

## Wealth Management and the Retail Strategy – an APAC Perspective

## Welcome the Working Rich

A recent book "The Middle-Class Millionaire" by authors Russ Alan Prince and Lewis Schiff talks about a new class of Americans called the "working rich". The book defines middle-class millionaires as those with net worth between \$1 million and \$10 million, including their primary residences. The book goes on to describe the way these middle class millionaires are different from the rest of the middle class. What is described in this book is really what is being observed around the world in terms of rising wealth and the number of first generation wealthy individuals. It can naturally be expected that these "middle class millionaires" would have banking needs markedly different from the rest of the middle class.

This article goes on to establish that this segment of customers is already sizable and growing at above-average rates. In addition, banks make above average margins from these customers compared to a typical retail customer. It is therefore required of retail banks to carefully align their retail banking strategies to take into account the needs of these wealthy individuals.

## Asia Pacific – Up Close

Asia Pacific, as a region, holds the third largest number of HNWI (High Net Worth Individuals) - at a little over 2.5 million. Singapore, India, Indonesia and Russia witnessed the highest growth rate in HNWI population. Asia Pacific by 2011 is likely to replace Europe as the second largest wealthy block after North America to hold wealth of \$ 12.7 trillion ahead of Europe at \$ 12.5 trillion but behind US at \$ 15.7 trillion. According to Straits Times, Asia Pacific contains 27.1% of the global HNWI population and 22.9% of global wealth and HNWI financial wealth in the region is forecasted to reach US\$10.6 trillion by year 2010. While the projections vary; all of them point to a large current and a much larger future business in servicing these wealthy individuals, popularly known as "Wealth Management" offerings. Despite the expanding wealthy class in the Asia Pacific region, financial services institutions are inexperienced in providing services to this unique group of customers. Most are still in the process of exploring different models and approaches that would best suit their target clients and business environment. Explaining briefly what wealth management is and how it is different from retail banking, the article

proceeds to talk about the trends observed in the Asia Pacific wealth management market.

## Wealth Management – What it Entails

Wealth management can be broadly defined as financial services provided to wealthy 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. This ties up with the observations made by authors of "Middle Class Millionaires" which notes the emergence of this class in the past 20 years. 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 a bridge between mass-market retail financial services on one hand and private banking on the other.

Asset management services are at the heart of the wealth management. But wealth management is more than asset management. It focuses on both sides of the client's balance sheet. Wealth management lays 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 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 asia pacific

**Banks with large retail networks lure clients from traditional wealth managers** – Retail banks having large branch networks are recognizing the potential of wealth management offerings that complement their retail banking offerings. This happens as their existing client base gets richer and instead of migrating to another wealth manager, prefers to stay with the same bank if the bank is offering wealth management services. The challenge here for the retail bank is to recruit the right set of talent to manage the wealth management business and set up processes, while at the same time clearly differentiating between wealth management offerings and retail banking offerings. If the customer does not perceive a tangible benefit, the move away to a traditional wealth manager is more likely. To counter this threat, traditional wealth managers are expanding their onshore presence vigorously.

**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 the 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. A larger share of wallet has a negligible impact on the wealth manager's scarcest resource - the Relationship Manager.

**Increasing Breadth of Offerings** - Breadth of offerings is likely to be a potent differentiator between wealth managers, in the days ahead. 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.

**Selling Competitor's Products** – This is leading to margin pressure as banks have to pay their providers. This is expected to lead to a short life-cycle for products, as wealth managers continuously search for new high-margin products. However one space that is likely to remain sacrosanct is Financial Planning Services – or the basic models that determine a client's general asset allocation. That will continue to be driven by the bank's proprietary models.

**Increased Investment in IT** - Historically wealth managers have not paid sufficient attention to systems as their counterparts in retail financial services have; 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 robust 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, improving aggregated reporting, adopting e-banking platforms to help clients service themselves and providing remote access technology to their Relation Managers. 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 the Asia Pacific and especially in India where growth upwards of 50% 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. Structurally higher margins will continue because clients demand complex and sophisticated products. In contrast, non-structural margins come about because of imperfections in the market and, eventually, these margins will be eliminated by regulation, technology or competitive pressure. Clients are increasingly reluctant to pay for ad valorem charges and prefer paying separately for advice – which incidentally is not related to the assets under management. Although the wealthy are prepared to pay premium prices for established exclusive and luxury products, they are increasingly reluctant to pay a premium for products or services that are simply re-branded mass market products and available at a lower cost elsewhere.

**War for Talent** - The current relationship manager (RM) model is under severe strain and needs re-engineering. Asia Pacific already has the lowest ratio of RMs to clients compared to the Americas and EMEA, and with anticipated growth rates; this is expected to worsen further. Wealth managers have to come out with new strategies to increase the supply of available RMs and improve the training to existing ones. Though poaching RMs from competition is likely to remain an attractive strategy, wealth managers are likely to look at training employees from other areas as well as recruiting new graduates with wealth management qualification to ensure adequate supply of RMs. In addition, relationship manager training is likely to focus on areas such as third party and own products, AML and KYC policies, taxation and legislation update, financial markets update and so on.

**Branding** - Branding has always been important in attracting and retaining clients – this however 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 customers** - 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 and confidence, prepared to devote more time to financial matters. “Traditional” clients are content to let their portfolio be managed by wealth managers 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 the investment space on one hand with brokerages, and trying to move into the “trusted advisor” space at the other end. Technology is bringing about far reaching impact on how 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. Worldwide wealth management offerings are done by specialized private banks, retail banks, brokerages, investment managers and specialized personal financial advisors (PFA). In India this service is currently being offered by leading private banks, foreign banks and brokerages.

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