

The game is changing

New rules reshaping wealth management



With its high price-to-earnings multiples and solid fundamentals, wealth management remains the most attractive banking segment. However, with revenue margins falling inexorably in past years, it's evident that wealth managers have been struggling to realize the full potential of their client portfolios. While this downward shift has been ongoing for some time, it has been exacerbated by the impact of the pandemic, which has injected unexpected volatility into the markets. That has led many to take a quick step back to completely reassess their portfolios and overall wealth management strategy. So it is pretty safe to assume that at some point soon there will have to be some significant reshaping of the sector, especially as changes in customer behavior, investment trends and the regulatory environment are only likely to worsen the underlying decline. And if we look at how the world has been changed by market, technological, political, and societal pressures over the last two decades, it's hard to believe that in 20 years the wealth management sector will be the same as it is today.

Not business as usual

Some wealth managers may tell themselves that what is happening is no more than an aberration to be followed by some kind of return to "normality." Others may decide this is not a problem for them at all, since their weight in the marketplace means that if the worst happens they will only suffer "bumps and bruises" rather than any catastrophic injury.

Maybe they are right. Those firms, both large and boutique, who are managing ultra-high-worth clients, for instance, may be able to compensate for shrinking margins by expanding their assets under management and moving their clients to higher-margin products to give them an acceptable equilibrium between revenues and costs.

However, for smaller firms, the picture is likely to be more complex, since they have neither innate resilience nor the ability to scale up in the same way. This leaves them much more exposed in an evolving marketplace where there is increasing transparency and sharing of information. Those that have relied heavily on confidentiality and "jurisdiction arbitrage" rather than on delivering superior products and services are unlikely to survive in this new era.

To protect themselves, many will be forced to seek refuge by becoming part of a larger business to shore up their margins. They won't be alone. In fact, it is likely we are on the cusp of a new M&A phase that will see the large fish eat the small and whole country portfolios being bought in an attempt to create the scale needed to remain buoyant in very choppy waters.

In parallel, banks where wealth management makes up only a small part of their business, as it does for many, may decide it's preferable to exit the market rather than bear the increased costs and risks associated with regulatory compliance.

Is Big Tech a threat?

So, what are the "influencing forces" likely to precipitate and drive change?

Technological change can have the swiftest, deepest, and most unexpected impact, of course. Who knows, for example, how an emerging technology, or even an existing one such as the Internet of Things, artificial Intelligence (AI), machine learning (ML), predictive analytics, or robotic process automation (RPA) might have an impact?

And what about “disruptors” from outside the financial services sector?

Big Tech, for instance, has fingers in many pies and is already starting to take an interest in the financial services sector. Google has its own debit card, while Amazon Cash and Apple Pay are attacking the incumbents in the payments arena.

Of course, their presence in these areas is a long way from them making a move into wealth management, especially when there is much lower-hanging fruit to be picked in the lending market. And even if Big Tech were interested, they would still have a huge perception barrier to climb – while you may be willing to order products online from Amazon, would you be willing to trust Big Tech when it comes to investing your funds? Probably not.

However, it’s not beyond the realms of possibility that at some point you might, given that in the future successful companies across all sectors will essentially be “data firms.” It is worth noting, for instance, a remark made by one-time Google CEO Eric Schmidt who said back in 2010: “One day we had a conversation where we figured we could just [use Google’s data about its users] to predict the stock market. And then we decided it was illegal. So we stopped doing that.”

Google is already involved in another sensitive area – healthcare – where it is applying AI to disease detection. If it succeeds there, and there is nothing to suggest it won’t, it will have added to a body of credibility that it could then transfer to other sectors, perhaps even wealth management.

Are the fintechs coming?

However, in the short- to medium-term, it is far more likely that incursions will come from a growing army of fintechs, whose numbers have tripled, while those of private banks have significantly declined. These technology-led newcomers will be highly disruptive and could significantly rearrange the traditional value chain when it comes to offering investment advice. And if fintechs enter the wealth management space, they will undoubtedly bring with them new ways of working that existing firms will have to respond to.

So, if established wealth managers are to maintain space in this potentially turbulent marketplace, they must be willing and ready to find innovative ways to differentiate themselves so they stand out.

That could mean looking to become best-in-class by prioritizing and rationalizing their product and service portfolio so they excel in a few, perhaps niche, areas where they know they can achieve a competitive advantage and provide a superlative customer experience.

There is a significant opportunity in Islamic wealth management for instance, where the guidelines relating to investment, inheritance, and even philanthropy are detailed and extensive. Building a credible platform that provides religiously acceptable products and services could enable the right provider to “own” this space.

This is a better place to be than trying to be all things to all people, which leaves you carrying unprofitable business lines, having to cover greater compliance costs in multiple areas, or being seen as a “lower-quality generalist” in comparison to a fintech who is seen as a specialist in a particular area.

