

Wealth Management - Transforming Banking in the Middle East

Banking in the GCC Region

Banks in the GCC region are transforming themselves into end-to-end service providers straddling core banking services at one end and investment management or wealth management services at the other end. This shift is in line with the huge amount of wealth being generated in the region, the changing profile of customers who want to have more say in how their investments are managed and increasing importance being attached to expertise offered by the bank in this niche area. Players across the spectrum from local regional players to specialized private banks are increasingly transforming themselves into one stop shops with wealth management services as a differentiator.

A sharp rise in oil prices in the last few years has brought about windfall gains to oil producers around the globe, and gulf economies belonging to GCC have been the primary beneficiaries. The GCC countries account for roughly 37 per cent of the world's proven oil reserves plus around 22 per cent of the world's proven gas reserves and are expected to have earned over US\$ 500 billion by way of oil and gas exports in year 2007. GCC nominal GDP has had an annual growth rate of almost 20 per cent over the last four years and is estimated to total US\$ 725 billion in 2006. A prominent investment bank's 2007 report said that GCC countries will have per capita GDP of US\$ 63,250 in 2050 which compares favorably with leading economies such as Japan at US\$ 69,000 and Germany at 67,000.

These changes are transforming GCC economies in multiple ways. Governments mindful of the fact that they have to preserve the prosperity for future generations are focused on diversifying their economies by reinvesting the oil wealth in other sectors of the economy. Financial services and real estate form the two largest industries after oil and gas which is the primary growth driver. The financial services sector has grown by leaps and bounds in the last decade. GCC's stock markets have registered good growth over the last few years with combined market capitalization in the region of US\$ 700 billion by 2007.

Since the late 1990s banking in the Middle East has undergone a significant transformation from a small regional market to a key participant in the global marketplace. Global banks enticed by its potential have set up operations in the region. With more banks and non-banking companies

moving in the region, competition has become increasingly fierce. Routine banking services such as savings/checking accounts have been commoditized; with cost as the only differentiator. This is leading to consolidation in the industry as banks merge to capitalize on the scale of operation to offer more competitive rates. Banks are increasingly looking to transform themselves to differentiate and prosper in this over competitive environment.

Transforming to Win

One of the clear differentiators adopted by GCC banks is to offer Islamic banking services. This change is widely documented and so one need not delve into the details here.

Another equally important transformation relates to the increasing need for these banks to offer wealth management services. Though most of the wealth creation is happening in the government sector; due to numerous actions taken by successive governments to share this wealth with the public at large, either through generous pay packets or with partial public ownership of these assets – the number of high net worth individuals in this region is increasing significantly. According to estimates, the number of wealthy individuals in the GCC countries (those with investible assets of at least US\$ 50,000 or more) crossed 387,000 in 2007. Liquid assets of these individuals were close to US\$ 80 billion.

Wealth Management – What it Entails

Wealth management can be broadly defined as financial services provided to high net worth clients, mainly individuals and their families. Private banking forms an important, more exclusive, subset of wealth management. Unlike private banking which has its origins in the seventeenth century, wealth management has come into its own only in the last 20 years or so. It developed in response to the arrival of mass affluence; a desire among some clients to be more actively involved in the management of their money; more sophisticated client needs throughout the wealth spectrum, and also a willingness on the part of some types of financial services players, such as retail banks and brokerages, to extend their offerings to meet the new demand. Wealth management in that sense can be considered the bridge between mass-market retail financial services on one hand and private banking on another. This has become a

critical differentiator for banks in the region.

Asset management services are at the heart of wealth management. But wealth management is more than asset management. It focuses on both sides of the client's balance sheet. Wealth management has a greater emphasis on financial advice and is concerned with gathering, maintaining, preserving, enhancing and transferring wealth.

Wealth management includes the following types of products and services:

- ▶ Core banking-type products, such as current accounts, time deposits and liquidity management.
- ▶ Brokerage.
- ▶ Asset management in its broadest sense: discretionary and advisory, financial and non-financial assets (such as real estate, commodities, wine and art), conventional, structured and alternative investments.
- ▶ Lending products, such as margin lending, credit cards and mortgages
- ▶ Insurance and protection products, such as property and health insurance and pensions.
- ▶ Advice in all shapes and forms: asset allocation, wealth structuring, tax and trusts, various types of planning (financial, inheritance, pensions, philanthropic),
- ▶ A wide range of concierge-type services, including art storage, real estate location, and hotel, restaurant and theatre booking.

