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Taking wealth management digital

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Executive summary

Digitization has transformed much of the financial-services industry during the past several years, yet wealth management and private banking (WMPB) firms have remained largely on the sidelines. There are legitimate reasons for their hesitancy thus far. However, the shift to digitization is inevitable, and it will transform the industry in the coming decade. The firms that develop a coherent plan for digitization will give themselves a head start in capitalizing on its advantages, which include stronger client relationships, reduced operating costs, and enhanced risk management and regulatory compliance capabilities.

A digital evolution

In many financial-services organizations, technology has moved from the back office to the front. The industry has become the world's most digitized, according to Strategy& analysis; indeed, some 60 percent of all retail banking transactions now are done online. But this transformation has been slow to impact wealth management and private banking (WMPB) firms. A recent Strategy& survey found that only 22 of 50 private banks had optimized their websites to integrate smartphone applications — and 14 had no mobile presence at all.

In the years ahead, however, WMPB firms will have little choice but to adopt a range of digitization strategies. This digital shift is being driven in part by changes among WMPB firms' clients. The typical WMPB customer in a developed market today is at least 65 years old, and it is fair to assume that subsequent generations will grow up far more comfortable with digital technology. In fact, these changes are already evident. In Europe, more than 47 percent of ultra-high-net-worth individuals use Facebook, and more than 40 percent of high-net-worth individuals under the age of 50 view social media as an important channel for communicating with their bank, according to a recent study by Assetinum. Similarly, a recent Deutsche Bank study found that more than 33 percent of all new banking business with customers between the ages of 16 and 39 is conducted fully on the Web. Among these younger clients, online channels (including social media) have become one of the most important information sources for investment decisions.

In a recent survey, only 22 of 50 private banks had optimized their websites to integrate smartphone applications.

Clients' preferences for how they handle investment decisions are also changing. A significant share of private banking clients, especially in Europe, still prefer to delegate their wealth management needs to a traditional advisor or private bank with an established track record, instead of seeking their investment advice online. However, clients in Asia and the U.S. are increasingly willing to make some investment decisions themselves — and even to share ideas online through social media platforms.

WMPB firms have often perceived a contradiction between privacy and the accessibility that digitization and social media provide. But the recent financial and sovereign crises have altered perceptions among clients, making them question the quality of their financial advice and putting a dent in the overall credibility of banks. As a result, WMPB clients are seeking greater transparency from their financial institutions, particularly about regulatory requirements and compliance. More and more, they want the full range of support — face-to-face meetings but also convenient, hassle-free online solutions that feature better account and transaction information on various devices — and they want to seamlessly switch between the two.

Technology is enabling upstart competitors to enter the market with innovative, Internet-driven offerings that answer these demands and challenge the traditional model of fee-based advice and personal interactions. In the U.S. market, for example, several new players allow members to post their investment portfolios and strategies online and compare performance via social networking tools and virtual communities. Although these players bring new transparency to the sector, they also allow clients to more easily challenge the advice of their wealth managers and take a more direct role in overseeing their investments.

Moreover, within WMPB firms, a variety of issues are now spurring the digital transformation. Diminished margins are putting greater pressure on operating costs. Banks face rising regulatory requirements for risk management, customer protection, and compliance with international anti-money laundering and "know your client" standards. More fundamentally, everyone is looking for a recipe for future growth, including better sales effectiveness and stronger customer analytics and insights.

Digitization can help WMPB companies respond to these pain points. We believe it will happen through a gradual evolution. The industry is deeply rooted in tradition, and although some new technology-driven upstarts are entering the market, major industry disruptions are unlikely. The classic, relationship-driven business model in private banking will not become obsolete, but there will be a shift from personal interaction to digitization-enabled client interactions — a "high-touch, high-tech" model. Ultimately, digitization represents a significant change for the industry, yet it is also a clear means for WMPB companies to serve clients in a multifaceted way, and thus to differentiate themselves. Clear forethought and planning will allow wealth management and private banking leaders to chart a new course for growth through digitization, while decreasing risk and increasing customer satisfaction and retention.

