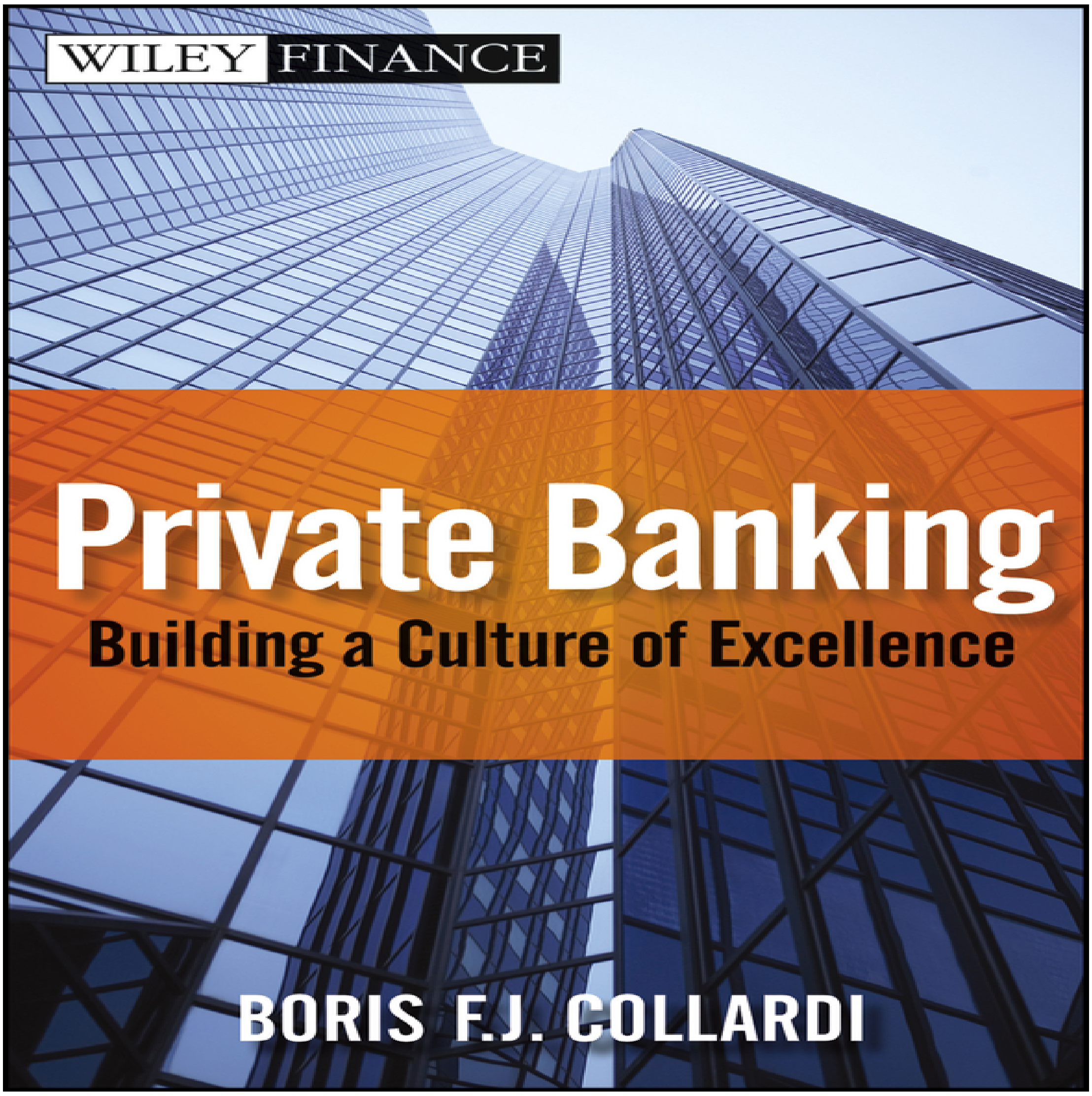
WILEY FINANCE
Private Banking
Building a Culture of Excellence
BORIS F.J. COLLARDI

Contents

Private Banking

Building a Culture of Excellence

BORIS F.J. COLLARDI

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Published in 2012 by John Wiley & Sons Singapore Pte. Ltd., 1 Fusionopolis Walk, #07-01, Solaris South Tower, Singapore 138628

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ISBN 978-0-470-82437-5 (Cloth)

ISBN 978-0-470-82698-0 (ePDF)

ISBN 978-0-470-82697-3 (Mobi)

ISBN 978-0-470-82699-7 (ePub)

This book is dedicated to my wife Cherin for always being encouraging and enthusiastic about all my endeavours, to Alex Widmer for sharing with me his passion for the business, and to my parents for giving me a great sense of curiosity and a keen interest in people.

Preface

Can an industry steeped in tradition adapt to an ever-faster changing business environment? The numerous challenges facing private banking, which are elaborated upon here, have arisen over many years. But the urgency with which these must be confronted has taken on a whole new meaning since the financial turmoil that made itself felt in all areas of financial services. This made the timing of this book especially meaningful.

I started to write this book in early 2008, on the eve of a period that would raise fundamental questions about the future of a business that has survived, literally, centuries. Today private banking is being shaken to its core by global events. These include volatile financial markets and the new wealth being created in developing regions of the world, offering not only tremendous opportunities but also potential risk factors to consider. Meanwhile, partly as a result of past crises, banks worldwide now face the challenges imposed by new regulatory regimes. These factors have contributed to a sense of urgency driving changes within our industry. Not only has the pace of change accelerated but the scope of potential issues banks face today is also enormously broad. This is affecting how the business adapts: Should a private bank act with uncertainty or wait for the dust to settle and risk losing out on key opportunities that accompany these changes? A period of rapid growth was followed by widespread setbacks, giving rise to a desire to make the business more sustainable and answerable to the considerations that influence the health and vitality of any industry. This, truly, is one of the most interesting periods our industry has faced. In that spirit, I decided to finish the book.

For perhaps the first time ever, each private bank is being forced to examine a business model that has survived for decades, in some cases, for over 100 or 200 years. What has transpired in just a short span over the past 30 years or so is now challenging that long-established model. Global economics and upheavals in financial markets, new clients coming onto the scene, and stricter regulatory requirements all are contributing to a radically changing environment. When I began in the business in 1993, every private banker decided autonomously on the services and solutions offered to his or her clients. Private bankers dealt with issues as they arose, dispensing investment ideas, legal guidance, and often also personal advice to clients more or less on an ad hoc basis. There was no uniformity, and thus no guarantee of any quality standard or minimum level of service—the banker was the bank.

Changes in the past years have radically altered the familiar, sometimes cosy world of Swiss private banking. Players are facing a variety of challenges. Today the business demands a high level of expertise in many different areas of competence along with professionalism that must exceed already significant expectations that clients rightly have. Given the growing complexity and inter-linkages among markets, the increased sophistication of investors and products, as well as the imperative to abide by regulations of different regions, a client advisor today must rely on a number of specialists. The all-in-one advisor of decades ago has been supplanted by someone backed by teams of professionals in areas ranging from local investment market and estate planning expertise to country-specific legal and compliance knowhow, to name just a few. Private banks must seek to remain viable for the future by refocusing or perhaps by expanding into new markets, either on their own or through acquisitions and partnerships. As the opportunities arise, so do the risks, given that an extended set of local rules and regulations must be applied and closely followed when private banks expand into foreign markets. After the financial crisis, regulators intensified their efforts to reduce the threat of a large financial institution failing. These rules should improve the safety and soundness of the system and help to restore trust in it. It is up to the banking industry to deal with this new environment and to comply.

Almost four years have passed since the collapse of Lehman Brothers in September 2008, and a number of open questions remain that must be addressed, such as how to further regulate systemically important institutions where a failure could undermine the stability of the entire financial system. Adding to the complexity, private banks in Switzerland must adhere to ever more stringent requirements governing foreign domiciled clients. Banking secrecy has been, and will continue to be the subject of much public debate, both inside the country and abroad.

While it should not be abused, privacy has played an important role in protecting clients' assets in the past and will continue to be valued in the future. There will still be assets held offshore, but the motivation for this will not be tax avoidance. Clients will want to maintain diversification of jurisdiction. This business will remain interesting for banks but time will tell in what form, and in which markets, successful players will operate in the wake of changing regulations. Adapting and upholding a variety of new and more complex country-specific regulations clearly increases the cost pressures that banks face, requiring them to find ways to provide cost-efficient service. Nevertheless, the only way forward is through meeting the requirements and anticipating how these will develop to ensure that the correct internal controls are in place and clients are well informed about compliance requirements. Private banks should serve as role models for their industry. No less is expected of them by their clients, their staff, and regulators. Growth must be based on factors that take into account the latest developments.

Even facing a wide range of challenges, however, the private banking industry is surrounded by plenty of opportunities. In terms of global wealth, the potential remains truly enormous, and there is still significant room for growth. Economic growth in many regions of the world has added a new dimension to the business. For example, a rising class of young entrepreneurs in emerging markets will favour private banks able to deliver to a high standard. Thus, the surge in demand for competent wealth managers in regions beyond Western Europe, especially in Asia, is opening up new territory for those private banks able to offer expertise and know-how. Singapore, for example, is already today a financial hub rivalling those in Western Europe, including Switzerland. Meanwhile, a number of financial firms, after the damage to reputation and balance sheets suffered in the financial crisis and amid regulatory pressure, are reexamining their business models. For strong firms, this creates unique opportunities to expand their business and reposition themselves in those markets.

Private banks will have to look at all of the forces and trends that shape the industry and identify the opportunities as they arise along with the challenges. They can never afford to lose sight of the fact that their business depends first and foremost on maintaining high standards of quality and personalised, superior client service. For a business that should always place the client at the centre, the question becomes, how can private banks continue to ensure that each and every individual in different places in the world gets the level of personal attention, delivered with the consistent high quality of service that he or she requires and has come to expect? In many ways, growing sophistication has transformed the way private banks operate. No single advisor could hope to fulfil all the needs of each and every client. This trend has led to a mass customisation, if you will. There is no room any more for the advisor who may lack the expertise, the information, and the people skills that the job today demands. The focus remains on clients, and the aim is still to provide the best individualised service. But how this is achieved has raised the bar in terms of the knowledge and expertise demanded of relationship managers. No matter how much the industry changes, clients are and will remain the most important element. They are to be viewed always as individuals, making decisions that can profoundly affect their lives and the well-being of those people who depend on them.

With these aforementioned opportunities and challenges in mind, this book aims to provide an overview of the elements that play a critical role in our business, illustrating how they may be aligned to serve a single objective: to strive for excellence in private banking, keeping the client at the centre of focus for all activities. This book seeks to highlight the current patterns and trends providing direction from the perspective of a private bank and based on the experience I have gathered over the past 19 years. Through my academic involvement as a member of the Advisory Board at the Singapore Management University (SMU), I have realised that very little literature was available on private banking. I hope that this publication will appeal also to the next generation of people interested in our métier, a factor of outmost importance given the relative scarcity of available talent in the private banking industry today.

The book is arranged schematically, with the first chapters providing an overview of the main elements that should be considered by a private bank, which will then each be explored in greater detail during the subsequent chapters. Although written from the viewpoint of Swiss private banking, this book also looks at the issues from a global perspective. My aim is to offer insight into the bigger picture of a business that is still in the midst of change to share a vision of the future of the industry and the potential directions that may be taken with regard to best practices and strategies. Yet it is important to note that any book can offer only ideas. It should not be construed as a reference guide full of ready-made solutions or a guaranty to success. It is therefore important to highlight that this book, though providing a practical framework, should not be construed as a strict how-to manual for running a private bank. There are many ways to go about formulating strategies and adapting to change. This book should be treated as a collection of ideas and suggestions; it represents just one attempt to answer the most pressing questions regarding what makes a private bank successful. It clearly does not offer all the answers, and in the end, the well-reasoned and sound opinions of each individual reader must decide what solutions are most suitable and practical, based on the particular situation.

To come back to my original question: Can an industry with such a long tradition adjust to an environment where change is taking place at an ever-increasing pace, affecting nearly all aspects of the business? Those institutions that will succeed must meet numerous challenges, taking into account modern practices and ideas, while continuing to respect established traditions. Private banking needs a courageous new vision, but it also needs to continue to develop the basic expertise, competence, and capabilities necessary to work well and efficiently.

There are many ways to approach this. I have tried to touch on a few that might resonate especially with readers in or associated with the industry. It always requires work to realise a vision, but it is possible. This is the message of this book. Despite the many questions the business faces, the outlook for private banking gives every reason to be optimistic. The way ahead won't always be easy. Yet the opportunities are vast. Private banking has a great future ahead of it.

Acknowledgments

When I started to write this book at the beginning of 2008, I did not anticipate that the upcoming four years would be the most intense, interesting, and thrilling ones I have up until now experienced in my professional life. I am not referring only to my career development but certainly also to the events that affected the financial industry and indeed much of the world during this period. The financial industry has entered a phase of radical change with the debate about the future of private banking—the very subject of this book—taking on new dimensions that hardly could have been imagined just a decade ago, or even when I started to write this book. Without a doubt, this period has provided me with much inspiration and a good deal of insight, furnishing fertile ground to bring this project to fruition.

Certainly, however, it would never have been possible to write this book during such turbulent times without the valuable contributions offered by those to whom I am grateful for their help and unflagging support. Two people in particular deserve mention for being there early on when the book was little more than an idea and sticking with it to the end. Christina Ziegler and Guido Ruoss have helped to take this book from a set of ideas to something with a carefully conceived and viable structure, providing considerable support in content management and research, going through numerous revisions, and pulling everything together whilst acting as a valuable sounding board. Without their help and unflagging commitment the book would not have been completed. I also would like to express my sincerest appreciation to Alice Ratcliffe for the extensive editing work and professional writing experience she has brought to the project.

Further I also would also like to thank the two industry leaders—Raymond Baer and Hans de Gier—for sharing their valuable experience and thoughts in the context of the book. My sincere thanks also go to Leo Charitos and Jan Bielinski for reading the manuscript and making valuable suggestions, which were readily incorporated. To Anthony Lassman, Gareth Penny, Alain Zimmermann, Andreas Zingg, Beat Blaesi, Gwen Walbert, Wolfgang Jenewein, Renate Meier, Daniel Aegerter, Marcel Widmer, Werner Hollenstein, Anne-Marie Nega-Ledermann, Eric Benischke, Cyril Schoch, and David Taylor for their valuable contributions and insightful discussions about their field of expertise. I also would like to thank the team from Wiley—Nick Wallwork, Jules Yap, Janis Soo, Emilie Herman, and Stefan Skeen—for their great editing support and production work. Finally, I would like to express my thankfulness and honest recognition to all the people who accompanied me during my career—in particular the employees of Julius Baer—for their trust and support and the various ways in which they have enriched my professional experience.

Chapter 1

A Framework for Excellence in Private Banking

One of the strangest lessons of the financial crisis was that despite the large number of people who were aware of the direction in which things were going and the many warnings sounded, the outcome was in a sense unavoidable because there were too many short-term—and short-sighted—incentives that were not aligned with long-term goals. As a business, wealth management poses interesting intellectual challenges: How can long-term goals of capital preservation and appreciation be matched with short-term market fluctuations? Another question is how do we achieve this while serving one of the most demanding client groups in a fast-growing and highly competitive market? This "culture of excellence" demands that one accepts basic assumptions, attitudes, practices, and concepts upon which to build a business capable of satisfying the most demanding clients. The best time to do that is not when business is booming; the foundations must be laid well in advance to take advantage of the opportunities provided by a crisis or recession.

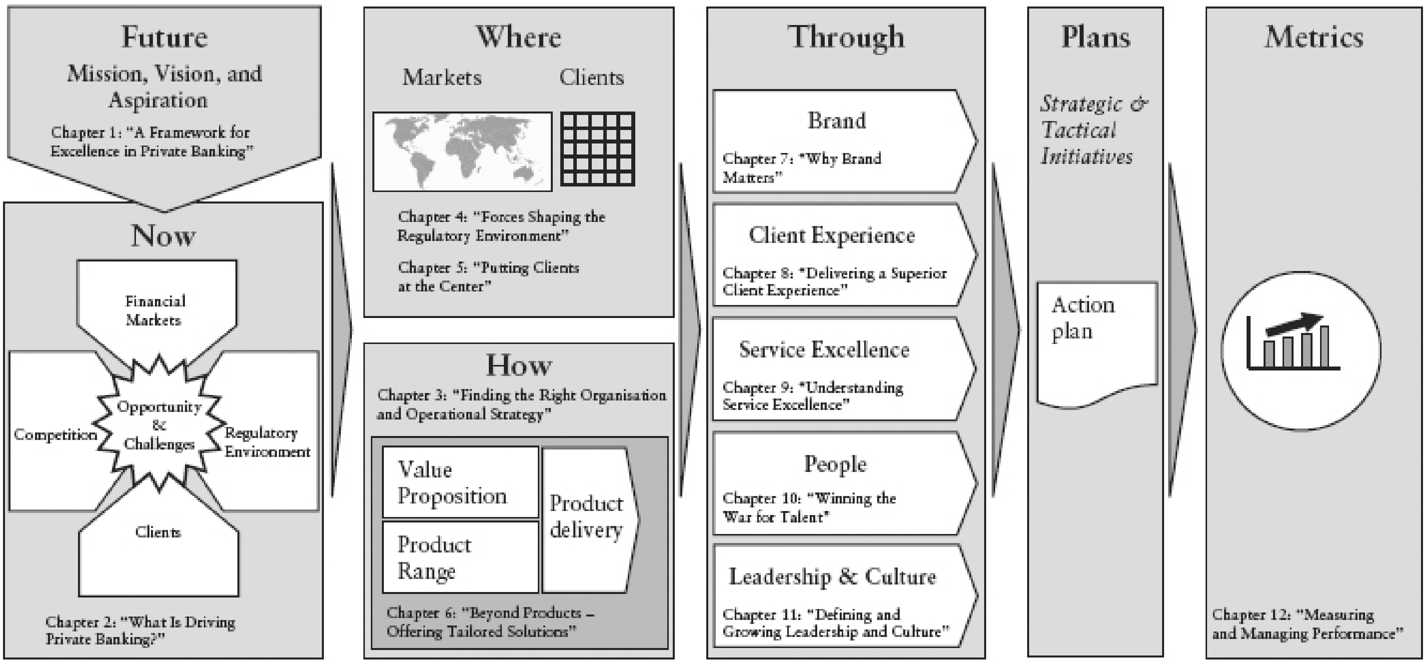
Is it possible to change systems and alter the incentive structure based on one single event or a particular insight? Rarely is this the case. Too often, institutions tend to stick with the paradigm that they have chosen and, furthermore, fail to communicate it or to inspire employees. Often, individuals are not even aware of the bigger picture and how they fit into it. People in banking generally know what is expected of them based on a job description and performance objectives. But sometimes they lack the understanding of how they, or their function, fit into the bigger picture, along with the bank's vision and the general direction the industry is taking. If a broader frame of reference is lacking, people have a more difficult time adjusting to the extreme fluctuations that may characterise private banking today. Achieving a "culture of excellence" in private banking isn't merely an exercise involving surveys to find ways to improve client satisfaction, or about putting pressure on employees to meet particular goals. It goes right to the basic foundations of the business. It requires redefining the concepts and terms that are often taken for granted. Then, and only then, is it possible to get to the point of asking how structures and processes can be improved to create value for all parties involved.

