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LAWRENCE SOMERSET & CO LTD
78-80 St John Street, London, EC1M 4EG, England
Tel: +44 (0) 20 7251 5613 Fax: +44 (0) 20 7251 5614
www.l-s-l.com

I. INTRODUCTION

In the last five years, journalists and pundits have used many superlatives—from ‘vast’ and ‘huge’ through to ‘revolutionary’ and ‘epoch-making’—to describe the changes in the economic markets in the USA and now in the UK and Europe.

Technology is the driving force behind this ‘revolution’, from the productivity of Silicon Valley to the increased availability of personal computers and domestic internet access. Not only has technology created a whole new class of millionaires—the ‘dot.com generation’—it is beginning to have a profound effect on the attitudes and behaviour of the more traditional classes of the wealthy. While this trickle-down may be still be at a slow pace in the UK, it is undeniably progressing.

For the financial services sector, the effect of the new technology is profound because it impacts both the relationships between suppliers and their market, and the ways in which the value chain is structured. In both arenas the impact is to disrupt the way things are currently done and to create the circumstances for new structures.

Existing models of managing financial institutions are becoming obsolete and, in order to survive, institutions will need to invent new ones. These must reflect the value added by customer-facing teams and in turn the leverage they are able to exert by using new technologies to bypass incumbent firms’ legacy systems and thought.

II. DRIVERS OF CHANGE

There are two categories of change impacting the wealth management sector which, combined, are difficult to ignore:

- Evolving client needs and the changing nature of existing relationships.

- New ways of constructing the value chain which threatens the relevance of internal competencies.

II.i. Evolving client needs

Empowerment

It is now widely accepted that a significant impact of the web is that it gives more power to consumer. This is increasingly apparent in the area of financial services. Before the internet, there was little information available for personal clients, and it was even an area of considerable mystique. Information was a scarce resource, with intermediaries and institutions creating businesses based on its restricted availability. On the world wide web, however, information is traded freely and is available in many forms for everyone. The availability of these huge amounts of information has gone a long way to redress previous imbalances in power.

In the case of the wealth management services, the relative power of clients is determined by how much they think they know and how prepared they are to use this knowledge. In the past, clients tended to believe that their own level of expertise was low and were therefore often willing, if not eager, to hand over responsibility to relationship managers and the like. Naturally, the client's inherent level of interest in money matters was also an important factor, one which determined whether they farmed out wealth management, or in some way contributed to the process themselves.

Now, clients have the ability to play a more active role in the management of their wealth

- **Awareness of alternatives**: the possibility to have ready information on a range of services from alternative suppliers and increased competition from new entrants.

- **Expertise**: educational information is increasingly available, in understandable, straightforward, 'jargon free' format.

- **Ability to benchmark**: software is freely available to compare suppliers.

Emerging new segments

As a result of these opportunities, new segments of client are emerging. While a proportion of these segments are made up of the new generation of wealthy, there has also been a marked change among existing owners of wealth. Armed with the sort of new information outlined above, it is no surprise that clients' perspectives on the industry have developed. They are now able to hold strong views both on the type of services they need and the way they want these services delivered.

Many existing wealth holders are realising that they no longer need to persist in passive relationships with their wealth managers, but instead can become more involved and take an active role in the

management of their money. The level of engagement in this role is one of individual choice, and spans from directed delegation to full management. Of course there have always been individuals who have taken charge, but the difference now is that **this option is open to everyone**.

Wealth level and attitude to risk are no longer sufficient means of assessing and characterising client needs. This has serious implications for financial institutions, as these were the old bases of segmentation. A whole new range of attitudes and behaviours must now be factored in.

There is also a rapidly growing class of newly wealthy: the last 5 years has seen a massive increase in the number of affluent (US $1m+) and very wealthy (tens of millions). These sellers, inheritors, earners, and winners are very different from the previous generation, they are:

- **Younger** – many in their 20s and 30s as opposed to their 50s and 60s, and
- **Iconoclastic** – not impressed with the old trappings – more likely to have a preference for feng shui than walnut panelling.