There will be a shift from personal interaction to digitization-enabled client interactions — a "high-touch, high-tech" model.

Three opportunities for private banks

For WMPB firms, digitization offers three sustainable and realistic opportunities. Each extends over the entire value chain, offering benefits from the front office to the back office (*see Exhibit 1, next page*).

1. Enhancing the value proposition and driving sales

WMPB firms are recognizing that many of their clients (and their clients' heirs) are online, spending an increasing amount of time in social communities and networks. Embracing the industry axiom, "Be where your clients are," banks have to develop mobile applications and leverage new technologies more innovatively to establish closer ties to clients, especially the digital natives. Designed correctly, such apps will help them identify client needs earlier and with greater accuracy. They will also provide online channels for transactions, advice, and information exchange, as well as client-to-client networking. As a result, firms will be better able to develop new offerings for their current customer base and attract new clients. Studies show that customers frequently request innovative and interactive customer financial education tools, and better-educated clients show significantly higher levels of investment activity. For example, a survey in Germany by Deutsche Bank concluded that educated customers typically hold equities in their investment portfolios at rates two to three times higher than less educated clients do.

Current industry examples show that a good balance between pull-information/push-communication and sales effectiveness is critical in these efforts. For example, providing clients with customized, relevant information and research about developments in the markets can be an opportunity to open a dialogue and assess their current needs. Several U.S. wealth management firms have designed innovative apps that have become hugely popular in a very short time. Besides providing news and the latest research reports, these apps allow clients to view their account balances and investment positions in a convenient and hassle-free way and handle basic transactions on their own (with a personal advisor available when needed).

Exhibit 1
The benefits of digitization for WMPB firms

<table>
<tr><th></th><th>Enhancing value proposition & sales</th><th>Cost reduction</th><th>Improving risk & compliance</th></tr>
<tr><td>Front office</td><td rowspan="2">- Effective customer acquisition
- Better and more consistent advice
- Multichannel integration
- Client interaction via social media
- Better service for self-directed clients
- More product and service customization
- Interactive client education
- Client networking
- Direct expert access for clients via digital channels
- Leveraging “big data” to benchmark clients against other client aggregates in their segment</td><td></td><td></td></tr>
<tr><td>Middle office</td><td rowspan="2">- Reduced footprint and overhead
- Reduced cost for delivery (e.g., reporting, research, communication)
- Higher self-service rate by clients
- Automated processes, including higher customization to client needs
- Faster response times
- Better access to data
- Digital document management</td><td rowspan="2">- Improved, digitally enabled risk and compliance tools and processes
- Digital suitability checks for specific products and clients
- Automatic portfolio alerts and risk management tools
- Real-time, client-triggered automated portfolio checks
- Digital tracking of all client interactions</td></tr>
<tr><td>Back office</td><td></td></tr>
<tr><td>Measures of success</td><td>- Net new assets
- Revenue growth
- Increased share of wallet
- Better retention/loyalty</td><td>- Lower operating costs</td><td>- Lower risk and compliance costs
- Fewer litigation cases
- Reduced reputational risk</td></tr>
</table>

Source: Strategy& analysis

At the same time, more personalized communication and a greater presence in social media — such as Twitter, Facebook, and specialized online communities and portals for high-net-worth (HNW) individuals — can help transfer personal advisor relationships to the online world and deepen institutional loyalty among clients. For example, banks can use their platforms to connect clients through interactive communities based on shared interests. This could be a crucial tool to forge ties with the children of HNW clients early on, and improve customer retention as wealth gets transferred to the younger generation. Some private banks have already started administering multiple Twitter accounts and Facebook pages to address different client segments. Tablet and smartphone apps specifically tailored for these segments are a logical add-on.