Before going into more detail about specific topics, it is worthwhile to lay out the framework of this book. The way in which the book is structured can also serve to develop a strategy for a private bank. This framework will look at the following questions: What makes a successful private bank? Which aspects are important? How do these fit together? How should important goals be achieved?

To successfully steer a company striving for excellence, and particularly a bank, the vision and mission statement offer vital direction, but it doesn't stop there. As outlined in Figure 1.1, there needs to be an honest appraisal of the business in its current state and how it really is performing. It also must ask tough questions regarding where and how it can best employ its resources, targeting which client groups and in which markets. Geography, the regulatory environment, and competition all play a role. In an ideal world, full data transparency would allow the market to be sliced and segmented so as to identify the most advantageous segments. In practice, knowledge of client behaviour is limited to the past, and the future is the realm of forecast and conjecture. Even the best strategy will be limited by what can be known. Running a bank therefore requires a mixture of managing and improving on what the bank already is doing, as well as transformational leadership, meaning venturing into new and unfamiliar territory. All of this requires measuring the performance on a regular basis to keep grounded. It's no use formulating high-flown mission statements that have no basis in reality.

FIGURE 1.1 The Seven Main Components for Achieving Excellence—An Outline for This Book

Source: Author



The framework shown in Figure 1.1 offers a schematic approach to the steps necessary to take a bank from a simple vision to really achieving its concrete goals. This is done through a process that, hopefully, will lead to excellence—by definition something that also requires defining strategy, honing it, and constantly seeking to either reaffirm it or, as necessary, to make adjustments. What is "excellence," and how can it be measured to know whether or not a bank is achieving it? To make it easy to understand the process that went into writing this book, the chapters are arranged in the same order as this overview: "future," "now," "where and how," "through," "plans," and finally, "metrics." These same elements correspond to the chapters, aiming to provide structure to a process that in practice is unlikely to be as neat as shown here. The chart represents an ideal to give guidance on the road to excellence. It does not rule out that there will be obstacles, detours, and unexpected bumps along the way.

The seven elements together define a strategy to achieve excellence. They can be further used to refine or to adjust an existing strategy or to guide a new business, an established one entering a new area, or, for example, one that aims to consolidate an existing business. The vision states how the bank would like to see the future. But first the current situation must be assessed, the now. Then management must decide where the bank wants to compete. This can include geographic regions or client segments that offer the most promising potential. Once that is accomplished, decisions must be made on how the bank will reach those markets and clients with a strong product range with a family of value propositions and excellent delivery. Then it must begin to implement that vision through its brand, people, performance management, and frontline processes. With the support of planning and information supplied by metrics, the process can be used on an ongoing basis to implement strategy, assess it, and alter it when needed.

VISION AND MISSION

The ideals and goals contained in the vision and mission statements take into account aspects of most chapters in this book. These are the inspirational elements that form the bedrock that defines a company's existence. Anyone who has worked in a corporate environment will be familiar with the concept of company vision and mission statements. Ideally, the vision gives a sense of the company's future aspirations. It gives a sense of purpose. Yet the reality often falls short of the ideal. Looking at existing vision and mission statements in all industries, no pattern emerges save for the fact that many companies want to be "number one," or "the best," or the "leading supplier." Nevertheless, while companies have used or abused the concepts of vision and mission statements, it is possible to create meaningful ones that confer tangible benefits. It helps to recall that the vision is about leadership and painting a picture of the future that should explain why a company wants to create something. A mission is about management—managing how the company will achieve that vision. The mission serves as the link that takes a company from its vision to setting and meeting concrete targets. A vision describes a better future without saying exactly how the company will get there. The mission turns the vision into a concrete endeavour.

PRESENT STATUS

Along the path to excellence, the "now" shown in Figure 1.1 represents the current state of affairs. Chapter 2, "What Is Driving Private Banking?," examines opportunities and challenges posed by the four main factors driving the industry. These include markets, the regulatory environment, clients, and competition. How these issues are dealt with and the success that individual banks have in facing changes in these major areas will be a determining factor in how they approach all the areas outlined here.

WHERE AND HOW?

To understand the "where" and "how" in the process, especially as it pertains to near-term developments, Chapter 3, "Finding the Right Organisation and Operational Strategy," takes a detailed look at how this aspect of the business is changing. Companies are reviewing their basic strategies, and in some cases, this is driving them to consider alterations to their business models. These might be "pure-play" private banks joined together with other businesses as part of a larger "universal" bank, or it could include larger organisations that choose to focus on individual parts of the business. Equally important in terms of such developments, Chapter 4, "Forces Shaping the Regulatory Environment, " provides an overview of the main changes that are key in terms of how banks can ensure that their business is transparent and meets stringent guidelines in terms of both local markets and international business. This is a major consideration when it comes to the discussion of where energy and resources should be deployed.

Chapter 5, "Putting Clients at the Centre," examines long-term trends that determine whom banks serve. Changes with regard to the client mix and client expectations are key factors driving the business, and they will continue to do so in the future. While it is possible to segment clients by wealth level, risk preference, or any number of other variables, in all cases each client has a right to expect a tailored, customised service suited to his or her personal goals. This is discussed in Chapter 6, "Beyond Products—Offering Tailored Solutions." Looking at how the changing market environment has affected clients' preferences for certain types of instruments along with changes in the regulatory environment that also affect both the way needs are addressed and the types of solutions offered, it is a foregone conclusion that products and services must be suited to individual clients. This requires tailoring solutions to ensure that these best match clients' needs.

PROCESSES, PEOPLE, AND PLANS

Allocating responsibilities allows goals to be achieved. But it is not the steps alone that are needed. There also has to be a way to give any story meaning by keeping in mind that all facets of this process are in some way intertwined. There are various ways that a bank can address the "thru" section of the path to excellence. A bank reaches its markets and clients through its brand. Especially in private banking, where brand is a relatively new focus, it is essential to understand what the brand stands for and how it can be reinforced. Chapter 7, "Why Brand Matters," looks at these aspects, while Chapter 8, "Delivering a Superior Client Experience," focuses on how clients perceive the bank, including by way of "touchpoints" that they encounter through advertising and by visiting the company premises. Chapter 9, "Understanding Service Excellence," explores the idea that everyone working in an organisation is a client, even of other employees within the organisation. Much of this involves "processes." Amid all the efforts to cultivate excellence, people, however, play the biggest role. Thus Chapter 10, "Winning the War for Talent," takes a popular industry phrase as its title to explain how escalating demand for staff, especially in fast-growing markets, is influencing the industry as a whole.

All these factors can contribute to an optimal result if they are viewed objectively. It requires planning to ensure that the processes and, more important, the people work together to achieve the goals. Chapter 11, "Defining and Growing Leadership and Culture," looks at how styles of leadership have evolved and how leadership can be encouraged, even in those who might consider themselves to be narrow specialists. Leaders must not only plan, but delegate. Planning is the art of turning goals into manageable steps.

METRICS

Every private banking "story" has a beginning, a middle, and an end. Very likely achieving goals in the quest to obtain excellence will prove that the process is self-perpetuating. To ensure that the bank is on track with regard to the strategy it has selected, targets are required. These need to be measured on a regular basis. Such targets can comprise key performance indicators (KPIs), for example. It is not necessary to measure 20 to 40 different parameters. A handful will do. They should be used to track developments in each region, market cluster, or organisational entity where the bank is active. At the management level, a relatively small number of KPIs tell the story. This is the focus of the final chapter of this book, Chapter 12, “Measuring and Managing Performance.”

CONCLUSION

This framework should serve as the unifying map to guide the reader through the different discussions in this book. By means of the steps outlined here, excellence gains a concrete dimension. It can be evaluated and analysed, and deficiencies can be addressed and strong points reinforced. Excellence then becomes more than just a word. It is something that can be strived for and, with effort, achieved. Without any plan, even the most inspiring vision will lead nowhere. Planning is the art of turning goals into manageable steps. By following a clear path and with a great deal of hard work, the desired aims can be achieved. The following chapters offer some insights into this process.

Chapter 2

What Is Driving Private Banking?

There are numerous forces at work shaping the private banking industry. Market volatility following the financial crisis of 2008 has led to a demand for simpler, more transparent types of investments among clients. Regulatory matters are also affecting the business. Concerns about the safety and soundness of banks have increased the pressure for stricter regulations to protect clients and to ensure that banks are adequately capitalised. As for clients, growth in nontraditional markets along with a shift taking place as a new generation takes over wealth planning also have affected how the business develops.

Competition, too, is undergoing change. Today’s competitor is no longer interested only in clients but also in securing the necessary talent to serve these clients in a market in which demand for relationship managers has increased. Where capital is concerned, banks that can demonstrate that they are able to exceed regulatory minimum requirements are at an advantage. Those that lack capital or the size necessary to compete in new markets are likely to join a wave of consolidation already underway in the industry.

How these forces together are shaping the industry makes private banking both exciting and challenging. The clock cannot be turned back. Private banks must accept that the world is changing and must seek to adapt. This chapter explores the issues that are critical for an understanding of how the industry will evolve in the future and to answering the questions that must be addressed to succeed in this new environment.

AN INDUSTRY IN THE MIDST OF CHANGE

Private banks are among the few service providers just as relevant to clients now as they were decades or even a century ago. In today’s dynamic marketplace, changes on numerous fronts are profoundly affecting how these banks approach their business. To take advantage of opportunities and anticipate risks, it is becoming increasingly important to assess the forces shaping the industry. This is done to get a clear idea of what lies ahead and which areas might offer the best avenues for growth. Due to its global nature, private banking is influenced by developments all over the world, in virtually every market and in real time. Today, it is no longer enough to wait for events and then respond to them. It is vital to understand the trends sweeping through the industry. Numerous factors come into play. The rising level of wealth in emerging markets has altered the client mix, making the business more interesting and varied. At the same time, it adds a new layer of complexity. Intense competition in some markets is challenging both new and established players. The financial crisis has led to a host of initiatives aimed at reducing risks, adding to an already intricate set of rules and regulations. Meanwhile, governments, concerned about undisclosed assets, are stepping up pressure on private banks to divulge information on assets that are held cross-border.

Although the private banking business model and geographic focus might undergo occasional changes, the central focus of the business remains the same. Its main goal continues to be to ensure that the wealth of clients is preserved, not just for a few quarters but for generations, providing growth on a sustainable basis without jeopardising assets. Delivering a high standard of service in a sustainable way, meeting and trying to exceed client expectations, maintaining their privacy, serving them with integrity, and deserving their trust remain the raisons d’être of any private bank. Due to the internal and external forces affecting the industry, private banks must make choices and take decisions now that will have a far-reaching impact for years to come in order to best serve new and existing clients. The speed at which events unfold today along with the implications that developments may have means that any actions must be carefully weighed. It is important to plan and to act when necessary, rather than face an uncertain future.

A note here is in order regarding the term "private banking." Traditionally private banking was viewed as a sub-service of wealth management, a category that could include many other types of businesses. Today, however, private banking is often used as a term interchangeable with wealth management. Unless a clear distinction is made, this book uses both of these terms to describe the activity of managing the wealth of high-net-worth individuals.

The next section of this chapter looks at the key forces having the greatest impact on how private banking is developing from a business perspective. The four drivers—markets, regulatory environment, clients, and competition—are the main forces that are shaping the industry today and most likely will be for years to come. To gain a better understanding of what these factors are and their potential impact, this chapter touches on many of the main themes that are explored in greater detail elsewhere in this book.

Swiss Industry, International Perspective

Switzerland has a long history as a financial centre. The country's financial industry[a] accounts for 10.7 percent of the GDP and employs in total nearly 246,000 people both within and outside of Switzerland. The financial centre pays each year an estimated 14 billion to 18 billion Swiss francs in taxes, equal to 12 to 15 percent of total tax revenue.(1) Swiss private banking enjoys a reputation unparalleled in terms of quality and client discretion. The country's modern and efficient infrastructure, educated population, sound currency, and stable government all contribute to its attractions as a banking centre. The Swiss law governing banking secrecy, adopted in 1934, though subject to much debate over the years, has certainly played a role as well.

Switzerland, with a population of about 7.8 million people, roughly equal to that of Greater London, provides only a small home market. The strong growth of private wealth during the 1990s led many Swiss and foreign banks, especially larger players, to expand their private banking operations on an international basis, both onshore and offshore.[b] Where the larger Swiss banks are concerned, this means going to where their customers are, including both Europe and some rapidly growing emerging markets.

Changes in the regulatory environment at home and expanding wealth in emerging markets are factors that are leading Swiss banks to rapidly expand their international presence, especially in Asia. A survey conducted by the University of St. Gallen found that no less than 63 percent of Swiss banking CEOs believed that having an international presence would be "important" or "very important" for private banks in the future. Furthermore, nearly two-thirds of CEOs "effectively believe that banks that increase their international presence meet a precondition for future success in private banking."(2)

Evolution of the Business Model

Providing personalised money management and advisory services to wealthy individuals or families is what a private bank does. But defining what a private bank is, in terms of its business model, is more difficult. Today there is a diverse set of models under which private banking services are offered. In Switzerland, the classic definition of a "private bank" is one in which its owners are partners who share unlimited liability. This type of structure has become increasingly rare over the years. In 2010 there were just 12 such private banks in Switzerland matching this description.[c] The classic private banking model aims to provide integrated services, meaning offering only products developed by the bank itself. Such an approach encompasses all parts of the value chain (production and delivery).

A key reason for taking this approach has been privacy. In other words, private banks saw a risk in having client information handled by outside parties. Beyond that, it was considered "a sign of weakness" if external products were employed, according to a study published by Hans Geiger, a professor of banking at the University of Zurich, and Harry Hürzeler, managing director of the Swiss Banking School.(3) Things have changed, however. One reason is that clients' needs have become more complex and sophisticated. This affects their requirements regarding financial expertise, taxation, and legal compliance. The range of product offerings and services likewise demands increasingly specialised know-how. A model whereby a single private bank offers the best possible solutions in all categories is growing less feasible. In fact, today third-party products and services are a sign of strength, in that they give clients what truly represents the top of the range in terms of quality.

This is leading to a business model that more often is characterised by different forms and various types of ownership. A private bank today might be owned by partners in the traditional sense, or it might just as easily be part of another, larger publicly traded financial group. Such an institution may offer private banking as its sole dedicated service, as a so-called pure-play private bank. Alternatively, private banking may be one of a number of multiple services offered to clients on an integrated basis, alongside asset management, investment banking, and retail services. In Switzerland, private banking can also be offered by regional banks in which the Swiss cantons hold a majority stake, serving both retail and wealthy clients. To add to the complexity, private banking services even might be by "non-banks" or companies having their core competencies in different fields, such as independent asset managers or insurers. Thus, while there may be only a few independent private banks in the traditional sense, the private banking industry in the broader sense has grown tremendously in size and scale, reflecting its attractiveness as a business, along with the increase in the level of overall wealth, which has drawn a variety of companies to this industry.

Global Financial Centres

As part of their activities, most private banks engage in cross-border business. Offshore wealth management comprises a significant share of global wealth. According to the Boston Consulting Group, the offshore component was estimated to amount to some €6.57 trillion in 2010, increasing from €6.32 trillion in 2009.(4) However, that study noted that the proportion of global wealth held offshore slipped to 6.4 percent, down from 6.6 percent in 2009. This was attributed partly to growth in markets such as China, where the offshore wealth business is less common, as well as to stricter regulations in Europe and North America, which prompted outflows from offshore assets. While onshore wealth management is a major business, it attracts little public attention compared with offshore wealth management. Offshore banking is often associated in the public's mind with money that has not been declared to tax authorities. It is often presumed by the public to be money belonging to criminals and dictators or other "politically exposed persons" (PEPs). This may have been one of the original motivations for depositing money in offshore bank account. Yet other legitimate reasons exist for holding funds offshore—assets that are fully declared to local tax authorities. Such assets might belong to an entrepreneur concerned about political stability and financial risk in his or her home country. Worries about capital controls, concerns about soaring inflation, or currency devaluations might all lead private clients to keep money in an offshore account. It is worth noting that, independent of why wealth might be held offshore, the distinction between "offshore" and "onshore" refers simply to where the money is booked. And due to mounting pressure from regulators, tax amnesties, and agreements hammered out between governments to force citizens to report foreign assets, it is becoming increasingly likely that money will be kept in such accounts only if it is declared.

In terms of offshore wealth, Switzerland is a global leader. The Boston Consulting Group has ranked it as the world's largest offshore centre. In 2010, banks in the country managed an estimated €1.77 trillion in offshore client assets, representing 27 percent of all global offshore wealth held in accounts. This was followed by the UK, the Channel Islands, and Ireland, with a combined €1.60 trillion in offshore assets for a share of 24 percent.

The globalisation of wealth, together with changing demographics and increasing regulatory pressure, are encouraging a rise in nontraditional centres. This is reflected in the growing dominance of Singapore and Hong Kong as major financial hubs.