The technology imperative

Another move that wealth managers could borrow from the fintech playbook is to make the greatest possible use of AI, RPA, and ML to improve and cut the cost of their back-office operations. Technologies like these could also be used to enrich the customer journey, not by replacing the human relationships that are so important in wealth management but by enhancing them with apps, new channels, and engaging customer-centric design.

The arrival of COVID-19 has already opened the door to this new kind of relationship, with digital channels having to replace traditional person-to-person business. Of late, we have also seen the rise of robo-advisors, automated digital platforms providing algorithm-driven services for planning and managing a portfolio.

But while there is a shift toward digitalization generally, each organization will need to tailor its digitalization strategy to its target market but taking into account that customers tend toward digital for transactions and information gathering but prefer human interaction when they need advice or when their portfolio is sizeable.

Of course, not all wealth management firms will have the in-house skills or expertise to take their technology up to the next level. For them, a quick way to solve any shortage in competencies would be to seek out an appropriate fintech that could underpin what they do with their technological expertise.

At a broader level, such partnerships are heralding the development of an increasingly integrated network of financial services providers who collectively meet their customers’ ongoing needs by providing solutions rather than mere products or services.

This is all part of a movement toward “autonomous finance” with more and more customers, particularly those in technology-aware demographics, wanting to have greater control over the management of their financial activities. So, from their wealth

managers, they are increasingly looking for simple yet powerful digital tools that will help them achieve what are often goal-oriented investments, such as a yacht purchase, for instance, or a move into more challenging asset classes.

Here, enhancing the customer experience through personalization is key since increasingly consumers of all types of financial services, and particularly Millennials and Gen Z who are tomorrow's clients, want to do business with the "right kind of company" – one that is in tune with their own values. This is being reflected in, for instance, investments directly channeled toward achieving specific value-based goals.

So, they are looking for socially responsible investments that are underpinned not simply by profit, but nonfinancial factors. Consequently, wealth managers must be ever more aware of environmental, social, and governance (ESG) factors.

This change in sentiment has been accelerated by the pandemic, which has shone a spotlight on organizations' wider community-based responsibilities.

And as ESG and sustainability criteria become ever more embedded into investment strategies, this could be potentially game-changing, since it moves such issues from being the preserve of corporate responsibility and elevates them to board level, which in turn will increase their visibility.

Initiatives like the EU's Sustainable Finance Disclosure Regulation (SFDR) are likely to trigger something of an investment revolution since they force the disclosure of ESG-relevant issues, meaning companies can no longer ignore externalities.

This suggests that increasingly, it is not the customer who must fit with the profile of a wealth management firm, but the other way around.

So, if wealth management is to stay true to that proposition, to maintain the credibility of its message, it may need to think about narrowing its customer base and confining its activities to markets and customer clusters that play to its strengths and capabilities.

Wealth management firms need to see what is happening as an opportunity to create a value proposition that will both set them apart and resonate with a specific audience. And if they can show that they truly share the same values as their customers, then create a powerful, distinctive offering to reflect this, they will be better placed to retain clients rather than see them migrate away with a departing advisor.

Fundamental repositioning, not incremental movement

While some degree of incremental improvement to their core wealth management business, such as digitalizing their traditional model and reducing their cost base, may help them in the short term, wealth managers must be prepared to get out of their comfort zone and do something different. Failure to do so will prevent them from implementing the deep innovation that will be needed in future.

Undoubtedly, this will require them to think more openly and expansively than before if they are to overcome challenges and capitalize on opportunities.

This means looking afresh at what market segments to be in and who they should be serving; what new tech infrastructure is required to ensure clients receive faster service of the highest possible quality; what competence gaps need to be filled through re-skilling; and whether becoming part of a wider financial system might offer greater opportunities, even though it might lead to less brand visibility.

Whatever the new vision, it needs to be captured in communications and articulated by leaders to clients, staff, and markets through a clear "transition" roadmap of short-term measures that take it forward.

A window of opportunity

Whether you have a business model built around confidentiality or are unable to make the investment required to upgrade your technology infrastructure, for all in wealth management change is in the air.

And while you may feel there is no immediate threat, it doesn't mean you can keep on doing what you have always done into some indeterminate future. So, even though there is comfort in not being first to break cover, it could mean missing the moment for controlled change, resulting in change being forced upon you.

Of course, it is difficult to prepare for disruption when it's not altogether clear what form it might take, given that wealth management firms are not under immediate duress from any particular threat.

But if we are approaching some kind of tipping point – even if you consider the results your firm is currently achieving to be acceptable – it would be prudent to consider how these new influencing forces will impact you over the next five to 10 years and what might be your strategic response. Because, given the pace of change, there will be no second chance to get it right.

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