Wealth managers distinguish themselves from retail financial services by the uniqueness of their client relationships – relationships that are broad, in that they encompass all areas of a client's financial life, and deep with respect to the advisor's intimate knowledge of a client's values and priorities. In turn, this breadth and depth of the relationship enables the wealth manager to develop and implement highly tailored solutions that address all aspects of a client's financial well-being.

Key Trends Impacting the Industry in the Region

Wealth managers seek increased share of wallet -

Unlike mass-retail financial services where a person deals with a large number of service providers, clients tend to entrust their wealth with probably 2-4 wealth managers. This still means that very few wealth managers can claim to have at least 50 to 60 per cent of client's wealth. This is changing. Wealth managers are seeking an increased share of wallet. First, this is an excellent source of new assets, revenue and increased profitability, with low acquisition costs. Second, greater share of wallet, makes it more difficult for the client to leave.

Increasing breadth of offerings – The breadth of offerings is likely to be a potent differentiator between wealth managers going forward. As the range of products to be offered for wealthy customers is quite large, wealth managers are moving into a hybrid model of producer plus distributor. Wealth managers realize that it is not possible for them to produce each and every product. At the same time they require a bouquet of products to acquire and retain a client. Alternative investments are seen as key with structured products, property, private equity and hedge funds all rated highly within the range of required offerings. To this end many are seen working on striking alliances with manufacturers of these products.

Increased investment in IT - Historically wealth managers have not paid sufficient attention to systems as their counterparts in retail financial services; but that is changing. This is due to additional requirements imposed by rapid and unprecedented growth, increasing client expectations on business responsiveness and quality, as well as increasing regulatory and fiscal changes. In this context, having good IT systems is seen as a key enabler for growth. To this end, wealth managers are reviewing operational processes, seeking core banking systems supporting wealth management products, improve aggregated reporting, adopting e-banking platforms to help clients service themselves and providing remote access technology to their RMs. Adopting core banking systems with investment products and e-banking support is likely to gather momentum in the immediate future.

High growth accompanied by pressure on margins - Growth is booming in MENA and especially in GCC countries where growth over 30% YoY is expected over the next five years. However, there will continue to be pressure on business margins due to changing client demographics, the entry of new product providers with different pricing strategies and wider use of technology. Wealth management will however continue to generate excess margins compared to retail mass market. Clients are increasingly reluctant to pay for ad valorem charges and prefer paying separately for the advice – which incidentally is not related to the assets under management.

War for talent - The current relationship manager (RM) model is under severe strain and needs re-engineering. Wealth managers have to come out with new strategies to increase the supply of available RMs and improve the training to existing ones.

Branding - Branding has always been important to attract and retain clients. However this is likely to get more attention going forward. In branding, the important features to be addressed are familiarity, positioning, differentiation and emotional attachment.

Changing profile of wealth management customer - The composition of wealth management clients is changing rapidly. The number of “traditional” HNWI individuals continues to fall and is being replaced by individuals with far greater financial knowledge, confidence, and willingness to devote more time to financial matters. “Traditional” clients are content to let their portfolio be managed by a wealth manager on a discretionary basis. “Self directed” individuals on the other hand, are confident of their own financial skills and are often reluctant to pay for advice. They tend to be very interested in the performance of their investments and use journals, newspapers and the Internet as sources of financial information.

Changing profile of wealth management providers – Wealth managers typically come from retail banks wishing to expand into investment space on one hand with brokerages trying to move into “trusted advisor” space at the other end. Technology is bringing about far reaching impact on how the competition plays out in this space. It is making it easier for new entrants to enter and for existing players to expand their offerings

quickly. In GCC countries, wealth management offerings are made by specialized private banks, retail banks, brokerages, investment managers and specialized Personal Financial Advisors (PFA).

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