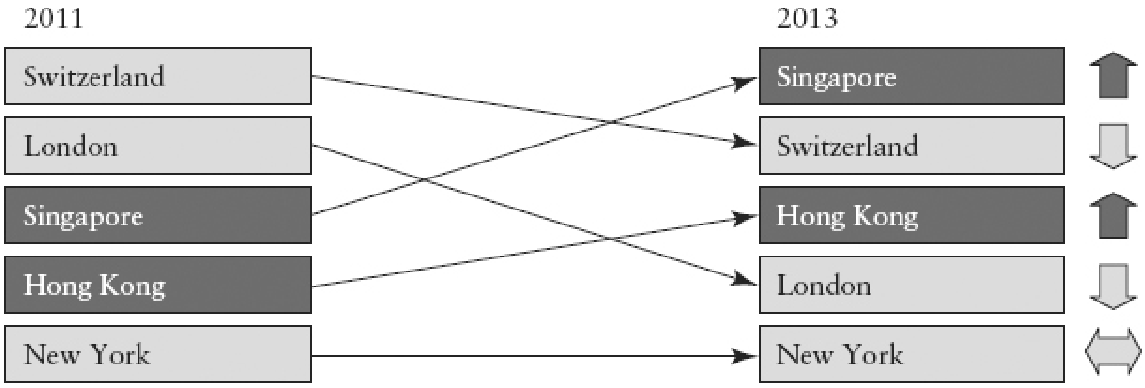
In recent years, Singapore's role as a major private banking centre has grown tremendously. According to a study published by TCP The Consulting Partnership AG based in Zurich, the total volume of offshore assets managed in Singapore was in excess of €421.09 billion.(5) Singapore has long aspired to be "the Switzerland of Asia," and in that sense it has become the uncontested leader, due to its modern regulatory environment, stable economy, a friendly and stable government, and an outstanding infrastructure.

According to the Global Private Banking and Wealth Management Survey 2011 by PricewaterhouseCoopers International (PwC), Singapore could very well become the leading international wealth management centre worldwide by 2013, surpassing both Switzerland and London (see Figure 2.1).

FIGURE 2.1 The Center of Gravity for Wealth Management Is Shifting

Source: PricewaterhouseCoopers International Limited. June 2011. "Anticipating a New Age in Wealth Management." PwC Global Private Banking and Wealth Management Survey 2011

Given increased regulatory pressures on offshore centres, which do you believe are currently the top five international financial centres that are the most successful now and will be in the next two years?



In addition, competition is intense. While Singapore and Hong Kong pose a genuine challenge to established centres and offer a wealth of opportunities, the costs to enter these markets are high and rising. This goes not only for hiring relationship managers (RMs), front office managers, and product specialists, but increasingly also for legal, compliance, and risk specialists as well, according to PwC.

Wealth Management in Transition

The 2008 financial crisis changed the banking industry. For one thing, clients have grown far less willing to put faith in markets, or, in many cases, the wealth management industry. Regulators meanwhile must reassess risks to financial institutions, especially those considered "too big to fail." Banks need to pay strict attention to regulatory regimes that will play a major role in determining how business develops. New wealth being created in emerging markets increases the resources that must be devoted to legal and compliance knowhow, infrastructure, and technology of a bank along with acquiring local experience. At the same time, taxpayers in many countries who were already under scrutiny before the crisis now face mounting pressure to declare their assets held abroad to tax authorities. Governments are putting pressure on banks to divulge information about foreign clients.[d] The slowdown in industrialised economies in the wake of the financial crisis serves to highlight the importance of new financial centres in emerging markets, leading banks to look increasingly to these regions for business. In terms of banking, such growth provides a catalyst, leading the industry down new paths in terms of regions and clients.

THE FOUR KEY DRIVERS

As mentioned, the main forces shaping the private banking industry can be viewed in terms of four main drivers: markets, regulatory environment, clients, and competition. Examining each of these in turn will help provide a better understanding of where the greatest opportunities (and risks) lie and how a bank might best deploy its resources. The order in which these four are discussed in this chapter should not be taken as any indication of their relative importance.

Markets

Banking is a business whose cycles track fluctuations in financial markets. A private bank's earnings are closely correlated with client assets, because a large proportion of the fees and resulting revenues are based on the assets under management. If the market drops significantly, reducing the value of client assets, this also might in some cases cause clients to be more concerned about the company managing their wealth, leading them to question the advice they have received. They are thus more prone to switch banks in periods of market distress than they would be when markets are steadily trending upward.

The problems that destroyed wealth in 2007–2008 were partly due to a failure within the financial system, making investors more prone to question the banking industry's safety and soundness. In addition, an increase in new types of financial firms further complicated matters. Traditionally, money has circulated in the system between savers, borrowers, and banks. However, the rise of specialist non-bank financial intermediaries ("shadow banks") over the years facilitated a complicated series of transactions outside normal channels, in which credits were created, sold, and funded by a number of different participants. Instruments designed to work well in liquid markets can come under pressure if one link in the chain breaks. As a worst-case scenario, the whole system can be compromised.

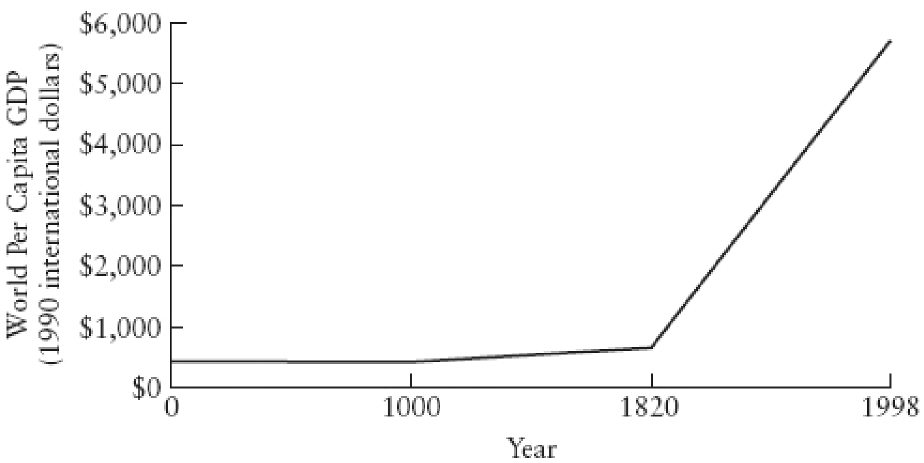
Risks are increased by the staggering volumes at stake: credit "intermediated" by the US shadow banking system was close to €16.84 trillion on the eve of the financial crisis, nearly double the volume of credit provided by the traditional banking system, according to the US Federal Reserve.(6) Other estimates by the Financial Stability Board, an international body whose members include central banks of countries of the world's major economies, found that on a global basis the figure pertaining to shadow banking is equal today to about €42.95 trillion, roughly the same as what it was at its peak before the financial crisis.(7) Not only did the system fail, but some supposedly "fail-safe" instruments did so as well. Little wonder that investors today have become skittish. The popularity of some higher-yielding investments was partly tied to a desire for higher returns during a period when bond yields were extremely low. In such markets, investors pay scant attention to risk.

Investors' attitudes have become increasingly subject to extremes, ruled by emotions that are closely related to the market. However, one study has suggested that people who approach financial decision making unemotionally do better than those whose emotions are involved.(8) Clients should take a long-term view instead of making investment decisions based on "shorter-term" (one- to three-years) trends in markets. Investment objectives should be aligned with clients' long-term goals and risk tolerance, factors that will be discussed in greater detail further on in this book.

Taking a longer-term view in investing can make sense. Figure 2.2 illustrates that over the long run, world per capita GDP has tended to expand, generating added value, which should be reflected in efficient financial markets over the long term and result in an increase in global wealth. While there may be no exact correlation between the day-to-day performance in stock prices and the underlying growth in the economy, functioning financial markets provide liquidity and allow private investment, resulting in wealth appreciation.

FIGURE 2.2 A Long-Term View of Wealth Creation: World per Capita GDP

Source: Maddison, A. (2006), "The World Economy: Volume 1: A Millennial Perspective," and "Volume 2: Historical Statistics." Development Centre Studies, OECD Publishing. http://dx.doi.org/10.1787/9789264022621-en



Still, based on a short-term perspective, markets tend to present a picture of unnerving volatility, alternating between sharp upswings and severe drops. For investors exposed to these violent swings, their emotional response is often either to jump in when asset prices are peaking, due to fear of missing an opportunity, or to sell at lows, worrying that they will have to book large losses. In both cases, this could lead investors to take risks that do not match their long-term risk tolerance. It is thus up to the relationship manager to stay close to clients and guide them through the advisory and investment processes. This allows the clients to achieve long-term goals without succumbing either to panic by becoming overly bearish when markets fall or to excessive exuberance when markets rise.

Taking the long-term view is important, nowhere more than in investing. There is bound to be another bubble that likely will be followed by the next crash. It is hard to predict in terms of timing, but it's a virtual certainty. No matter how much regulation is applied, risk will be part of the system. Volatility has increased partly due to technology, giving rise to phenomena like the "flash crash" in May 2010. With volatility a given, there is an even greater need to focus on longer-term goals.

Evolving Regulatory Landscape

Regulatory aspects are crucial. One area of concern relates to the level of capital banks need to safeguard against risks. Fears about the potential for the collapse of a major bank have led regulators to focus their attention on mitigating the chances that a financial institution might fail in the future, possibly jeopardising the entire system.

The other key aspect is compliance. Governments in many developed nations, facing large budget deficits, have intensified their efforts to collect taxes on assets held by wealthy citizens abroad. These developments have major implications for private banks and the industry as a whole. How the issues are resolved will significantly affect the business.

Capital Adequacy

New rules to ensure that banks have enough capital are having an impact on the entire banking industry. Private banks are usually over-capitalised, in that their business focuses on managing private wealth assets rather than on more capital-intensive activities such as lending or trading. However, the discussions about risks have sensitised clients, particularly those of private banks, making them more aware of the importance of a sound balance sheet.

International rules governing the level of capital needed by individual banks were first drawn up by the Basel Committee on Banking Supervision in Basel, Switzerland during the 1980s. These were based on relatively simple formulas to safeguard against risks. The first Basel Accord's familiar formula of capital equal to 8 percent of "risk-weighted" assets was lauded for its simplicity but was deemed insufficient, and Basel II ensued, followed by Basel III. This updated version is to be phased in starting in 2013. It is scheduled to come into full force by 2019. As part of these changes, the world's largest banks will need to set aside extra capital. The so-called Swiss finish applied to the biggest Swiss banks is expected to call for these to hold more capital as well. It is not surprising that particular attention is being paid to such risks, given the enormous scale of Switzerland's banking industry relative to the country's size.

Tax Reporting and Disclosure

Sharing information on taxable assets with foreign authorities remains a central part of the discussions. For example, the European Union aims to have an automatic exchange of information system whereas separate bilateral agreements reached but not yet ratified between Switzerland and the UK, Austria and Germany are foreseeing an "equivalent" framework while still granting a certain level of privacy protection to the client. Outside of the European Union, the US Internal Revenue Service (IRS) has been active in seeking to increase pressure on foreign banks. The IRS established the Qualified Intermediary (QI) programme in 2000, followed by the US Congress's adoption of the Foreign Account Tax Compliance Act (FATCA) in 2010. Both measures aim to enlist foreign financial institutions to gain information on accounts held abroad. For further information on these subjects, refer to Chapter 4, "Forces Shaping the Regulatory Environment."

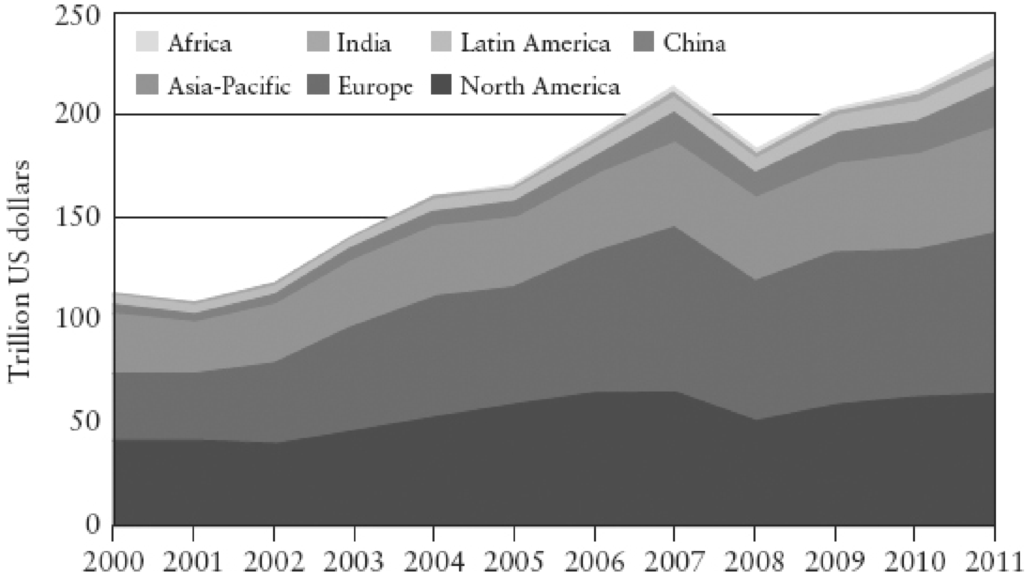
Private banking as a major industry has not just shaped Switzerland, but to a degree it has determined how Switzerland is perceived outside the country. Due to its bank secrecy law, the country has come under pressure from national authorities, as well as international bodies such as the OECD. The Swiss government agreed in 2009 to adopt the OECD "Model Tax Convention," which provides a basis for bilateral tax treaties among the organisation's member countries. Article 26 of the OECD guidelines stipulates that member states must provide information with regard to "taxes of every kind and description." Switzerland has negotiated or is in the process of finalising new double-taxation agreements with many countries based on these guidelines.

A Changing Client Profile

The pool of clients or potential clients, along with the wealth that can be managed for them, has expanded enormously in recent years. According to a study by Credit Suisse, the total wealth of all people in the world amounted to €194.55 trillion at the end of 2010 (see Figure 2.3). Total world wealth is expected to increase by 50 percent to €290.56 trillion by the end of 2016, based on the report published by the Credit Suisse Research Institute. (9)

FIGURE 2.3 Total Global Wealth Held by All Individuals in All Income Ranges (2000–2011)

Source: Credit Suisse Research Institute, Global Wealth Report 2011, October 2011



Given this rapid growth, banks must take into account the changing client profile and consider how this is affecting their business. A client of a private bank, often termed a "high-net-worth individual" (HNWI), typically has at least €0.84 million in assets. Based on this definition, the number of wealthy households is rising not only worldwide but especially in emerging markets, leading to what some commentators have referred to as a "tectonic shift" in global wealth distribution.(10)

The Rise of Emerging Market Wealth

Growth in emerging markets has outpaced that of developed countries, and wealth in these regions is being created as a result. China has overtaken Japan as the world's second-largest economy. Other countries also are well placed to grow, including India with its enormous population of young people. Wealth has expanded in the economy of Russia and in the economies of countries in the Middle East, Latin America, and Africa, also supported by rising global demand for commodities. Moreover, emerging economies are also drawing more investments and further fueling wealth generation. In 2010, for the first time since records have been kept, developing and transitional economies absorbed more than half of global foreign direct investment flows, according to the United Nations Conference on Trade and Development (UNCTAD).(11)

A changing mix of clients is influencing how these individuals approach management of their wealth. In the past, private banking clients typically were from established European and American families where wealth is passed on over generations. They tended to be more passive regarding their assets than an entrepreneur, for example, who has made money starting a business and prefers to be more actively involved in investment decisions. The service offering must be adjusted to meet the specific needs of new client groups. Many clients from developing economies are business owners who are still in the wealth-generation phase and need more integrated services that combine traditional wealth management with corporate finance or credit capabilities, (which a bank may provide either as an in-house offering or through co-operations with dedicated third-party providers). Private banks must also develop a deeper understanding of local investment opportunities to accommodate the growing demand for wealth to be invested domestically.

Generational Shift

As the baby boom generation retires, a new, younger group of clients has come to the fore. It is not uncommon for these clients to have gone to business school and to be acquainted with financial market theory. Clients tend to be getting younger; in 2010, 17 percent of the world's HNWIs were 45 or younger, increasing from 13 percent two years previously, while in the Asia–Pacific region (excluding Japan), fully 41 percent are 45 or younger, based on an annual survey published by Capgemini Merrill Lynch.(12) These clients tend to be more demanding. Transfer of wealth from generation to generation also is making succession planning a key issue. The younger generation not only is getting involved earlier than might have been the case with their parents, but may also have a more sophisticated knowledge of financial markets. Therefore, it is vital to bond with young clients as early as possible.

Competition and Growth

Clients need solutions that are tailored to ensure that their money is managed in accordance with country-specific law and regulations and in a tax-efficient manner, according to how securities and other assets are treated in each relevant jurisdiction. By offering expertise in this area, banks can position themselves vis-à-vis competitors. It is not just products that make a difference; increasingly, it is the advisory role that sets them apart. For example, income and capital gains often are treated differently from one jurisdiction to another. The country or countries involved and the period over which securities are held, as well as the client's specific situation and objectives all have significant implications on the suitability of an investment.

The financial market crisis raised worries about the safety of individual banks. Clients want reassurance that a bank is sound. As mentioned, after the financial crisis threatened to or in fact did topple some banks, clients wanted the assurance that their assets were not at risk. Clients now pay closer attention to key performance indicators including, for example, the loan-to-deposit ratio and risk-weighted capital (i.e., core or "tier 1" capital as spelled out by the Basel rules). Having a solid balance sheet today is an important positioning element vis-à-vis competitors. Clients today are paying closer attention to such metrics, and these can have a significant impact on how a bank might be viewed relative to its peers.