Neither the existing wealth holders nor the newly wealthy will any longer fit preconceived notions. For example, increasingly in this sector there are:

- People wanting internet access and a face to face relationship.
- People wanting different services for different streams of money. Freedom of access to information has meant that it is now possible to pick out types or even particular funds very specifically.

A time for re-assessment

It is difficult to predict how the emergence of new attitudes and behaviours will effect wealth management institutions in the long term. Several factors, which have implications for how institutions and their actions are **perceived**, are already evident:

- The increasing value placed on impartial advice.
- The increasing necessity for transparency about products and charges (though the cheapest is not always the best!).
- The pressing need to re-interpret client-institution relationships.

How and when these factors are ‘internalised’ or integrated by institutions is a matter of great importance given the current market place. Institutions are likely to want to opt for a gradualist approach to responding to these developments, particularly with respect to existing client relationships in order to maintain margins. However, changes on the current supply-side increase the pressure to acknowledge the new market environment.

II.ii. Disrupting the value chain

Outsourcing has long been an important part of the delivery of wealth management – for example, funds, administration and custody services. But, the advent of browser technology has freed up the value chain in ways that give seamlessness to business operations and promote the creation of 'virtual companies'.

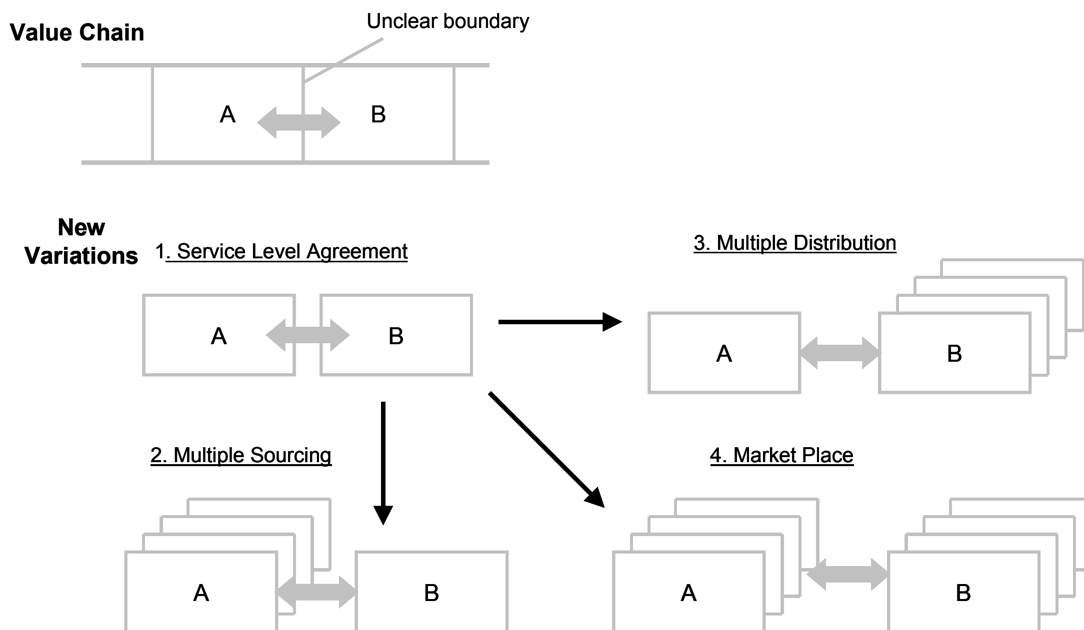
Virtual companies exist in other sectors already: personal lines insurance and fleet motor finances for example, but they have not yet made significant in-roads into the wealth management businesses.