For self-directed clients who are willing to take on a greater share of their own portfolio decisions, sophisticated but user-friendly online trading platforms are becoming increasingly popular. The most successful platforms offer support through all channels: individualized online support by a personal advisor to get clients started, followed by real-time chats, 24/7 call centers, interactive online training seminars, demo versions, and face-to-face workshops. Key success factors for these offerings are attractive pricing (often bundled with transactions and advisory services), accessibility on any device (smartphone, tablet, laptop), direct access to specialists (without needing to rely on an advisor as intermediary), and support whenever the client wants it — which differentiates online WMPB offerings from those of standard online brokers.

2. Reducing operating costs

WMPB firms should leverage technology to drive standardization, efficiency, and automation. Companies in all industries have been using technology to drive down costs for decades, and digitization is merely the latest manifestation of this trend. However, given the current competitive pressure and reduced margins in the WMPB space, banks must find more innovative approaches. These include leveraging technology both internally and externally.

For example, banks can use digitization internally to streamline processes, such as more efficiently rolling out new programs and investment ideas to their relationship managers. Large banks have made significant strides in this area and are continuing to invest in it. Externally, digitization can help a bank standardize its client relationships — which can vary significantly from one manager to another — along with its reporting processes and other communications between the client and the manager. Digitization can also allow banks to make account information available for clients to access themselves, at their own convenience, rather than calling and asking a relationship manager to fax something to them.

Another element of cost reduction is the better use of relationship managers' and specialists' time. For example, they can use online chats and videoconferences to provide more content in client interactions, thereby drastically reducing unproductive time (within privacy constraints). Innovative client management interfaces can also help relationship managers automatically identify clients to contact (with "alarms" for specific trading situations, deviations of their portfolio from a preset risk profile, and so on). These measures remove some of the administrative burden on managers, allowing them to handle more clients with no drop in service levels, while wringing out operating costs.

3. Improving risk and compliance functions

As regulatory requirements grow more stringent, the middle office has to deliver timely alerts via automated checks on different types of risks, including early-warning systems for credit defaults, individual portfolio monitoring, and recognition of reputational risks in the market. Using digital solutions more effectively in the middle office can help manage risk and compliance, which will reduce costs and protect both the brand and client interactions.

Some firms are already using tablet applications in this way. During face-to-face meetings between relationship managers and clients, these applications incorporate standardized risk and compliance checks and provide an electronic audit trail, reducing risk and compliance costs for the bank. This is a significant improvement over paper-based audit trails, which are labor-intensive and more prone to error. In addition, some banks have set up digital portfolio risk management tools that can be tailored to the needs of specific clients. For example, some tools allow clients to run real-time portfolio simulations and risk scenarios, or warn them if their portfolio has exceeded predefined risk tolerances. The tools can also be configured to alert relationship managers to contact clients in case of special market events or portfolio moves (and also to track the compliance and effectiveness of the managers themselves).

These applications effectively bring risk management closer to the client, not only improving compliance but also adding value to client relationships, which ultimately builds loyalty to the bank itself — and not to the individual manager.