Tougher laws and increasing complexity of regulations have placed a bigger burden on banks' administrative activities and have led to a greater portion of resources being spent on compliance. Increasing costs have put pressure on margins. This is driving consolidation within the industry. Rising costs are forcing banks to carefully choose the specific markets they target. Rather than entering multiple new markets, they must think about increasing economies of scale in specific markets. Growth brings benefits, but with it comes the danger of so-called reputational risk; as a bank expands, it might lose oversight of problems than can crop up in a division or region. Where competition is concerned, strong brand management and the ability to consistently deliver on the promises of the brand and the service offering are essential. Doing this will help to attract key talent, ensuring that the bank will be competitive in the future and can continue to position itself as a premium player in a market where only the best-positioned companies will succeed. Banks, especially private banks, need to keep risk functions centralised, and management plays a key role in safeguarding the bank's reputation and brand. It is also in a bank's interest to avoid dilution either to the brand or the service offering. Periods of expansion must be managed carefully.

CONCLUSION

Private banks face numerous challenges. Not adapting to the forces shaping the industry will only make the way ahead more difficult. Instead, banks must acknowledge changes and find ways to best structure their business, making choices that will affect the business well into the future. The four key drivers—markets, regulatory environment, clients, and competition—each have major implications for how the industry will develop. Those who understand and manage to master these forces and the related changes can look ahead with confidence. The same challenges that banks must confront also offer them the chance to succeed. The opportunities are there. Taking an active role in this business will prove to be rewarding, fascinating, and enormously interesting. Private banking does indeed have a great future.

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aThe financial industry comprises both the banking sector (retail banking, wealth management, asset management, investment banking) and the insurance sector.

bOffshore clients are individuals who deposit their money in a bank outside of their home country. Onshore refers to those whose money is booked in their home country.

cThe Swiss Private Bankers Association lists the following 12 "unlimited liability" banks as members: Baumann & Cie, Bordier & Cie, E. Gutzwiller & Cie, Gonet & Cie, Landolt & Cie, La Roche & Co Banquiers, Lombard Odier & Cie, Mirabaud & Cie, Mourgue d'Algue & Cie, Pictet & Cie, Rahn & Bodmer Co., Reichmuth & Co.

dAccording to an OECD study on high-net-worth individuals published in 2008, the wealthiest taxpayers accounted for a significant portion of total income tax. In Germany, for example, the top 0.1 percent of taxpayers contributed about 8 percent of total income tax, and the top 5 percent of taxpayers about 40 percent. In the United States, the top 5 percent paid 60 percent of total income tax. The relative percentages in other OECD countries are likely to be of a similar magnitude. Significant resources are allocated to this segment, not because wealthy taxpayers are necessarily less compliant in their tax affairs but rather because of various factors, including the large amounts of tax at stake, the wealth and increasing number of high-net-worth individuals (HNWIs), the complexity of their situation, their access to sophisticated tax products, and the potential impact of their noncompliance on the community, the OECD said.

Chapter 3

Finding the Right Organisation and Operational Strategy

A company that focuses on a single area of expertise is likely to be better at it than a company that divides its efforts among many different types of business. A standalone private bank is probably the best model in today's business environment. A group that has private banking as just one focus among many others tends to be more complex; dealing with complexity takes time away from the most important activity in private banking—serving clients. It is possible to outsource some tasks to different providers, such as delivering specific types of products. At the same time, it is not possible to outsource all the main parts of the business. This is neither practical nor desirable.

To maintain quality, banks must be able to control all parts of the value chain, including the interfaces to external parties. These considerations form the basis for the discussion in this chapter.

ORGANISATIONAL FORMS AND TRENDS

The problems in the financial system that culminated in the collapse of some long-established banks and the near-collapse of many others in 2008 resulted in more than just monetary losses. For some banks, it marked the end of an era in which the prevailing mindset was often one of "bigger means better." To its proponents, the benefits seemed obvious: take different business operations, such as investment banking, institutional asset management, private wealth management, and retail banking and combine them into one big, complex financial juggernaut that would produce "synergies." Few companies that pursued this model have found as concise words to describe the opposite and ensuing problems that arose as financial markets unravelled during the bleakest weeks of the crisis. The losses these institutions sustained, not to mention the client defections that occurred, are evidence that there is no guaranteed safety in combining different businesses to create an enormous financial superpower. Even in good times, when too many dissimilar activities exist under one roof, inefficiencies result. In bad times, losses can escalate, as the "too big to fail" rescue of such institutions demonstrates. Government policymakers are rethinking the risks of having such behemoths in their home countries. Because wealth management generally provides a steady stream of revenue, often operating with a substantial capital cushion, it is a welcome addition to the larger group. For the private bank, however, the arrangement can turn out to be less than ideal. A private bank that is profitable in its own right can suffer collateral damage if another business within the group is hit with losses. And of course, private clients might rightly wonder if they are best served by a bank embedded in a larger, complex organisation.

Proponents of the "integrated" model argue that running many different activities within a single organisation produces benefits both for clients and the bank's shareholders. Universal banks in the past have sought to convince investors that gaining exposure to many different markets and businesses would stabilise and enhance returns. Until the crisis in 2008, it was understood that an investment bank needed to belong, or at least compete with "bulge bracket" firms that rank among the global leaders in areas such as mergers and acquisitions, equity and debt issuance, syndicated loans, and the like. This type of business combined, for example, with retail banking, asset management—and wealth management—was supposed to offer stability and growth from interactions between the different activities. But having many irons in the fire was not always as beneficial as some believed. In theory, one part of the bank was supposed to provide a buffer to offset problems in another (very often with the private banking serving as the "stabiliser"). Instead, it might happen that problems in one area would tarnish the reputation of the sound businesses. The downside risks became clear in 2008, when the crisis affected some of the world's biggest and best-known institutions, leading private clients in many cases to shun these banks or to withdraw wealth. Since then, financial companies have begun to reexamine the idea of whether it is sensible or even feasible to strive to cover a vast range of different businesses. Those favouring a clear separation, with a strong focus on just one area, can make a case—even more so perhaps after 2008—that being a provider of every service to nearly every client carries too many risks. In the end, a bank's main consideration should be what business or businesses it wants to engage in. The considerations involved in this decision are the topic of this chapter.

The strategy a bank chooses must take into account client expectations, developments in financial markets, a new, more stringent regulatory environment, and the landscape for product and service offerings. For private banks specifically, when a strategy has been established, it is necessary to determine which structure is best suited to the core value proposition—namely serving clients' needs and help them to achieve their goals. How is this to be achieved?

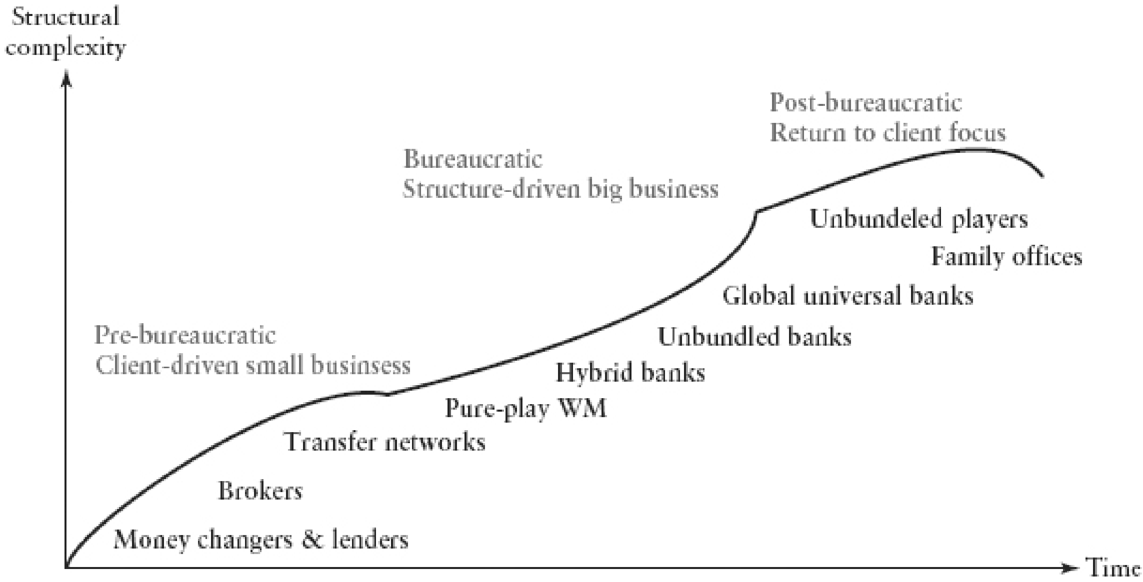
PRIVATE BANKING STRUCTURES

The current private banking landscape in Switzerland is the result of an evolution that began over two centuries ago. The oldest surviving Swiss private bank, Wegelin & Co. was established in 1741*. At the end of World War II, there were dozens of private banks in Switzerland whose business matched the formal definition of a private bank—one that is owned by partners, with at least one partner having unlimited liability for the bank's commitments. Today many different types of banks are grouped under the general classification of "wealth manager" or "private bank," while the number of those matching the narrower definition has dwindled to just 12 institutions as a result of mergers, sales, or adopting different business structures. Acquirers of private banks were often larger universal banks, which purchased these with the aim of expanding in a lucrative, high-margin business. In addition, banks better known for their retail offerings also tried to increase their wealth management activities by appealing to wealthy clients and those in the upper tier of the growing affluent sector. Technology also has enabled wealthy individuals, typically those with investable assets of at least €84.22 million or more, to set up their own family offices.

For banking as a whole, Figure 3.1 represents how the model has evolved: "pre-bureaucratic" describes a rather simple, less specialised type of operation. Moneychangers, brokers, and money transfer networks are considered pre-bureaucratic. Organisations in this category tend to be small enough to be run in a simple, straightforward manner. The founder is usually involved in the everyday details, including most, if not all significant decisions. These tend to have a flat hierarchy and lack standardised processes. They might be small operations run with just a few people. Such types of businesses have been around since antiquity and some of them still survive today.

FIGURE 3.1 The Three Waves of Organisational Evolution

Source: Author



“Bureaucratic” organisations offer a greater number of products and services. The structure clearly starts to differentiate between various activities within the business. Standard routines governing processes are common. Leadership and reporting structures, discussed in Chapter 11, “Defining and Growing Leadership and Culture,” are more developed. There is a need to manage increasingly large numbers of people, products, and services. This approach can generate efficiencies by organising people into groups dedicated to specific tasks and goals. If care is not taken, however, it can give rise to silo mentalities and intensify friction arising from internal politics, reducing efficiency. Organisational inertia may ensue. This type of organisation is the prevailing one in banks. But with the advent of increasingly bigger banks, incorporating many different activities, the business model has grown increasingly complex. The financial crisis exposed the weaknesses of this structure, where complexity can overwhelm even skilled managers. When a structure becomes too entrenched, hierarchies too codified, and rules too complicated, inefficiencies arise. Thus, a highly bureaucratic organisation defeats the purpose for which it was designed—to increase efficiency and reduce costs. In the interim, some banks have started to simplify their organisations to focus on fewer areas, concentrating instead on niches and/or core competencies.

Flatter hierarchies and more direct decision making are typical of the “post-bureaucratic” organisation, characterised by its focus on a core activity. In such a company, visionaries recognise opportunities based on new trends and technologies. This leads to more flexible and client-centred organisations. A post-bureaucratic structure can be seen as an antidote to the top-heavy structures that impede internal change and make it difficult to focus on the core business.

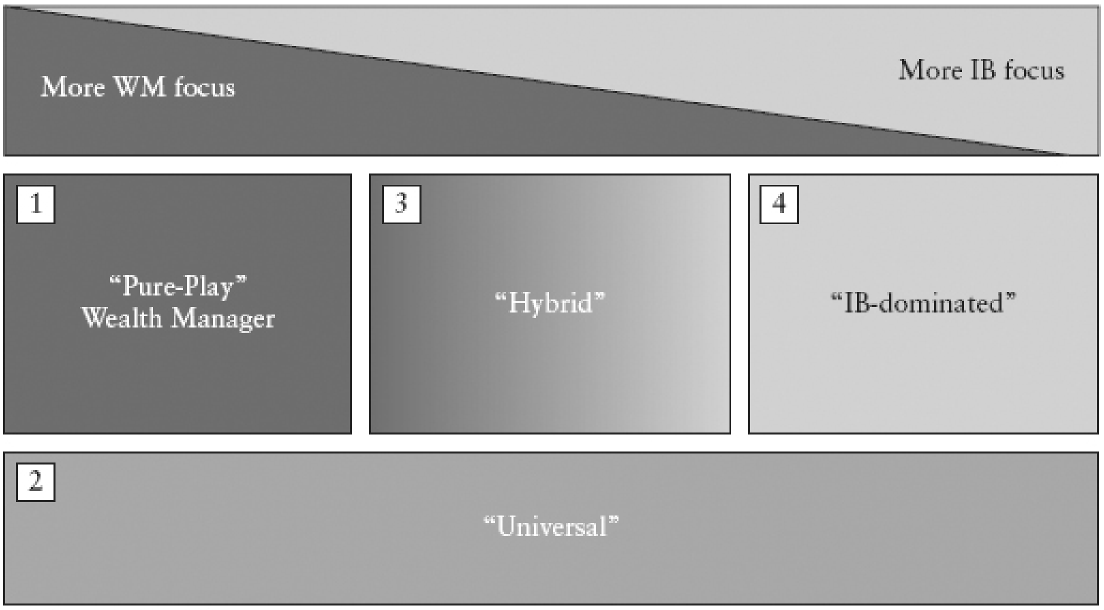
Devoting more attention to core competencies is understandable, especially after the problems encountered during the 2008 financial crisis. Not only were some businesses too complex and inflexible, they needed capital. In the interim, some banks got bailouts from public authorities. Many that experienced problems were also forced to sell non-core businesses, including wealth management businesses. This trend created a window of opportunity for private banks to buy client assets at reasonable prices.

Organisational Structures

Management consultancy Oliver Wyman identified the four most common banking models that incorporate wealth management within their overall structure.(1) As shown in Figure 3.2, pure-play wealth managers are those that focus on a single business: wealth management. Banks of this type include private banks such as Julius Baer, Sarasin, and EFG International. Universal banks, the second category, are active in many different businesses. Some examples include BNP Paribas, HSBC, and RBS. Banks classed as hybrids make up the third category. Hybrid banks are similar to universal banks but lack their extensive international retail networks. UBS, Credit Suisse, Deutsche Bank, and Merrill Lynch (which was sold to Bank of America in 2008) belong to this category. The final group is made up of institutions dominated by investment banking. Two such firms, Lehman Brothers and Bear Stearns, failed in 2008. The other two remaining major US investment banks, Goldman Sachs and Morgan Stanley, changed their status to bank holding companies during the crisis.

FIGURE 3.2 Organisational Models of Wealth Managers

Source: Oliver Wyman, “The Future of Private Banking: A Wealth of Opportunity?” 2008



WM = Wealth Management
IB = Investment Banking

Another way to look at the different operational models is to focus solely on how the wealth management business is positioned within the larger group. It might be that the private bank or wealth management unit operates independently, sharing only the brand. Or the wealth management unit could be part of a retail bank or be integrated into a corporate or investment bank alongside the corporate finance and asset management units. It might also be a unit run alongside, but distinctly separate from the retail bank.

Apart from internal factors influencing the changes shaping the banking industry, external factors including increased regulation are affecting it from the outside. Banks are subject to increasing scrutiny. Pressure is being brought to bear, especially on the banks deemed "too big to fail." Because they possess assets that might be greater than their home country's annual GDP, the failure of one of these could severely strain the financial resources of an entire nation. Based on the different types of structures just discussed, the pure-play private bank has some advantages in this regard over institutions with multiple businesses due to its clear focus.

Universal vs. Pure-Play?

The study by Oliver Wyman also analysed the synergies arising from combining businesses. Using a "hybrid" organisation as a model, it looked specifically at four particular areas where benefits are presumed to exist, to weigh how much value is derived from joining different activities. Are there real benefits to having a variety of different operations in one large financial group? If these exist and can be measured, which parts of the operation gain from having a combination of different activities united in a single organisation? The following points shed some light on the assumption behind combining businesses and benefits for the individual units or activities:

Lowered cost of funds: An investment bank is likely to have a higher credit rating when overall earnings volatility is smoothed by the wealth management unit. This should lower the cost of funding for the investment bank.
Increased trading flows: As a result of the wealth management business being included within the business, the investment bank is likely to enjoy higher revenue due to increased internal trade flow.
Margin income: Having a wealth management business in-house provides a greater source of inflow into structured products and funds, as well as investment solutions. When these are provided in-house, the wealth management unit can serve as a distribution platform for the group's investment banking and asset management products.
Client referrals: Clients can be referred among the various businesses within the group, including to the wealth management unit.

Taking into account these points, only the fourth—client referrals—offers obvious benefits to the wealth management business. To sum up, the study found that the investment banks in this type of operation derived on average an estimated 7 percent of revenues from synergies, while retail banking showed no gains. Asset management benefited the most, claiming fully 12 percent of revenue from synergies gained by being part of a combined group. Wealth management gained only 1 percent. The findings were based on data gathered in 2006. In the wake of the financial crisis, the figures might be skewed even more decisively in favour of the other businesses relative to private banking.

Risks to the wealth management business can increase when it is brought into the same organisation alongside other activities such as investment banking. Wealth managers, due to the nature of their business, usually hold well in excess of the minimum required capital. As banking groups can leverage business based to some degree on client deposits, the wealth management business may even, as noted in the first point, provide the group's other businesses with a means to take on more risk. And if the group suffers major problems in another area of the business, the wealth management business could experience outflows of client money, which would mean that assets on the group balance sheet also need to be reduced. Thus, in this sense the wealth management business truly might serve as a stabiliser—but not in the manner intended.

The Problem of Referrals Management

For private banks, the main incentive to be part of a group that includes other businesses can be found in the potential for client referrals. However, based on a report by the Boston Consulting Group,(2) many universal banks struggle when trying to implement effective systems for gathering leads. To make referrals work, all parties must agree that there is a value in having a unified entity. Setting up a referral system is not so easy. It requires clear rules. Very often, banks fail to keep records on referrals, and the managers also might neglect to offer benefits within the company that are needed to encourage them. At the heart of a working referral system, there needs to be commitment from management, incentives, trust, and a system to ensure that clients are getting the service and the continuity they need.