There are two sets of implications for the wealth management industry resulting directly from browser technology. First, as outlined in detail above, vast quantities of information will be available which hitherto had not been distributed, leaving old structures with little competitive advantage. This means that the **downstream** parts of the value chain will be greatly empowered. We have already seen this in our own research, for example, strategic asset allocation can, in some businesses, command a premium over stock picking and custody services.

Second, the impact of this technology will be to create the potential for **new forms of connectivity** between parts of the value chain. Under the current regime, relationships exist between internal departments – but boundaries are often ill-defined (functions may overlap, or service objectives may not be clear).

In the new models, connectivity will also mean 'disconnectivity' – increased flexibility where functions are interchangeable and can be more easily outsourced.

The four models, also shown in diagrammatic form, are as follows:



1. Service Level Agreement: Creates a clear boundary between the departments which could operate under a service agreement. This already exists in many contexts for back-office functions and implies new contractual obligations which will help to improve service quality and perhaps reduce costs.

- Having made the switch to an SLA basis other variation and the potential for multiple connections is created on one or both sides and this leads to the other three models

2. Multiple Sourcing: Multiple sourcing by entity and further along the value chain – this would be the prototype for product or service outsourcing. The objective of the sourcing model is to provide a wider product and service range to clients.

3. Multiple Distribution: Multiple access downstream and could represent alternative or parallel distribution channels.

4. Market Place: Multiple relationships both upstream and downstream and might represent a new form of market or clearing house function. From the client perspective this could lead to greater choice and lower prices.

* * *

The previous discussion gives rise to some clear imperatives for strategy, which are too numerous to go into in this paper. For now, we will concentrate on the aspects of change that relate to the client relationship and how it is managed.

For individuals just arriving at the need for private client services, the challenge is perhaps more fundamental: why do they need a relationship at all? In other words, with options on the internet getting better all the time, a relationship may no longer be seen as an essential. The challenge for institutions, as we see it, is to develop new business models that can support the kind of service that will justify a ‘relationship’ in the mind of future clients.

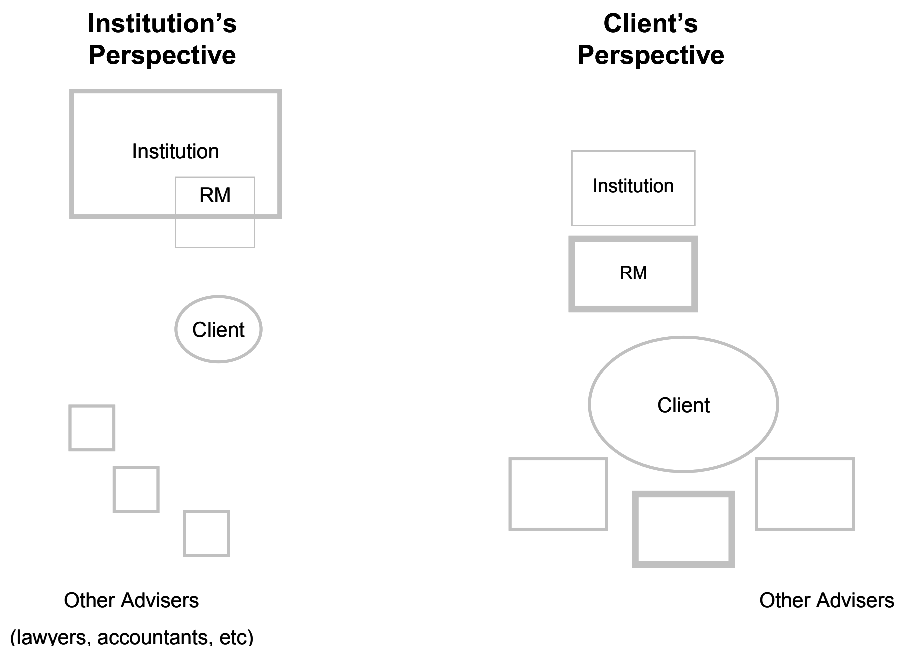
III IMPLICATIONS FOR WEALTH MANAGEMENT

III.i. Perspective on the nature of client relationship

From our own research across many different types of institution we have consistently noticed that the **supplier's view of a client relationship is frequently different from the client's view of that same relationship.**