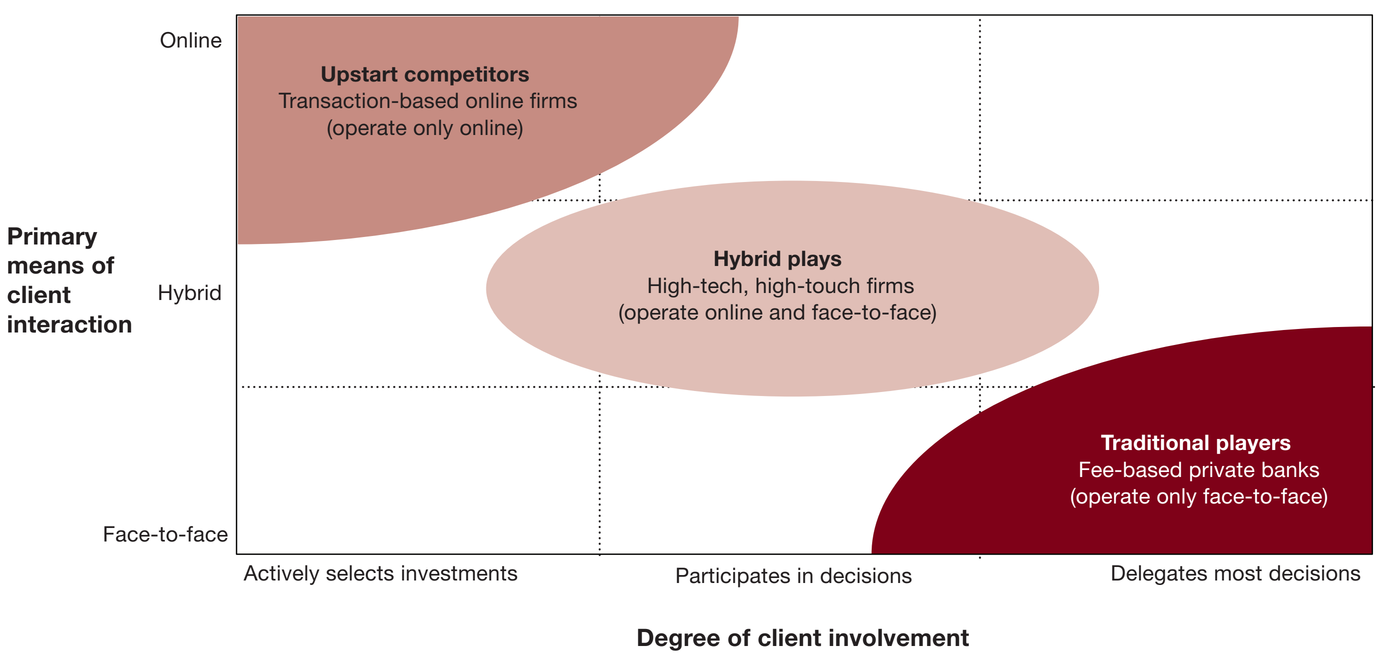
Paradoxically, digitization has also bred new forms of operational risks that have become increasingly difficult to manage, ranging from data theft and confidentiality breaches to full-blown “denial of service” hacker attacks. In Europe, several well-documented incidents involved bank employees who downloaded confidential client data to portable devices and then either sold it to outsiders or leaked it to the press. Such events can do incalculable damage to a bank’s reputation. Accordingly, firms will need to ensure that any digitization efforts do not create new vulnerabilities, and they must safeguard client data confidentiality as well as manage internal access rights to client data.

Choosing a business model

To take advantage of the new digital opportunities, WMPB firms will have to take a fresh look at how they run their business. We see digitization splitting the sector into three distinct models (*see Exhibit 2*).

At one end of the spectrum are the traditional private banks with fee-based, personal advice models. These firms will continue to offer high-touch, personalized service to clients who still seek to delegate the bulk of their investment decisions. Although these banks will have

Exhibit 2
Private banking's digitization spectrum



Source: Strategy& analysis

to offer some digital interaction features to clients — mainly passive elements like 24/7 account access — they will mainly limit their digitization initiatives to less visible middle- and back-office functions. Their value proposition will continue focusing on “best-in-class” advice, long-lasting client relationships, and a superior banking experience. However, they will gradually lose market share as more technology-enabled models become popular, and the number of these traditional firms will shrink. Even more important, they will face significant obstacles in acquiring new customers going forward, as more technologically enabled providers will capture new customers earlier in their life cycle. Traditional firms will face significant challenges in trying to win over these customers later on.

At the other end of the spectrum are transaction-based, online-only providers, which cater to self-directed clients who seek lower costs and a greater role in their investment decisions. This sector is already very popular and increasingly gaining market share in the HNW space, as new and innovative companies add personalized advisory services to their low-cost online transaction platforms. However, there are substantial drawbacks to this approach. We expect that the already low margins will further shrink in the online-only segment, due to limited differentiation potential, low client loyalty, and high cost sensitivity among online-only customers. After all, customers who switch to these providers primarily for the lower costs can just as easily switch to other providers later on.