Very few banks actually achieve an effective referral system. There may be different reasons for this. One is that employees might not want to entrust their clients to another part of the bank and are reluctant to risk jeopardising a relationship with a good customer. In practice, it's not so easy to give up clients, and not just in private banking. Retail bank managers also tend to be unwilling to voluntarily refer their wealthiest clients to the private bank, fearing inadequate compensation for lost business. Beyond that, existing client relationships usually are hard to change: an entrepreneur, for example, may have worked for decades with his or her branch manager or corporate finance advisor.

It is clear that when wealth management is brought into a group with other business units, the main benefits in most cases go not to the wealth management unit but rather to the other businesses. Yet in a pure-play wealth management business, there may also be tensions and imbalances arising due to competing aims among the company's core activities. Besides looking at how wealth management may be integrated within a larger group, it is important to consider the organisation of the wealth management unit as a separate entity that often must take into account different, sometimes even competing parts of the business. This is discussed in greater detail in the following section.

DESIGNING THE ORGANISATION

Chapter 1, "A Framework for Excellence in Private Banking," introduces a model that can be implemented to manage a private bank, serving as a guide to the process of turning a proposition for the future into a concrete strategy, an action plan, and a system with the necessary controls. The changing business environment has forced private banks to reexamine where and how they want to compete. In looking at the best ways to organise people, activities, and resources in order to implement the strategy, a three-pillar model representing the main areas of operation within a private bank can be envisaged. It is also important to consider why large corporations have been formed in the past and whether the same forces still work in their favour today.

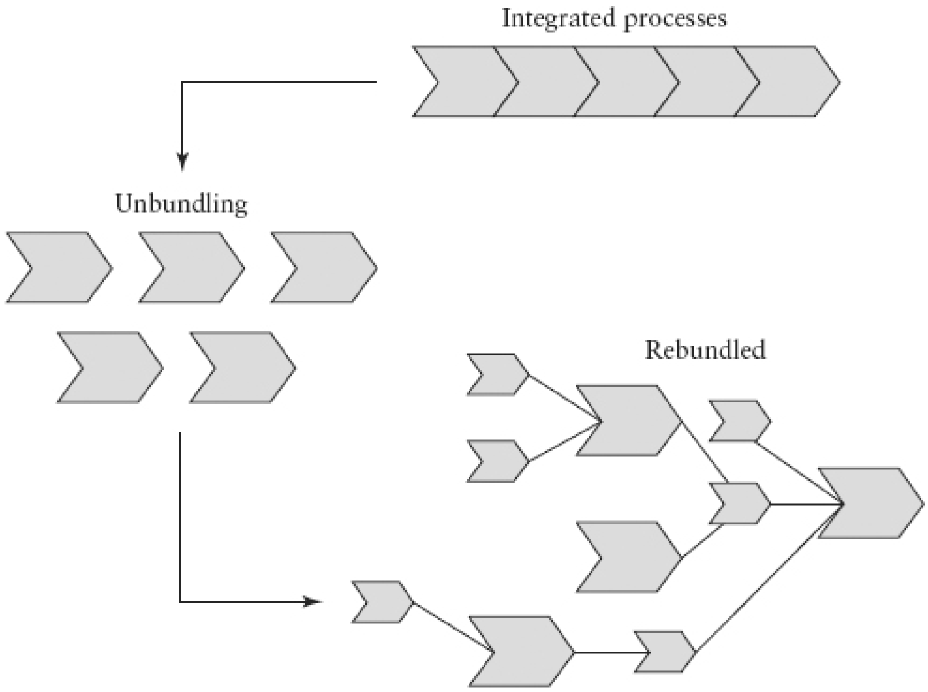
A key aspect is how much it costs to provide goods and services in-house versus the cost of getting the same goods and services externally. In both cases, assuming the market price for these goods and services is the same, the decision comes down to the costs associated with acquiring the same goods or services. Once such costs become higher than would be the case to source externally, internal production no longer makes sense. When this tipping point is reached, companies, including banks, may benefit from unbundling—separating, outsourcing, and/or divesting certain non-core activities as is discussed in the final section of this chapter.

Bundling and Unbundling

Nobel Prize–winning economist Ronald Coase first introduced the concept of transaction costs in a 1937 article, "The Nature of the Firm."(3) Asking why companies exist, he determined that it is profitable to establish a firm when it can reduce the costs involved in transactions that arise during production and exchange in a way that individuals cannot. As long as costs associated with coordinating the exchange of goods and services are lower within the company than they would be if the goods are sourced externally, it makes sense to keep the production and services in-house. For example, in the early years of the automotive industry, automakers produced many more parts in-house. But a great deal of time and energy was expended to produce these items. There were substantial costs involved in administration of the production, for example. If it were less costly, a vertical production system starting with making the steel to produce parts, downstream to manufacturing the upholstery, would make sense. But overseeing such a production process would require a large number of internal resources, ranging from ordering materials to legal resources that are needed where patents and regulations are involved. The model of an all-inclusive, vertically-integrated company where most of the value chain is kept internal thus tended to give way to outsourcing those aspects of production, where it makes sense to do so. With a modern car today having about 30,000 parts, it would be impractical in the extreme to try to produce everything in-house. The auto industry has thus “unbundled,” encouraging external companies to specialise in specific areas of manufacture. Figure 3.3 depicts this process of unbundling.

FIGURE 3.3 Unbundling and Rebundling of a Value Chain: How Businesses with a Variety of Activities Might Reform to Concentrate on Their Special Areas of Expertise

Sources: Manuel Keller, “Virtual Private Banking: Vision or Illusion.“ Zurich: Swiss Banking School, 2000



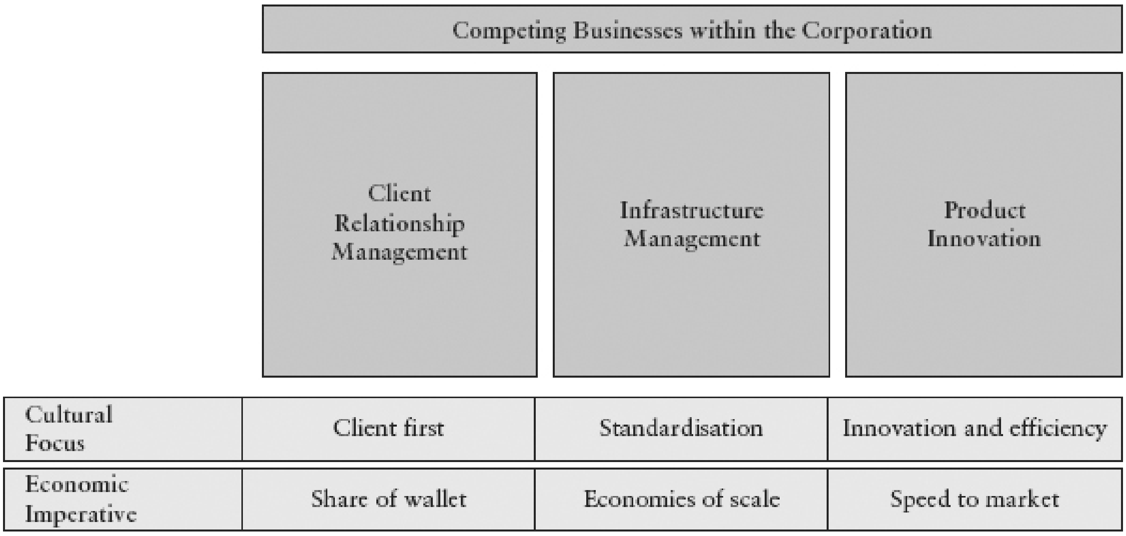
Thinking in terms of “unbundling” can give an impetus to other industries. The car radio is an example. A radio supplied with the car increased the price of the car by so much that it proved impractical. Already in 1930, American Paul Galvin introduced one of the first commercially successful radios for cars. These were sold under the brand name “Motorola,” reflecting the radio’s mobility. His entire company later changed its name to the one associated with this early, successful product. Motorola became a recognized leader in the audio industry.(4)

The Three-Pillar Approach in Corporations

In 1999 management consultants John Hagel III and Marc Singer, in an article published in the Harvard Business Review, explored the nature of costs arising from core functions within an organisation.(5) They described the three main areas central to most companies’ activities: customer relations, products (including product innovation), and corporate infrastructure, represented as three pillars (Figure 3.4). The friction that arises between these creates a drag in terms of lost efficiency and higher costs. Traditionally, these “interaction” costs have been regarded as an inevitable part of doing business, and most companies strive to make these various activities work together as efficiently as possible. There are limits in terms of what can be achieved by streamlining core processes, however. Technology meanwhile is challenging this model by enabling smaller, more specialised companies to take over certain tasks. As a result, the basic assumptions about corporate organisations need to be reexamined. The rise of nimble specialists focused on just one core process—for example, product innovation—shows that while size, reputation, and integration were advantages enjoyed by big companies in the past, today these same large corporations face competition from all types of agile niche players. At the same time, the core processes within these big companies often compete with each other, meaning that none are as efficient as they would be if they existed separately. Hagel and Singer argued that what most managers have considered to be the three “core processes” are in truth three separate and distinct businesses. Each has goals that are in some ways incompatible with the other two. To work together, each must compromise, sacrificing some of its efficiency.

FIGURE 3.4 Competing Businesses within the Corporation

Source: “Unbundling the Corporation” by John Hagel III and Marc Singer. Harvard Business Review, March/April 1999



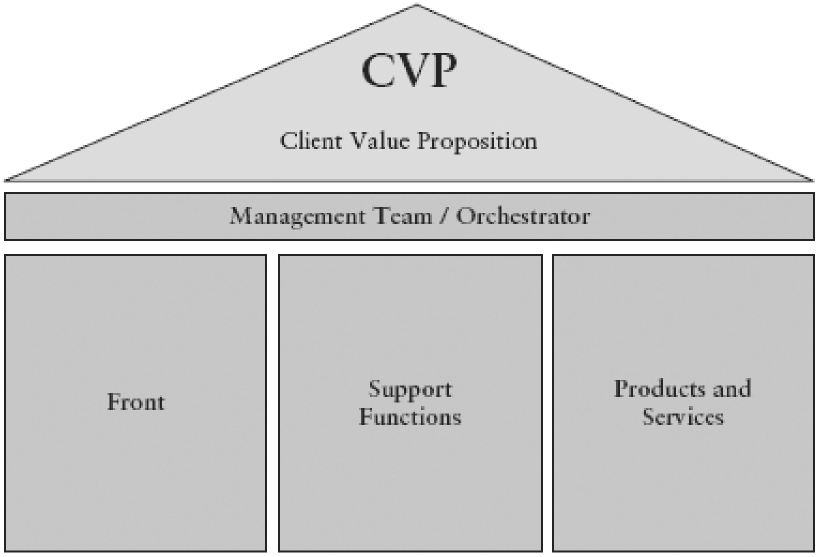
Each of these three business areas is driven by fundamentally opposing economic, cultural, and competitive aims. For example, customer relationship management (CRM) strives to give each client the best possible experience and service. As the name implies, the emphasis is on the relationship, so one of its goals is to offer as many different products and services as possible. It aims to build ties with new clients while satisfying existing ones. By contrast, infrastructure management is capital-intensive and therefore most profitable when economies of scale are pursued to spread the fixed costs over many different clients. Standardised solutions are its ideal. It is most cost-effective when functioning as an impersonal, standardised provider. The third core activity, product innovation, has yet another aim. It focuses more on employees than on customers, so its efforts are directed mainly towards attracting talented staff to create new products. While all three of these activities often coexist within a single company, some friction is inevitable. According to Hagel and Singer, compromises thus are necessary when all three processes exist side by side.

The Three-Pillar Approach Applied to Private Banking

Figure 3.5 represents the three main functions needed to run a private bank. The first pillar, referred to here as “front,” comprises all of the client-facing activities and services, meaning those parts of the operation that come into direct contact with clients. Support functions build the basis to enable the front to serve the clients. Usually the support functions cover all employees who are part of the mid- and back-office functions. The third key area develops and provides products and services to relationship managers (RMs) and clients.

FIGURE 3.5 The Three Pillars Applied to Private Banking

Source: Author, inspired by “Unbundling the Corporation” by John Hagel III and Marc Singer. Harvard Business Review, March/April 1999



Hagel & Singer's Business (see previous chart)	CRM (client rel. man.)	Infrastructure managment	Product innovation
Cultural Focus	Client first	Standardisation	Innovation and efficiency
Economic Imperative	Share of wallet	Economies of scale	Speed to market

Similar to Figure 3.4, the three pillars represent the attributes and characteristics of each of these main activities. As in other corporations, when all three are included in a company, each has to some extent goals that do not align with the priorities of the other two. This creates tension as individual areas are forced to make compromises and concessions to accommodate the others. The management team's job becomes one of coordinating or orchestrating so as to deliver value to the client. To accomplish this, management must attempt to strike a balance to minimise tensions among the separate areas of function. If management succeeds in elegantly orchestrating the cooperation between the activities, clients will respond positively. Satisfied clients will increase the amount of total assets entrusted to the bank: they will stay with the bank longer and even give referrals.

Each of the three pillars needs to be organised in a particular way to ensure that the main goals are met.

Pillar 1: The Front

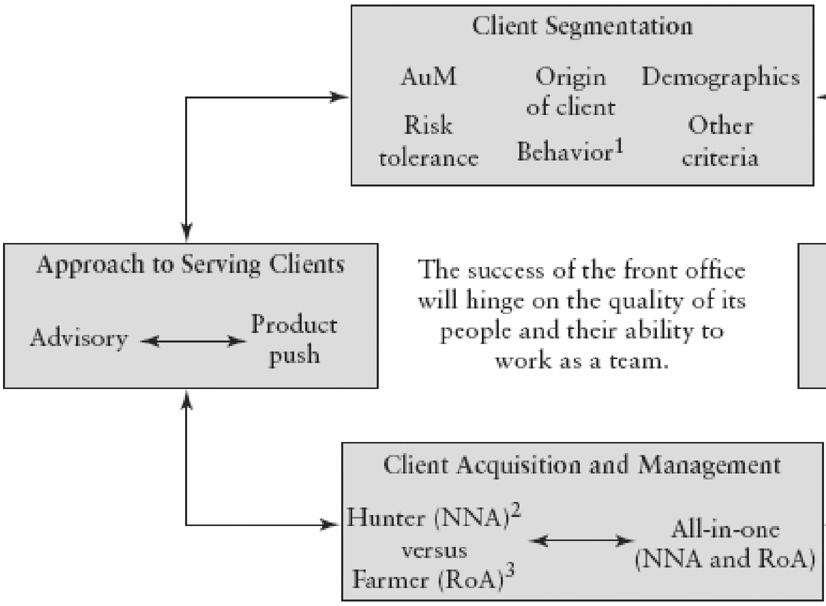
The operations referred to as the "front" functions encompass all the activities of the business that come into direct contact with the client. This is where the client relationship is established and maintained.

Private banking is a business that depends on networking and is focused on people. The relationship managers are the bank's key assets, and relationship managers' personal networks, in turn, are their greatest assets. A relationship manager needs to have a certain basic level of banking and financial expertise, and as the regulatory and product environment becomes increasingly complex, relationship managers' networks of expert advisors also gain in importance. Relationship managers thus are becoming orchestrators of an array of services. They needn't have the answer to every question, but they ought to know where to go to get it. The front office organisation needs to reflect this. Relationship mangers should be organised into teams. The bond between the client and the individual relationship manager, which lies at the heart of the client value proposition, needs to be expanded in a discreet manner to include other team members, which also helps to anchor client loyalty to the brand (see Chapter 7, "Why Brand Matters" and Chapter 9, "Understanding Service Excellence.")

The ideal organisation for a front office in private banking will vary, based on the number of clients, the client segments targeted, the approach used to serve clients. and the types of relationship managers employed. According to Boston Consulting Group, there are different types of relationship managers, which it refers to as either "hunters" or "farmers."(6) As shown in Figure 3.6, relationship managers are focused on acquiring and managing clients. Those whose main aim is to increase net new money (NNM) might be referred to as "hunters." Those focussed on increasing the return on assets (ROA) might be better described as "farmers." According to the study, the more experienced a relationship manager becomes, the more likely it is that he or she will evolve from being a hunter to a farmer, the latter often a function of age, experience, and increasing client load.

FIGURE 3.6 Factors Affecting the Organisation of the Front Office

Source: Global Wealth 2008: A Wealth of Opportunities in Turbulent Times © 2008, The Boston Consulting Group



[1] For example, clients could be characterised as self-directors, participators, or delegators of wealth management.
[2] Hunters focus on generating net new assets (NNA).
[3] Farmers focus on increasing return on assets (RoA).