Views differ in three important respects:

- **The strength of the relationship** Institutions' views are frequently more positive than customers'.
- **The locus of the relationship** Institutions often view the customer relationship as being with the institution, or even the brand. In banking this may well be the case, but in wealth management, the customer view of relationships is often seen as residing with individuals: in particular with the relationship manager and their assistants/ advisers.
- **The breadth of the relationship** Institutions frequently see themselves in the position of a trusted 'lead adviser' for wealth management, whereas clients frequently perceive a more narrowly based relationship, around a limited product range.



This is of course a generalisation, and we acknowledge that different types of institutions will naturally have different forms of relationships, emerging from the core service proposition. For example, a bank may have a more strongly institutional relationship than a full service stockbroker, where the personal relationship is very prominent, and an asset manager may be somewhere in between.

There is, nevertheless, a need for a closer examination of the true value of the client relationship and the factors that are driving change: institutions of all kinds frequently make errors or assumptions about clients and how they should best be managed.

III.ii. New pressures on the relationship manager role

A new breed of client will want a new breed of client relationship manager (CRM), and perhaps an entirely new approach to the relationship itself. Above all, modern CRMs will need to mirror their clientele – and will perhaps differ from them only in the size of their portfolios and the greater extent of their expertise:

- They may have been successful *outside* of private client businesses, in dynamic, fast paced professions. Although some may have a background in fund management, venture capital and investment banking, many will have come from outside of financial services all together. The latter are especially important in bringing creativity and fresh perspectives to the formation of client portfolios.

- They will have substantial business experience, acumen and networks, in particular in the new economy (high tech, internet, telecoms, etc.).

- They will be younger.

- More of them will be women.

In addition to this, the modern CRM will have a new set of values and a style of thinking which will define their approach to the client and the tone of their relationships. This style and tone will have also evolved, it should be:

- Problem solving, not product pushing.

- Open, free thinking, ideas driven, with few limitations.

- Collaborative, not 'client hogging' – will bring in outside expertise and other advisors as and when needed (abolishing the internal bunkers which prevent expertise from flowing freely towards client situations).

- Not subservient – CRMs will conduct a dialogue of equals.

- Championing the possibilities of money, the doors it can open, the experiences it can bring…money = fun, not something to be hidden away, not something to be ashamed of .

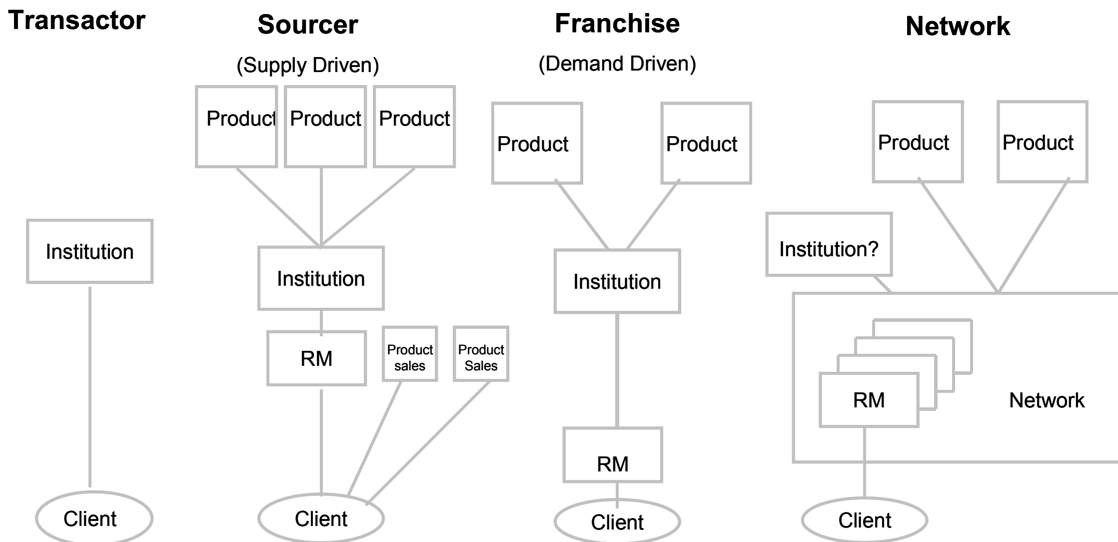
This a tough brief and the real challenge facing financial institutions is how to find such people who have the range of skills required to meet these new requirements, and who will still work as employees.