The third business model — a hybrid of the other two — provides individual advice seamlessly across online and traditional face-to-face channels, giving clients the best of both worlds. By providing the advantages of digital along with personalized service and support, this model gives greater choice and control to clients. It will become increasingly appealing both to self-directed online clients — who prefer more individual advice and tailored information — and to traditional face-to-face clients as they gradually embrace digitization and opt for digital solutions to make their private banking experience more convenient or engaging. At the same time, back- and middle-office activities will be digitized as much as possible to reduce cost-to-serve and fulfill all risk and compliance requirements. Given the current transformation in the market, we assume that most traditional players have to move toward a more hybrid business model. But given the investments required by such large-scale digitization projects, we expect that only the largest private banks and private banking divisions of integrated commercial banks will be able to successfully implement such a model and benefit from economies of scale.

The digitization road map

Digitization is a dynamic issue for WMPB firms, requiring their leaders to separate threats from opportunities and decide on the degree to which digitization should dominate their operating model. Their decisions will likely vary by market position, corporate heritage, and other factors. In some cases, businesses may have to sacrifice some short-term business in order to invest in longer-term goals. All of these issues require significant management attention, yet many companies today have no clear digitization road map — they may have adopted a set of ad hoc measures, but they lack a clear vision of what they need to do moving forward. To address this gap, the management team should start with the following measures:

- Determine the expectations about digitization held by internal stakeholders, such as the board of directors (and, if the firm is publicly traded, the shareholders).
- Assess the digitization expectations of current and potential future clients.
- Evaluate the threat of disruption to their current business from more digitally proficient competitors, including those outside the traditional financial-services industry.
- Understand how evolving technology will continue to drive digitization in the industry.
- Decide whether to focus on the external, client-facing (front-office) or internal (middle- and back-office) implications of digitization — or both.

After considering these issues, senior executives can begin to define their institutional approach to digitization. First, they must decide on an overall digitization strategy and a system for implementing these initiatives across the organization. Some firms will adopt a leadership position and embrace cutting-edge technology, whereas others may benefit from a fast-follower strategy.

Businesses may have to sacrifice some short-term business in order to invest in longer-term goals.

In addition, firms must decide on how the governance of digital initiatives should be managed. Based on our experience, overall coordination and control of projects should be handled by a dedicated central team that oversees everything the bank does in the realm of digitization. This team — which may report directly to the CEO — decides which digital initiatives should be run at the central corporate level, and which will be decentralized and owned by individual business units. Some WMPB firms have already defined a "head of digitization" role or have established an advisory board for digitization efforts, responsible for coordinating and prioritizing the firm's ongoing efforts.

Finally, it is critical to understand the cultural components of digitization. First, clients in different markets have different expectations. For example, clients in the U.S. and Asia more commonly rely on a broker model and are much more willing to share investment ideas and take advantage of networking platforms. In short, they are more comfortable talking about money. By contrast, traditional HNW clients in Europe prefer a high-touch model with a long-standing advisor relationship, and they are generally far more private and less willing to share financial information outside of such interactions. Global banks that have clients all over the world may need to tailor their digitization approach for individual markets.

The second cultural component is internal. Some very long-standing, established investment houses, including many based in Europe, have a very traditional approach to client service and operations. These firms are more likely to see digitization as a threat that they must defend against. In the U.S., by contrast, new competitors are less bound by tradition and more likely to take advantage of technology to reinvent the WMPB experience for clients. Neither is completely "right"; rather, banks must understand their heritage and make sure that any digitization initiatives get integrated seamlessly into the existing corporate culture.

Conclusion

The only wrong approach to digitization is to do nothing. Change is coming to the WMPB sector, and firms must decide whether they want to cling to the status quo or adopt a more proactive approach. Some more traditional private banks may opt — for legitimate reasons — to hold off on substantial digitization initiatives, yet this is not sustainable in the long term. In fact, the majority of WMPB firms will benefit from defining a coherent strategic approach that best fits their specific situation, institutional vision, and client base. The longer they wait, the more difficult the challenge will become, and the more ground they risk ceding to competitors.

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