However, this depends very much on the strategy and incentives of the individual bank. A bank with a growth strategy will encourage relationship managers to increase net new money (NNM), having as its main focus a hunter strategy. A well-functioning team needs a mixture of both, however, including younger and older relationship managers. Based on their different ages, levels of experience. and opportunities to tap networks, different relationship managers might pursue a mixture of strategies. The team also needs to have access to specialists. In order to face the challenges of the increasing competition for relationship managers and the need to develop leadership, an environment should be able to develop relationship managers with both “soft” and “hard” skills through coaching and mentoring and by supplying experts able to offer advice. With that in mind, the front office could be organised along the lines of the following format:

- A team head (coach, mentor, leader, role model)
- Four to eight relationship managers (mixture of hunters and farmers)
- One or two assistants
- Product specialists able to provide an interface to a network of experts

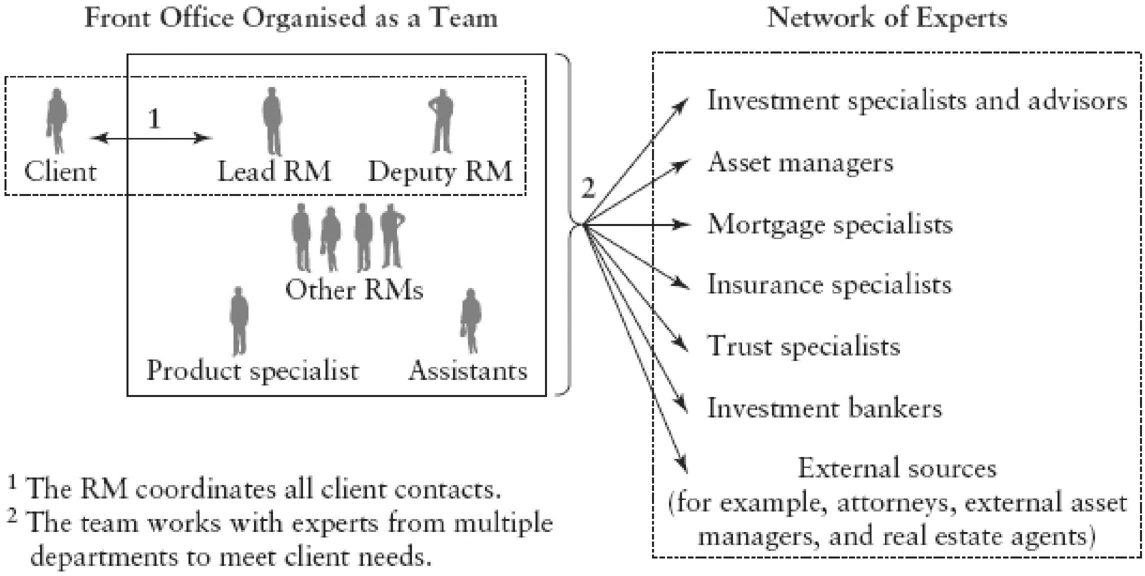
Historically, the main value proposition of private banking has been to offer the benefits secured by a trusted client advisor. As much as banks seek to emphasise the team approach, clients still appreciate the continuity, stability, and assurance provided by having a primary relationship manager (RM). However, markets have grown less predictable and products more complex. This has led to a need for a heightened level of expert advice that typically can no longer be satisfied by a single individual. Perhaps the solution to this dilemma lies in the “front-centred web” model. In this approach, a relationship manager or a team of relationship managers may serve as an interface between the client on one side and a network of experts on the other.

Today’s high-net-worth client needs access to a variety of different experts, including specialists in the areas of asset allocation, fund selection, estate and tax planning, currency hedging, and succession planning, to name just a few. Depending on the size of the client base and the economics involved, these experts may either be in-house or vetted specialists from outside the bank. Product specialists are one example of in-house experts who can be called on to brief clients regarding specific topics that are highly complex or might address and analyse rapidly unfolding events in financial markets. Product specialists can be assigned to a regional team but can also serve other teams through a type of matrix organisation that may also allocate them to the unit that provides products and services. One example might be a product specialist working in the product and service department of a Swiss private bank in Singapore, who could be the ideal expert to brief a Swiss-based client on opportunities in emerging Asian markets.

Figure 3.7 provides an overview of how a front-centred web might be organised to deliver value to clients.

FIGURE 3.7 The Front-Centred Web

Source: Global Wealth 2008: A Wealth of Opportunities in Turbulent Times © 2008, The Boston Consulting Group



Up to this point, at least in theory, the whole organisation could be operated without any physical premises as a sort of "virtual value web" where team members work out of home offices using the latest communication tools to coordinate their activities. However, this utopian vision will probably break down when the first client asks where he or she can go to make a deposit. For the foreseeable future, clients will still place a great deal of confidence in the existence of real, physical buildings, be it the "bricks and mortar" premises in prestigious locations in cities, or offices in places with a high traffic of wealthy individuals. In other words, to engage in wealth management activities, it is still necessary to have a high-visibility branch network infrastructure that is part of the support function pillar. As discussed in Chapter 7, "Why Brand Matters," and Chapter 8, "Delivering a Superior Client Experience," it is important to provide a premium level of client experience, considering all instances in which the client could encounter the bank, from advertising to its appearance on the street and to the reception area or individual meeting rooms. These facilities need to be managed as part of the responsibility of the support pillar shown in Figure 3.4. Alternatively, such tasks may be outsourced.

Pillar 2: Support Functions

The support functions are required to make everything else happen in the organisation. They work best when allowed to take advantage of economies of scale and standardisation.

The front office could not operate effectively without the assurance that flawless support provides. Besides proprietary know-how and organisational expertise, the support functions set a private bank apart from an independent financial advisor or a family office or broker. How best to organise these? Based on the approach outlined by Hagel and Singer, support functions rely on principles of cost-effectiveness and efficiency delivered by economies of scale and standardisation. If a bank wished to establish a purely digital booking platform, the more clients persuaded to use it, the greater would be the cost savings per transaction. The complete opposite is the case for the front, where every added client leads to increased costs. It takes time and many other investments to satisfy the new client's needs and to deliver real value.

The bank's legal and compliance departments are included in support operations. The complexity of legislation and associated costs is increasing. Here, too, the challenges faced are best met by taking advantage of economies of scale—meaning an increasing number of clients must be acquired to spread the costs associated with legal issue and compliance. If these operations are maintained at best cost, and economies of scale are not an option, the bank would have to try to save through standardising products and services—reducing the number of markets and segments in which it is active or by offering fewer products and services. In addition, public relations and human resources are part of the support functions. The greater the number of individual tasks that are similar, the higher the savings will be.

A private bank needs therefore to decide if it has a large enough client base to carry the costs of these support functions in each market where it wants to be active. Or does it need to find a partner, to merge or outsource one or more of these functions? Beyond that, there is the question of what, if anything, the bank could or should standardise if it wants to save costs. Should it focus on fewer markets or a smaller number of client segments? Should it reduce its product and services palette? How far can it go down this path without compromising value in terms of solutions tailored to each individual client?

These support functions need to be guaranteed in any private bank: legal and compliance; risk management and controlling; finance; facilities management (for both the physical branches and office network); human resources; IT and operations including execution and custody; and marketing and communications.

Pillar 3: Products and Services

This business creates and provides financial products and services.

The final section of Chapter 6, "Beyond Products—Offering Tailored Solutions," addresses the questions related to the types of products and services that a bank should offer. This chapter looks at how products and services are approached at the organisational level. When thought of in terms of a standalone business, this pillar focuses on innovation, process efficiency, and speed, expressed as time to market. Product designers must be able to exploit opportunities as they arise, and they must do it faster than the competition, allowing these products to capture first-mover advantages such as premium pricing and market share. The task for the private bank then becomes one of choosing which products and which services need to be produced in-house and which might be externally sourced. And, no matter whether they are sourced externally or provided in-house, there is also an organisational aspect: for external products and services, the selection needs to be organised, while in-house products also require their own organisation.

One way to address the various issues that arise in the area of products and services is through open architecture, meaning platforms to provide both in-house and externally sourced products, presented without bias or advantage for either internal or external offerings. Technology, which has significantly reduced transaction costs, has enabled such systems to be devised and operated, while open architecture extends this flexibility to financial products and particularly to funds.

EXAMPLE OF PRODUCTS AND SERVICES MANAGEMENT
At Julius Baer, a department called Product Management is responsible for product development. If a client demands a new type of product that has not yet been created, the relationship manager may pass along the request to the relevant department, which will look into whether there is a greater demand for such a product. It does this by evaluating potential demand throughout the bank. If such demand is present, work will begin to determine whether such a product should be developed internally or sourced externally from an outside product provider. In cases where the product is developed internally, the legal structuring, marketing, IT and operations, and communications teams may be involved. It might also be that the bank decides to create the product by itself, along with the legal framework, and then subcontracts the investment advisory services to an outside investment manager. Alternatively, the design, engineering, and management of the product may be outsourced as well.

CONCLUSION

Historian and economist Alfred Chandler, in a seminal study of four American conglomerates published in 1962, found that these shared a common trait in that they were based on a "decentralised" organisational model.(7) The organisational model, he postulated, works best when the company's structure is brought into alignment with the strategy. If it is not, the existing structure may hold back changes in strategy, including those necessary to the company's long-term growth. Chandler's theories are often summed up as "structure follows strategy." If that is the case, for a company to be successful, it must first determine its strategy before deploying a particular structure.

This means that an organisation's primary focus has to be defined at the outset. Once this has been achieved, it can then focus on the structure that best suits its aims and, if necessary, it can unbundle those businesses that are not aligned with its focus.

For banks, the financial crisis underscored the need to rethink existing strategies to position for a future in which stricter regulations and greater risk control play a larger role. If structure truly follows strategy, banks, too, must rethink their traditional structures in order to align them with the strategies that they need in today's wealth management market.

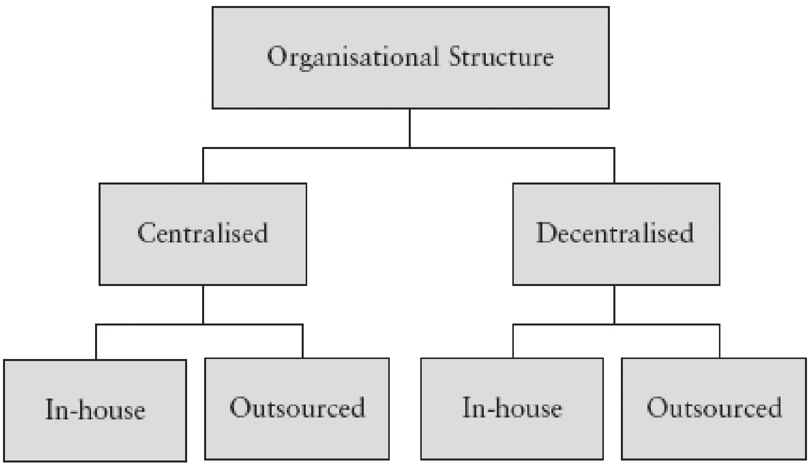
Some experts believe that in the future, banks will concentrate solely on the client advisory process and leave investment management, legal structuring, research, and the like entirely to external providers. This might be cost-efficient, but banks need to have a solid proprietary offering in the core areas that demonstrates capabilities and guarantees certain standards of security and service. For example, no matter whether the bank has its own in-house funds or not, it needs to have a fund selection capability and an actual team providing this service. The goal is to offer the client and the relationship manager a short list of recommended funds that are all good choices, depending on the predetermined risk level and to ensure ongoing continuous monitoring of these funds.

The concept of "structure follows strategy and the organisational form" will be essential for a successful implementation. It is impossible to manage what one can't measure. Similarly, it is not possible to add value in sales and delivery if a bank doesn't sufficiently understand those functions that it outsources.

Assuming that the bank is not being built from scratch, one must look at every aspect of the business model, asking how every part can be refined to contribute to the delivery of the client value proposition. It is therefore necessary to look in detail at the operating model to see how the structure and processes can be improved. This contributes to the efficiency of operations to the benefit of the client while providing a reasonable return for the bank. Figure 3.8 outlines the main question that will determine how each process or function is to be approached. It shows the key decisions that need to be made to turn the operational model into an organisational structure. Which functions should be in-house or outsourced? What is the best organisational structure? Should the company be organised centrally or decentralised? Here is one example: a bank decides to outsource its payroll activities but still needs to decide whether there will be one global partner, such as an international accounting firm, or whether each country should subcontract the work locally. Another example would be, assuming a bank chooses to have fund selection in-house, it must decide whether it is better to have one team based at its headquarters doing the job for the global operation or whether it is better served by regional teams that can take into consideration geographic preferences.

FIGURE 3.8 Decision Tree for Structuring the Organisation

Source: Author



The financial crisis followed an extended period of rapid growth when many wealth managers pursued revenue gains at all costs. With their asset bases now diminished and revenues less certain, private banks face significant pressure to go over their operating models in detail, seeking ways to get better control over their businesses, support functions, and processes. This is necessary in order to cut costs and improve margins, while providing better service to clients.

Choosing the optimal organisational design can be a significant help in streamlining operations and keeping costs at reasonable levels. This chapter opened with the question, What is the ideal organisational form? In the end, there is no single answer. It will depend on each bank's strategy, positioning vis-à-vis clients, and the market environment in which the bank operates. In the near future, it is quite likely that wealth management units of universal banks might try to leverage their brands, aiming to exploit economies of scale by reaching out to the affluent sector. Meanwhile, pure-play wealth managers are likely to pursue open architecture models, creating a distance between themselves and asset managers on the one hand and investment banks on the other, to focus on their main activities of client-focussed wealth preservation and offering independent advice. To add the most value, private banks invariably will need to focus their efforts on the front pillar—the main client-focused area of their business—and the network supporting it.

It will not be possible for a private bank to focus entirely on the front pillar, however, while outsourcing all support functions, and product and service activities. Private banks must take into account the changing nature of the business, making it difficult to establish service-level agreements with third parties. The regulatory environment is also changing, and in many cases, this creates new demands on private banks. Legal and compliance operations within the bank thus become even more important, serving a role that requires clear processes. Private banks will need to use all the advantages of value webs—interactive and fluid organisations that can access different experts to provide support when needed.

Unbundling is about focusing on core knowledge and skills. Open architecture serves to offer competitors' products on an equal footing as the bank's own. In practice, the barriers to both open architecture and unbundling in private banking are significant but not insurmountable. Admittedly, technology has reduced the cost of getting the product, of getting information about products, and communicating with suppliers. But the private banking value proposition has always been about customised solutions for every client. Maintaining credibility and control of key parts of the business could be compromised if a bank relies too much on outsourcing. Core processes—not just the front, but also important knowledge and skills—cannot be fully outsourced.

One way to address this is to unbundle different parts of the business—that is, the different parts of the value chain representing all the steps necessary to achieve a desired result. Other industries already have looked to this model and are in the process of unbundling their businesses. In wealth management, however, few players thus far have had the courage to pursue this aim. The need for client confidentiality and the ability to provide all the necessary services while maintaining security all argue for keeping all processes under one roof. A perceived need to directly control all aspects of the business leaves most banks with the idea that they have to run all three core processes within the three main organisational pillars in-house, despite the inefficiencies. Even here, many support functions can be and have been outsourced. An increasing number of banks have opened up product innovation to the market by implementing an open architecture approach. For example, Credit Suisse offers third-party products via its Fund Lab platform. It sold a significant portion of the company's asset management operations to Aberdeen, a leading asset management specialist. Julius Baer split off its asset management into a separate unit. The remaining bank is one of the largest pure-play wealth managers in Switzerland.

The following principle should apply: do not outsource something that is not working internally. If the bank cannot get the process right, how can it define the interfaces and the agreements to avoid difficulties when these same functions are outsourced? Having first-hand experience is vital, too, for pricing and quality control. Outsourcing may shift the work and responsibility to a third party for providing the product or service. But a significant amount of management attention is required. An outsourcing arrangement needs constant monitoring and management of the relationship to ensure that the bank's brand and reputation are not damaged by substandard products or inadequate delivered products and services by external partners.

In the end, effective implementation and execution is more important than having either the perfect strategy or model. Chapter 12, "Measuring and Managing Performance," addresses this topic.

In private banking specifically, unbundling makes some sense. The main aim of the RM is to focus on separate, individual clients, with the goal of providing ways to generate long-term wealth preservation. Time-honoured traditions of service and individualised offerings, exclusive client meeting rooms, and a deliberately low-key and highly personalised approach work best. Not only would the relationship managers gain from being freed of offering internal products when clients prefer external ones. In addition, an unbundled products division would no longer be held hostage to in-house relationship managers' demands and could extend its offerings more effectively to a broader audience. The infrastructure business, too, could pursue its goal of achieving economies of scale by offering its booking platform to multiple parties.

NOTES

1. Oliver Wyman. 2008. "The Future of Private Banking: A Wealth of Opportunity?"

2. Boston Consulting Group. 2008. "A Wealth of Opportunities in Turbulent Times. Global Wealth.

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6. See note 2 above.

7. Chandler, Alfred D., Jr. 1962/1998, Strategy and Structure: Chapters in the History of the American Industrial Enterprise. Cambridge, MA: MIT Press.

*All except the US business of Bank Wegelin & Co. was acquired by Raiffeisenbank in January 2012.

Chapter 4

Forces Shaping the Regulatory Environment

Regulatory developments cannot be thought of as something happening separately from the "real" world. They are very much a part of banking and one of the major factors affecting the industry. For private banking, there are two main issues likely to have the biggest impact in the foreseeable future: tax compliance and discussions about consumer protection.

Looking at the first of these, a transition to full tax compliance for all clients must be part of the strategy of any serious private bank. This marks a break with the mindset of the past. We are moving toward a new private banking paradigm.

Apart from the tax environment, consumer protection, driven by regulations, such as MiFID in Europe, are having a major impact as well. Consumer protection laws are aimed at increasing transparency and accountability. It is becoming extremely important to match the product to the profile of the client.

A further trend that is having a major influence on private banking is growing activity in mergers and acquisitions. This is being led in part by the need for consolidation to address rising costs. Understanding all of these aspects will be key in terms of positioning and defining the role of financial services organisations.

This chapter presents an overview of some of the major points and developments that are especially relevant in this regard for private banks from a Swiss perspective.

THE REGULATORY ENVIRONMENT

The regulatory environment has a major impact on banking. This was always the case, but it has become quite evident in the wake of the 2008 financial crisis. Although it is difficult to predict how the situation will look in the coming years, nearly all indications are that regulations will be stricter and play a significant role in how the business develops. The forces at work shaping the industry include both those within national boundaries and global efforts to make the financial system less prone to systemic risks.

International vs. National Interests

Every country with a banking industry wants to secure returns from financial services. It is an industry that offers a good source of tax revenue and provides a significant number of jobs. Switzerland, with its long history of private banking, is no exception. Amid a growing number of rules dictated by global concerns, Switzerland's approach has increasingly shifted toward one of international cooperation.

Swiss banks' discretion is older than the modern Swiss state. Starting in the 17th century, an increasingly powerful French monarchy depended on borrowing to maintain not only extravagances (e.g., Versailles) but also a standing army. It turned to Swiss-based bankers. These included not just Swiss, but also some former French citizens, Protestants who had been forced to flee France. Reflecting the growth in the business, in 1713, the Great Council of Geneva called for bankers to keep client registers, while prohibiting bankers from disclosing their clients' names unless authorised. The French Revolution in 1789 created more demand for Swiss banking services as titled gentry sought a safe place to keep their wealth.