III.iii <u>Wealth management – new models</u>

One solution is to consider new models for structuring the business which reflects the new balance of power.

What impact will these new forms have on the wealth management business?

In theory, there are a profusion of new business models, driven by a variety of factors, here, we have identified four models, of particular interest for the impact that they have on the nature of client relationship:



Transactor

If the CRM is a tough role to fill, one solution is to do away with it. The transactor model has already hit the market in the form of on-line broking. The client is sufficiently empowered to take decisions and uses the services provided by the institution.

Significantly, this model cuts out the relationship manager entirely and is obvious for an online proposition. It is likely to lead to price competition and low margins however, and is also aimed at a segment of users defined by their lack of need for relationship.

Current exponents of this model are seeking additional ways of adding value – both for the client to counteract competition and for themselves to relieve pressure on margins:

- Increasing "stickiness" – the pull to return – through user interaction, e.g. bulletin boards for investors (Interactive Investor)
- Segmenting to offer more intense services to frequent users – faster links, more information (e.g. Power Trade service from E*Trade)
- Adding interest through shopping (Merrill Lynch)

- Adding longer term, higher margin businesses to the portfolio, often by buying additional businesses (e.g. Charles Schwab and the US Trust buy-out).

Sourcer

If one CRM cannot meet all the clients needs, build a team who can.

In order to offer clients the best advice, one must provide the best investment opportunities. Unfortunately, these opportunities, such as the possibility to invest in ‘alternative investments’ (e.g. Hedge Funds) may not be available from one institution. This lack of availability may be countered, by sourcing the product from other suppliers. Whether sourcing new services or improving existing outsourcing arrangements, the key to added value for both institution and client is that the process and the product complement the brand and strengthen the existing product range and relationship.

In a model where outsourcing becomes a core function, there is also additional emphasis placed on the role of relationship management. When outsourcing increases the range of products / services that an institution can offer, these in turn must be discussed with the client. To accommodate this, the role of relationship manager can be adapted in one of two ways:

- **Broadening the relationship manager role**
  This route can be challenging, because it calls for a relationship manager with greater expertise. It also challenges the stability of the existing client relationships by introducing a broader discussion about client needs, a situation possibly long overdue (but one which carries an element of risk).
  - Raising questions which should perhaps have been asked much earlier
  - Introducing another firm’s products
  - Exposing the CRM role as bounded

- **Complementing the relationship manager role with product specialists and other team members**
  This scenario is already followed by many American institutions, and can become problematic because of the introduction of internal competition for client attention and the feeling experienced by some clients of being ‘over sold’.

The sourcer model has been tried and tested in a variety of forms in other industries, and is already a facet of many fund management businesses – to add on alternative investments for example - but few institutions have fully embraced the implications of offering best advice to their clients. The advent of the web is likely to encourage and increase its prevalence in the future.

This model runs several risks:

- First, forcing the institution to become ‘product’ orientated and seeking to control the sales channel, for example by imposing sales and cross-selling targets. This is often counter to the interest of the client. What is initially presented as client choice ends up as hard sell.

