisors is critical to achieving success as a product specialist. Developing new and innovative products to address the evolving needs of clients at a segment-specific level is also critical.

Conclusion

The constant forward march of technology is opening new markets in wealth management. The automation of business intelligence, an increasingly connected distribution network and advances in CRM are reducing the cost to offer clients comprehensive wealth management services. This reduction in costs furnishes nontraditional providers with an excellent entry point into the wealth management space. However firms decide to approach the wealth management market, their strategy must be appropriate to their capabilities and the customers they want to serve.

Next steps: Where does your wealth management strategy stand?

Figure 5 lists important questions and key determinants for success that all firms should consider as they construct their wealth management strategy.

Role	Important questions	Key determinants for successful wealth management strategy
Traditional wealth management provider	• How will you differentiate your offering in an increasingly crowded market? • How will you defend current profit margins against the competition? • What is your strategy for filling your business pipeline? • Your customer base is increasingly diverse; how will you serve it best? • Who will you recruit to serve your customers? How will you retain the talent you do find? • What is your current process for retaining assets passed on to next generations?	• Focus on providing a comprehensive wealth management offering to the UHNW and HNW segments; create products packaged around the advisory relationship. • Develop a comprehensive strategy for capturing intergenerational wealth transfer.
Expanded wealth management provider	• What is your strategy for profitability in down market segments? • Will you build or buy the technology platform necessary to serve down market clients? • Your customer base is increasingly diverse; how will you serve it best? • Who will you recruit to serve your customers? How will you retain the talent you do find? • If you are already serving the wealthiest segments, how can you protect your brand's strength as you move down market?	• Build a comprehensive solution for traditional, affluent and young affluent segments; create offerings packaged around the advisory relationship. • Take a segment-specific approach to wealth management: 1. UHNW/HNW: personal touch. 2. Affluent: personal touch + technology. 3. Young affluent: Use technology as primary interface to provide high-quality advice.
Best-of-breed manufacturer	• What is your strategy for forming partnerships with primary advisors? • Are you designing innovative products targeted to specific segments? • Will your firm compete on scale or through product differentiation? • How will you encourage advisors to sell your products?	• Develop new and innovative products that address segment-specific needs in one or two areas; products should also be advisor friendly. • Shift the corporate mindset to that of a solution provider that packages advice around products (if competing on value added services).

Figure 5. Key questions and determinants for success for constructing a wealth management strategy.

Path forward

Crafting a viable wealth management strategy requires a deep understanding of particular customer segments, careful monitoring of the competition and, most importantly, an honest, thorough assessment of your own capabilities. To discuss how we might assist in analyzing your wealth management options, contact us at *bva@us.ibm.com*. To browse through additional resources for business executives, we invite you to visit our Web site at:

ibm.com/services/insights

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