Through the 19th century, Swiss banks flourished. Switzerland's Constitution, adopted in 1848, led to a more centralised government and ensured political stability. A wealthy class of industrialists had sprung up in Europe, helping to drive demand for banks serving individual families. But following the 1929 stock market crash and during the subsequent economic depression, banks, including those in Switzerland, faced tough times. In 1931, Germany intensified exchange controls, and in 1933, the Swiss government was forced to bail out a bank that had nearly gone bankrupt when the Nazi government blocked repayments of foreign loans. France was also putting pressure on the Swiss, claiming legal authority over French accounts abroad. Amid efforts to tighten banking regulations, the Federal Act on Banks and Savings Banks was passed in 1934. Article 47 of the Act threatens fines and/or imprisonment for people who disclose information learned as an employee at a bank.

In 1984, the Swiss people voted in a public referendum against loosening bank secrecy by a 73 percent majority. At the same time, the Swiss government's desire for good relations with the European Union and the need to be seen to be proactive in the fight against money laundering and organised crime has led to changes through the years that make it easier for banks to provide information about accounts deemed to be criminal. Meanwhile, the net has tightened on criminal money, as both international and Swiss anti–money laundering efforts brought pressure to bear.

Coinciding with the global financial crisis, scrutiny on Switzerland and other centres managing offshore wealth has increased. Governments facing high costs to bail out banks in their home countries and restore fiscal stability are in no mood to tolerate tax evasion. While Swiss regulations still ensure secrecy, the onerous reporting requirements placed on account holders that are US or European Union (EU) member state taxpayers has created heavy demands on banks in terms of client reporting. Unlike foreigners whose main focus in having a Swiss account was for purposes of privacy protection, a person with an account in Switzerland today is more likely looking for higher quality services, while taking into consideration the regulatory environment of his or her country of residence. Thus, they are likely to be demanding and sophisticated clients. These clients choose their bank based on quality and expertise, not on bank secrecy.

Tax compliancy is getting ever more difficult. Tax law is becoming an increasingly weighty matter—literally. Figure 4.1 shows the number of pages in published US tax law. These increased to over 72,000 in 2011 from 400 in 1913. Not just tax legislation but financial laws are becoming more voluminous. As shown in Figure 4.2, the number of pages in some key US legislation governing financial firms also has increased. The Federal Reserve Act of 1913 was just 31 pages long. By contrast, the draft Dodd-Frank Bill dating from 2010 was a whopping 2,319 pages long. The final version was cut down slightly to "only" 849 pages.

FIGURE 4.1 Increase in Pages Contained in US Federal Tax Law, illustrated by Pages in the CCH Standard Federal Tax Reporter: from 400 in 1913 to 72,536 in 2011

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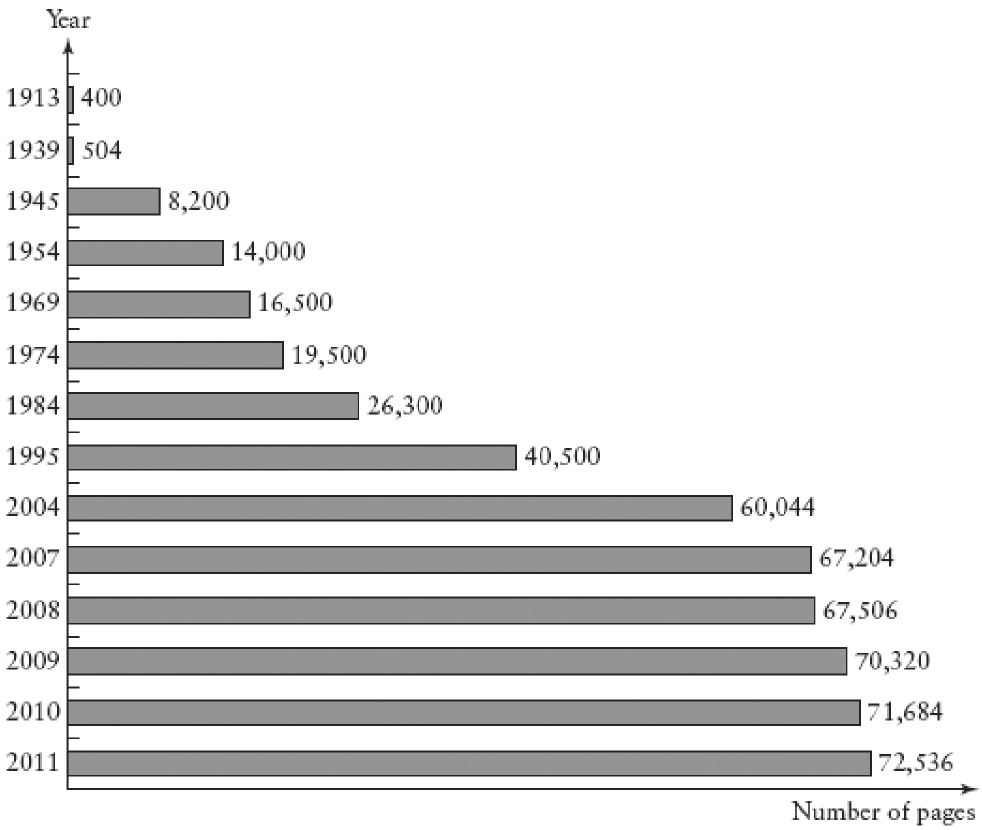
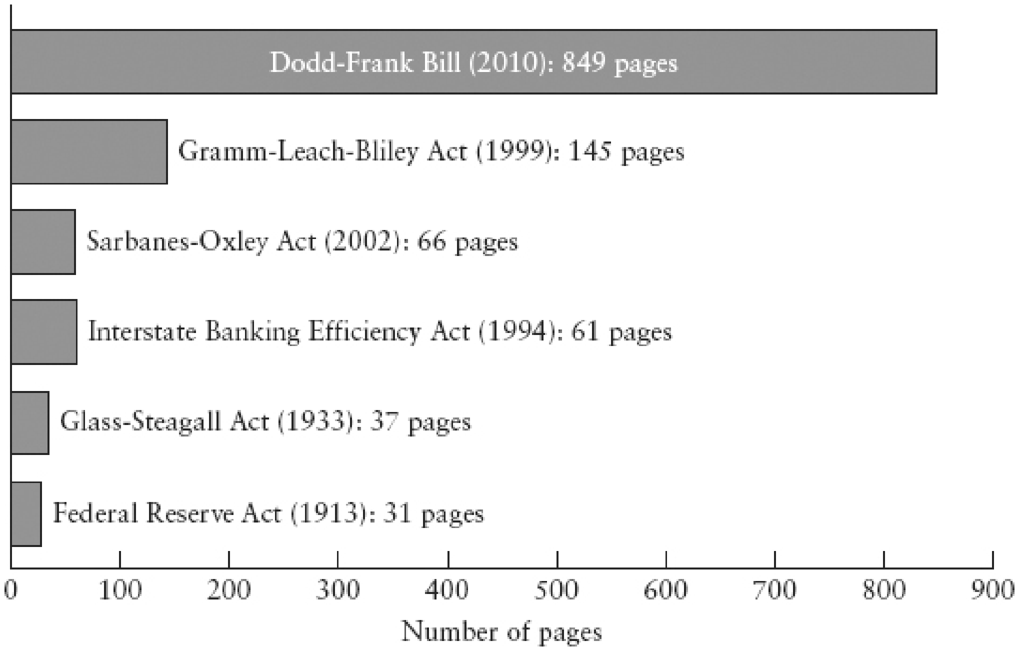


FIGURE 4.2 Increase in Pages of US Bank Legislation

Source: Mark J. Perry, University of Michigan. 2010



A growing complexity in the rules is just part of what banks must deal with. They must also understand changes in the environment and how these are affecting clients and clients' businesses. The EU Savings Tax Directive came into force among EU members in 2005 to ensure uniform information sharing for tax purposes among all EU member states. The taxes are applied to cross-border savings income (for example, interest on bank deposits including savings accounts, interest from bonds and income from investment funds). Following bilateral discussions with the EU, Switzerland signed similar rules that came into force in 2005. These allow a choice. Clients can either authorise the bank to share information about their accounts directly with tax authorities, or banks may directly deduct a "tax retention" from clients based on savings income, without revealing the clients' identity. The tax rate has been increased in stages to 35 percent of income on interest. However, since the EU aims to have an automatic exchange of information system only, separate bilateral agreements reached but not yet ratified with the UK, Austria, and Germany foresee an "equivalent" framework but still granting a certain level of privacy protection. (For further information see also the Appendix at the end of this chapter.)

Not only are rules pertaining to customers being tightened. Bank capital standards are in the process of an overhaul, which includes raising banks' capital requirements. Banks automatically set aside capital to cover risks related to lending or other activities and to general exposure. Global standards were introduced in the late 1980s. The first set of rules relied on a simple formula to assess the capital needed to cover "risk-weighted" assets (i.e., the level of risk calculated for a particular borrower). These rules were collectively called the Basel Accord, after the town where the Basel Committee that drafted the rules is located. The original version of the Accord, adopted in 1988, was straightforward. This was an advantage. But these rules were soon considered to be too broad, and by the 1990s, they were deemed no longer adequate. For example, under the old rules, bonds issued by a sovereign government in the bank's domestic currency were treated as effectively "riskless"—banks did not have to set aside extra capital for such lending. Such an approach today would be unthinkable. New versions of the Basel agreement have been drafted and adopted. The latest is Basel III. It will be phased in gradually by 2019. It requires many banks to raise capital and could force some to scale back or divest some businesses.

In addition to capital rules, there has been much discussion regarding proposals to tighten restrictions on banking activities, including calls among some experts and politicians to reinstate aspects of the US Glass-Steagall Act. Passed by Congress in 1933, the Act prohibited commercial banks from engaging in investment banking and related businesses. This was designed as a safeguard to protect investors following bank failures after the stock market crash of 1929. In 1999, due to belief that Glass-Steagall was outdated, a new US law, the Financial Modernization Act (commonly known as the Gramm-Leach-Bliley Act) broke down the barriers that Glass-Steagall had erected. The new law merely acknowledged what already had been tacitly accepted. Bank holding companies in the United States were already engaging in securities underwriting, even before the law was set aside. Conglomerates active in banking could own securities affiliates that generated a substantial amount of revenue by, for example, underwriting bond issuance. Ending the Glass-Steagall–type separation reflected what had become in reality common practice. In retrospect, it is easy to ask whether allowing commercial lenders to buy and sell sophisticated derivatives was such a good idea. The calls to reinstate some kind of separation between investment banks and deposit-taking banks—a new Glass-Steagall—are continuing, including in Europe. Banks deemed "too big to fail" are the focus of such discussions. Whether separating these institutions into smaller, independent units could help to mitigate risks posed to investors and ultimately to governments should a major banking group fail is one consideration driving these discussions.

Pure-play private banks are generally in a better position in this regard, given that theirs is a business that does not require large amounts of capital to cover risks. Private banks' loans to clients usually are secured by clients' assets. Trading for the bank's own account (proprietary trading) is not common practice among wealth managers. While financial assets lose value in times of market stress, clients of private banks still pay fees for services that provide a relatively steady stream of revenue, while investment banks' earnings tend to be much more volatile. Even so, stricter rules along with pressure from investors are leading many banks to review their business models. The rationale in the 1990s and the early part of the present century favouring ever-bigger financial conglomerates has started to look less appealing. A paring down of these firms could provide opportunities for private banks. As larger groups with different businesses under one roof split wealth management and investment banking, choosing to focus on one or the other business, the landscape for private banking is changing, too. Freeing up existing operations, creating new ones, and reorganising old companies will offer both opportunities and new concerns to existing private banks. This could reduce the number of players in some private banking markets. It also could create opportunities for mergers and acquisitions among independent private banks and those spun off from bigger institutions.

Waves of Regulatory Pressure

It is possible to think in terms of waves of regulation—a phase of more restrictive rules followed by deregulation. Then a crisis ensues and brings the next round of regulation. Finding innovative solutions in business is often a positive endeavour. But developing financial products and services aimed mainly at circumventing existing rules to make money for the industry provider can bring not only risks to consumers but the risk that too many participants join the trend, reasoning that "everybody's doing it." As more players join, fearing their competitive position will suffer otherwise, destabilisation follows. A crisis ensues. This is followed by a regulatory backlash leading to new, more stringent rules. The cycle then repeats.

In banking, the cycle has been characterised by recent phases of significant regulation followed by deregulation. In the UK the "Big Bang" in 1986, for example, created a revolution in London's City, allowing banks to buy brokers and abolishing long-established fee agreements. It transformed what had been seen as a gentlemen's club into one where all types of individuals and companies could compete in a faster-paced environment. Throughout the 1980s and 1990s, a liberalised spirit prevailed not only in the financial markets but in many countries throughout the world. China established its first special economic zone in 1980. East Germany opened the Berlin Wall in 1989, followed in 1990 by German reunification. South Africa's detested system of apartheid ended in 1990. The Soviet Union broke up in 1991. Millions of people around the world were starting to get their first taste of publicly sanctioned free-market capitalism.

But while countries seem able to make a positive transition to adapt to change, for banks deregulation often seems to be followed by going from boom to bust. It is possible to point to several instances where this has been the case. But even this cycle can offer benefits. Using the US mortgage industry as an example, deregulation encouraging institutions to keep granting mortgages in the 1970s led to excesses and the eventual failure or closure of many of these mortgage lenders. Stricter regulation ensued. In the 1990s, mortgage-backed securities offered banks a way to "securitise" mortgage loans and other asset types in order to avoid having to set aside capital to safeguard against the risks of direct lending. Thus, to circumvent capital rules, a new industry was born. Some would argue that this made mortgages available to many people who otherwise would not have been in position to finance their own home. Securitisation, for example, in mortgage instruments would within two decades be widely blamed for unleashing a crippling financial crisis. However, it also allowed new structures and ideas to be put in place. Depending upon the phase in the market cycle, stricter regulation may be greeted as either beneficial or onerous.

The crisis of 2008 added fuel to the regulatory fire, and politicians who survived the debacle have made themselves popular with many voters by vowing to curb bank excesses and cap bankers' salaries. Banks that had to ask their governments for bailout money were not in position to protest. Governments through bailouts felt they had earned the right to intervene at both regulatory and strategic levels. The trajectory toward increasing regulatory pressure is expected to be maintained. Regulation will increase.

Threats and Enablers

Among factors driving the world towards stricter regulation is the growing belief that markets may not always be efficient when left to themselves. While efficient market theory may work in a vacuum, the human factor creates unpredictability. Humans, unlike markets, are not always rational.

Regulation is also being driven by the real threat that a large bank could go bust. Apart from the systemic risks such banks present, contributions these institutions make in good years in terms of tax revenues generated and jobs provided lend weight to the argument that a bank can be "too big to fail." Even though some have slimmed down since the crisis, large banks may still have assets several times greater than their home country's gross domestic product. Governments will protect the banks' long-term viability as needed through stricter regulation to avoid, if possible, the threat of further bailouts.

Cooperation on regulatory issues can also be beneficial to banks. This is true especially when adopting rules provides "reciprocity" with the other party. In the flat tax agreements with Germany and the UK, for example, part of the agreement calls for giving Swiss banks better market access in those countries. Globalisation also is extending not just the reach of companies but the reach of governments and regulatory bodies. Technology, too, is leading to more complex products that require sophisticated oversight. With the capability to move assets and prices at speeds hard to imagine in the past, the dramatic recent events in markets have shown that selloffs can hit quickly, affecting prices from Singapore to New York. Whether "animal spirits" or simply humans acting in their own perceived self-interest are to blame, the speed at which markets can move may justify certain regulatory safeguards in this regard, too. Banks also want to reassure clients, shareholders, and the governments in their respective countries. This climate may make it easier to introduce legislation and new rules aimed at strengthening the banking system.

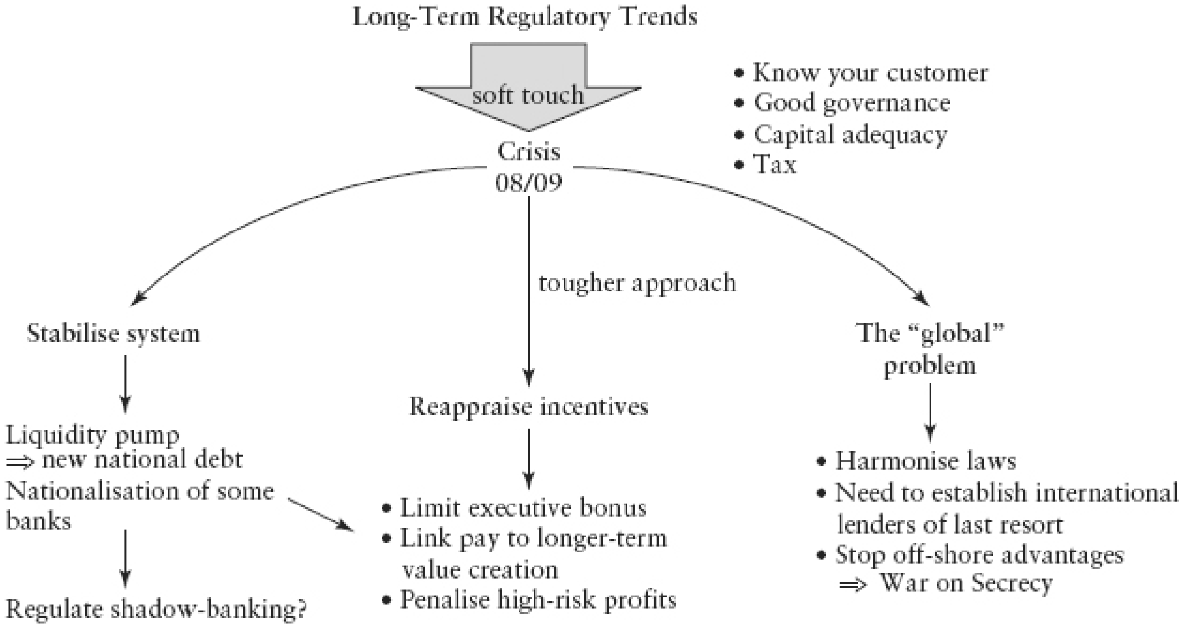
There are also forces driving changes apart from efforts to create a level playing field. Private banking is often accused of turning a blind eye to money laundering. Switzerland has made efforts in the past two decades to put an end to such abuses of its banking system. These include know-your-customer rules under which banks that do not report suspicious activity can be penalised. In addition, the Financial Action Task Force, an international group with representatives from 34 governments and two regional organisations and operating under the auspices of the OECD, regularly puts pressure on financial centres it regards as lax. Set up in 1989, its mission has been to develop policies to combat money laundering and terrorist financing. To achieve its aims, it rates countries based on how effective they are at combating money laundering. For further details on the bodies overseeing financial firms and an overview of some key rules, see the Appendix.