- Second, the ongoing impact on the brand. If the institution is outsourcing too much of the value added, what is its remaining role, and is it sufficient to sustain a credible brand?

- Third, if the name of the game is sourcing, what need does the CRM have of the institution?

Franchise

The notion of the franchise model emerges in response to the tension between the organisation's objectives and those of the clients. This model recognises that the CRM holds the client relationship, but seeks to align CRM and institutional objectives through service provision and a service level agreement.

The new potential offered by the web is to establish the relationship manager/ manager team in a more autonomous position, calling for a more active management style than often found in most client businesses. In this model, the CRM still retains strong links (often based on the flow of information) with a single institution, but has more autonomy over how the clients are developed and freedom to select services required by his/ her clients.

A variation on this model has been employed in the past by many full-service stockbroking forms in which brokers share in the commission income generated by suppliers. Many of these firms are now moving away from this model because it is not considered an effective vehicle for growth – once an income sharer reaches a desirable workload and income, he/she stops searching for new clients.

Also, CRMs in many banks implicitly think in this way, viewing long term client relationships as their 'pension fund', however they seldom have any way of realising the capital value of their fund. Some can 'retire' by taking a handful of large clients with them and then acting as an 'homme d'affaires'.

If employed successfully, the outcome of franchising should be to attract new clients, but this relies on ensuring the CRM is motivated to grow the franchise under his control. The benefits for the CRM come when he is able to become a profit centre and take on his own staff and be responsible for service delivery. This could occur when managers are offered equity in a county or regional office – and some examples of this are beginning to appear.

Network

The logical extension of the franchise model is the network. In the network, relationship management is established as an independent activity, which can be considered as a more distinct business activity. Through its structure the network also allows the opportunity for aggregate product sourcing/buying and therefore cheaper selling (beneficial to the client).

A parallel structure can be seen in the UK **life assurance** sector. Life assurance used to be sold widely through IFAs – but in the last fifteen years, as they have come under increasing regulatory and compliance pressures, some IFAs have established a new professional operating structure – networks. These are in some cases large organisations that attract membership from independent IFA businesses. Through aggregation they are able to offer better deals from suppliers – and offer a range of services that small individual IFAs would not be able to support (for e.g. compliance and panel management). This means both more choice and lower prices for clients and the possibility for higher commission and more efficient marketing and administration for practitioners.

The network model has significant implications for institutions and the roles they play. Under this model the institution could be a network company or it could be an independent provider of products and services such as regulatory compliance and training. It is also a model which could evolve organically within the industry if relationship managers decide to 'go it alone'. One reason for them to do this would be the strong relationships they have with clients and the economic upside from participating in the equity of a business. However, it is difficult to see how existing institutions would want this model to evolve since their share of the value added would decline significantly.

The model would appear to be <u>very</u> suitable to new entrants into the market place, and <u>not</u> an easy one for existing institutions with financial commitments to existing structures.

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Conclusion

For most of the last decade, it could be argued that most financial institutions have been converging around a single view of how private clients should be managed – a centralised model, supported by in-house products.

What we now see is the breakdown of this supplier/ regulator driven consensus in favour of a variety of radically difficult business models designed for different client segments.

Established institutions are thus faced with making strategic decisions, which are far more fundamental in nature than they have had to confront in the past, when most of their business strategy was evolutionary.

These decisions have major implications for the target market, the economics, the culture and the brand, and those that are quick to move will more readily achieve the momentum and brand identity to secure their position in a quite new environment for private client wealth management.

The Author

John Lawrence is a founder director of Lawrence Somerset and has been a strategy consultant for 15 years. His main focus is working with senior management of financial institutions on market-based e-commerce strategies.

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Lawrence Somerset is a UK-based management consultancy firm with a strong market research capability which specialises in advising senior management of financial and other service businesses on issues of strategic importance. In the past five years we have worked for over 50 clients in the UK, and several others from elsewhere in Europe and the United States.

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