HOW REGULATORS AND THE INDUSTRY ARE ADDRESSING GLOBAL AND NATIONAL CONCERNS

As shown in Figure 4.3, long-term regulatory trends may focus on a variety of laudable goals. These include good governance, a fair tax regime, ensuring banks are adequately capitalised, and efforts to stamp out criminal abuse. Against this backdrop, the financial crisis of 2008 had the effect of triggering another wave of regulation. The rules that followed the crisis aim primarily at stabilizing the system. They reexamine incentives blamed for excessive risk-taking. They also tackle the sheer enormity of challenges facing what is today a highly globalised industry. For each of these three areas of concern responses have been developed. While this book was being written, major changes were still in the offing, but the trends are easy to identify. They run in the direction of much stricter regulation on all fronts.

FIGURE 4.3 Major Regulatory Trends Arising from the 2008 Crisis

Source: Author



The "War on Privacy"

The pressure on Swiss banking secrecy accelerated following the 2008 US presidential election. President Barack Obama was involved in efforts to curb use of tax havens to stop tax abuse. Prior to the election, two legislators from opposing political parties (Senator Carl Levin, Democrat from Michigan and Senator Norm Coleman, Republican from Minnesota), along with the then-Senator from Illinois, Barack Obama, introduced legislation to combat offshore tax haven and tax shelter abuses under the Tax Shelter and Tax Haven Reform Act of 2005. Although the bill was not enacted, the Obama administration and other governments continue to put pressure on foreign banks to provide more transparency about their clients. And in July 2011, a new US bill called the Stop Tax Haven Abuse Act was introduced by Senator Levin.

Bank secrecy has led to heated discussions in Europe as well. German Finance Minister Peer Steinbrück provoked outcry in Switzerland in 2008 when he said at a meeting "instead of just cake, we've got to use a whip" to put pressure on the Swiss, saying the country should be put on a blacklist if it refused to become more cooperative on taxes.(1) The pressure increased as Germany employed what were considered illegal measures to acquire data from a Liechtenstein bank that revealed the identities of a large number of alleged German tax evaders.

Of course, there are those who say some countries' governments have gone too far in their regulatory zeal. In September 2008, the then-President of the Swiss Banking Association, Pierre Mirabaud, complained that surveillance had become almost "Orwellian." Swiss banking secrecy has been compromised in the eyes of many in the nation through events in the past years. In 2009, UBS agreed to release the identities and account information for about 4,450 clients believed to have violated US law, fearing that if it did not comply with the US request, it could have lost its US banking licence or faced a bigger fine. As it was, UBS paid a fine to the US government of €656.91 million.

Booking Centre Competition

The local regulatory frameworks governing various booking centres* can make these more or less attractive in the eyes of foreign banks and investors. Financial centres compete for business. This also is a major factor driving regulation, as the various centres demand that they be granted a level playing field. Competition also has become fiercer due to new financial hubs that have sprung up in past years. Singapore in particular has become a force not only in Asia, but globally. In only four decades it has established a thriving financial centre based on strong international trading links, efficiency, deep and liquid capital markets, and a strategic location as the gateway to Asia. In 1999, Singapore's government decided to establish Singapore as a private banking centre. The subsequent regulatory developments have boosted the growth of the industry, making it one of the most significant emerging financial centres. Hong Kong, too, has grown in importance to wealth management and private banking. Hong Kong, a special administrative region of China, has a strong economy, excellent domestic and international services, and a long history as an international trade and financial centre.

CONCLUSION

In terms of banking, Switzerland is a financial powerhouse. With two global banks, and a number of private institutions managing client wealth, the assets overseen by these institutions both for Swiss nationals and nonresidents totaled 5.5 trillion Swiss francs at the end of 2010. The regulatory environment for Swiss private banks will be influenced by many factors. Chief among these are rules governing cross-border business and those designed to protect consumers. Changes are expected to continue and will lead to more regulation. If the trend toward a separation of investment banks and banks taking client deposits continues, this could bring about changes that provide opportunities for mergers and acquisitions.

NOTE

1. Der Spiegel Online. Steinbrück sagt Steueroasen den Kampf an. 21 Oct 2008. Accessed Nov 2011. http://www.spiegel.de/wirtschaft/0,1518,585512,00.html.

APPENDIX: SOME KEY REGULATORY BODIES AND LEGISLATION

Rules and, therefore, costs rise with the number of markets a bank operates in. Rules governing different jurisdictions coupled with a growing body of legislation governing how a bank interacts with specific clients is further increasing costs and the time spent ensuring compliance is adequate to the task. It is the job of international regulatory bodies to turn the demands originating at the policy level into recommendations or minimum standards. Failure to implement these can be met with sanctions and the threat of exclusion. In this portion of the book, various international and national bodies are described that play a key role in regulatory oversight. There is also a description of some, but by no means all, of the pertinent legislation that is having an impact on the industry.

International Regulatory Bodies

While not exhaustive, this list provides an overview of some of the more significant regulatory organisations that have been active in the recent discussions on banking regulation.

Bank for International Settlements

The Bank for International Settlements (BIS) was established in 1930 and serves today as a centre to promote cooperation among the world's central banks. Regular meetings are held at its headquarters in Basel to discuss the global economy and markets. It publishes research reports, monitors worldwide lending, and serves as a forum for issues pertaining to international banking for both the public and private sector. It also provides the premises for the Basel Committee on Banking Supervision.

Basel Committee

The Basel Committee on Banking Supervision serves as a forum for representatives from over 20 nations, having been expanded over the past decade from a small group to a larger one, reflecting the growing importance of emerging nations to the global economy and the strong growth in bank assets in these economies. It formulates standards for banking that must be first drafted into national law to be enforced, the most recent being "Basel III." While the Committee does not have the power of enforcement, its rules offer a standard of continuity and uniformity that ideally should lead to a level playing field for banks throughout the world. The latest set of rules governing capital is set to be phased in starting January 2013 and to be completely in force by January 2019.

Financial Action Task Force (FATF)

The Financial Action Task Force (FATF) is an independent intergovernmental body that was established in 1989. With its administration housed in the OECD, it combats money laundering and seeks to halt financing of terrorist networks. Its 40 recommendations on money laundering and nine special recommendations on terrorist financing are aimed at curbing abuses in these areas. It also ranks countries in terms of their efforts to prevent criminal activity of this nature, bringing pressure to bear on those that fail to show progress in halting these activities.

Financial Stability Board

Previously known as the Financial Stability Forum, this body, like the Basel Committee, is based at the Bank for International Settlements. It includes both government regulators and representatives from major banks. Set up in 1999, it has a more hands-on role that includes assessing vulnerabilities that could arise in markets and the financial system. Its tasks also include monitoring markets, contingency planning, and setting up early warning systems.

International Monetary Fund (IMF)

With its 187 member countries, most countries in the world belong to the IMF. It aims to promote international monetary cooperation and exchange rate stability. It also can provide resources, including loans to members suffering payment difficulties. Among its activities in response to the financial crises, besides lending programs to emerging countries, recently it has assisted Greece by providing loans during the crisis in Europe, its largest direct access to lending (as opposed to "precautionary access" to a loan that might not be drawn down). The IMF also makes global and country economic assessments, and can offer advice on necessary reforms to ensure soundness in the financial system.

OECD

The Organisation for Economic Cooperation and Development (OECD) provides information and advice to its 34 member countries. Apart from providing offices for the FATF described here, it publishes a range of research including studies examining the reasons for the financial crisis in 2008, and ways to address the resulting economic downturn.

Partial List of National Regulators

EU

European Union (EU) regulation at the supra-national level is still rudimentary. The European Central Bank has no direct mandate to regulate or supervise banks. Much more focus to date has been on achieving a single market among the member states within the 27-nation European Union. These individual countries take decisions that affect their own markets. Germany's Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin for short), for example, works to ensure the stability of the German financial system. It is the main supervisor for the country's financial institutes, including 1,900 banks and 717 financial service institutions, as well as 600 insurers. In France, regulation of banks is conducted by the Banking Commission (Commission Bancaire) within the Banque de France. In Italy, the Bank of Italy, and the Commissione Nazionale per le Società e la Borsa (CONSOB) supervise the country's banks and financial markets.

Switzerland

The Swiss Financial Market Supervisory Authority (FINMA) protects investors and ensures the functioning of financial markets. It also acts as a supervisor and regulator for the financial industry and has authority over banks, insurance companies, exchanges, and securities firms and investment vehicles. FINMA is also the regulator in Switzerland responsible for adopting the global capital adequacy standards spelled out by the Basel agreements, including Basel III, into national law. The Swiss traditionally make the rules tighter, adding the so-called Swiss finish to boost capital beyond the minimum spelled out by the international guidelines.

United Kingdom

One change in the UK, in the wake of the 2008 crisis, is that one of the country's regulators, the Financial Services Authority (FSA) that was financed by the firms that it regulates is being abolished in 2012, following what was viewed as its widespread failure to adequately oversee the markets it was supposed to be monitoring. The Bank of England, (BOE) founded in 1694 as the government's banker, will instead absorb the FSA. Besides its role as a central bank, the BOE is responsible for protecting and enhancing the stability of the UK's financial systems. As the FSA is being merged into the BOE, a new independent body has been created within the BOE, the Financial Policy Committee. Its task will be to identify, monitor, and take action to remove or reduce risks that could be potential threats to the financial system. The third part of the UK's regulatory governance structure is the country's Treasury.

United States

In the United States, the banking regulatory framework comprises several different bodies. The Federal Reserve oversees state banks and trust companies that belong to its system, and the Federal Deposit Insurance Corp. regulates state banks that do not belong to the Federal Reserve System. The Fed also ensures that markets operate efficiently. In times of extreme turmoil it can, for example, inject liquidity through its open market desk. The Office of the Comptroller of the Currency regulates US banks that have the word “National” or “N.A.” after their names, generally the largest banks. Regulators also include the National Credit Union Administration, and the Office of Thrift Supervision. In terms of market regulation, the Securities and Exchange Commission (SEC) has as its main objective to protect investors and maintain fair and efficient markets. The Commodity Futures Trading Commission (CFTC) is a government body that regulates futures and options markets in the United States, and like the SEC it can levy fines and sanctions. Unlike bank regulators that are regulated by outside agencies, the US futures industry is overseen by a self-regulatory (industry) body, the National Futures Association. The Internal Revenue Service (IRS) is the federal body that oversees and operates US tax filings. In the fiscal year 2010, it collected more than €1.94 trillion in revenue for the government and processed more than 230 million tax returns.

Hong Kong Monetary Authority

The Hong Kong Monetary Authority (HKMA), which serves as Hong Kong’s central bank, is responsible for regulating and overseeing banks that fall within its region. The HKMA strengthened its supervisory role following the global financial crisis. It conducts reviews of both institutions and markets, and cooperates with other bodies in the region, including the Securities and Futures Commission, in conjunction with the Financial Secretary.

Monetary Authority of Singapore

The Monetary Authority of Singapore (MAS) serves as the central bank to Singapore and also has an extensive regulatory function. Singapore’s Parliament passed the Monetary Authority of Singapore Act, which created the MAS on January 1, 1971. It has the authority to regulate all elements of monetary, banking, and financial aspects of Singapore.

Regional and National Legislation

Here is a brief overview of some, but by no means all, of the significant regulatory developments that have been relevant for private banking during the past few years.

United States

QI

The Qualified Intermediary (QI) agreement governs foreign banks’ dealings in US securities and the treatment of US clients by foreign banks. Introduced January 1, 2001, it requires that foreign banks document all clients to determine whether the account holder or beneficiary is a US person as someone who would fall under the QI Agreement. US residents and US citizens as well as green card holders must then decide to opt for voluntary disclosure of information or else refrain from investing in US securities. If the bank fails to comply, it will lose its QI licence and can be prosecuted criminally. The QI process represents a simplification of the administrative processes for banks. It also preserves Swiss bank secrecy by leaving it up the client to choose either to disclose information or stop investing in US securities. Given that the QI regime is actually not a tax compliance regime, the US authorities want to amend the current model by implementing the so called FATCA regime, which will require the disclosure of all US clients regardless whether or not they are holding US securities.

FATCA

In March 2010, the United States signed into law the Foreign Account Tax Compliance Act (FATCA). The law aims to ensure that financial institutions outside of the United States report information on US citizens who hold accounts. The Act was actually contained within the Hiring Incentives to Restore Employment (HIRE) Act; based on comments by US official bodies, it is an important development in that country’s efforts to combat tax evasion by US taxpayers with investments in offshore accounts.

Dodd-Frank

The Dodd-Frank Wall Street Reform and Consumer Protection Act was passed in 2010 in the United States. Named for its two sponsors—Barney Frank (Representative, Democrat, Massachusetts) and Chris Dodd (retired, Senator, Democrat, Connecticut)—it creates new regulations pertaining to bank capital and leverage. It also makes changes in some of the agencies with oversight capability and adds some new ones.

European Union

Withholding Tax

The EU Withholding Tax is part of the European Savings Directive on the taxation of income earned on interest within the single market. Taking effect on July 1, 2005, its aim was to ensure that banks in all countries disclosed interest earnings of all EU accountholders. Switzerland and some other countries were unwilling to disclose account holders' names, however, as this would violate bank secrecy laws. The withholding tax was agreed on as a compromise. It allows governments to receive the tax on interest income, while the bank can still preserve client confidentiality. Individual clients can either opt to waive secrecy to avoid paying the withholding tax or to maintain their anonymity and pay the tax, which now is 35 percent. The scope of the Directive is limited; it covers only individuals and interest payments.

MiFID

The EU's Markets in Financial Instruments Directive (MiFID) came into force in November 2007. It aims to integrate European financial markets and improve the organisation and functioning of investment firms, facilitating cross-border trading and increasing investor protection. It applies to the 27 EU members, as well as Iceland, Norway, and Liechtenstein. Firms covered by MiFID are authorised and regulated in their home country. An authorised firm can use the MiFID "passport" to provide services to customers in other EU member states. It works on the principle that politicians should focus on the main objectives of the legislation, leaving technical details to be worked out afterwards by specialists. In this case, the European Securities Committee (ESC) and the Committee of European Securities Regulators (CESR) worked on the second (specialist) level. The CESR can then issue nonbinding guidelines for implementation by the member states (level 3) and finally, at level 4, the European Commission monitors implementation in national legislation. Those firms that do not conform to the guidelines can be prosecuted in the European Court of Justice.

Double-Taxation Treaties

Switzerland—OECD

Double-taxation treaties are bilateral agreements between countries dealing with the proper allocation of taxes in an international context. These agreements also include a paragraph pertaining to the exchange of information in tax matters. The OECD provides a double-taxation model agreement, which recommends a structure and the contents of such agreements between OECD member countries. In March 2009, Switzerland agreed to adopt the OECD standard on providing administrative assistance with regard to tax matters, including the exchange of information clause (Article 26) in the OECD's agreement. This allows for exchanging information on tax matters in cases where a "specific and justified request" has been made. Following the agreement, the Swiss Federal Council directed the Swiss Federal Department of Finance to begin negotiations on revised double-taxation agreements with various countries, including the United States.

Switzerland—United States

In 2009, following Switzerland's show of willingness to adopt the OECD's standard on tax assistance, the Swiss government officially declared that it would cooperate with the United States in offering assistance not only in cases of suspected tax fraud, which were considered more serious, but in tax evasion cases, which in the past were considered a less grave offence. At the same time, Swiss banks have adamantly resisted attempts to allow so-called fishing expeditions by which foreign authorities demand a great deal of client information, hoping to catch a few tax cheats.

New Bilateral Tax Agreements with the United Kingdom, Austria, and Germany

The treaties with the UK, Austria, and Germany on the introduction of a final withholding tax were signed in autumn 2011 and spring 2012. The agreements are expected to enter into force by January 2013, providing legislators in Switzerland, Germany, the UK, and Austria approve them. Similar treaties with other countries may follow. In a nutshell, the treaties stipulate that individuals domiciled in these EU member state countries may “regularise” their existing Swiss bank accounts and deposits either by choosing an anonymous one-off flat rate payment or by voluntarily notifying the respective UK, Austrian, or German tax authorities.

Going forward, income from assets (i.e., interest income, dividends, capital gains, and other income) held in accounts and deposits with Swiss banks received by clients who live in Germany or the UK will be taxed anonymously by withholding the payments at source. Or these clients, if they choose, may instead authorise their bank to disclose their income to the relevant tax authorities and pay taxes through the normal channels.

*A booking centre refers to the place where the assets of a client are booked. The location of the booking centre is then the governing law for assets booked in this location. Assets booked in Switzerland, for example, fall under Swiss law, those in Singapore under the laws of that jurisdiction, and so forth.

Chapter 5

Putting Clients at the Centre

It is important to understand the wishes, fears, opportunities, and challenges confronting clients. They are the key drivers in terms of how we shape the organisation to deliver on the promises represented by the brand and associated with the high standards that characterise this industry. One of the great things about private banking is that it allows you to meet people who have much experience and who often have been successful in their lives and careers. You can learn a lot from them. These people come from different walks of life. Each one has a story, from the heiress representing the new generation of a noble European family to a self-made millionaire who started a company in Asia. Each day, it is possible to discover a new facet of an industry, or a country, some interesting fact about an environment, or to meet people who found the right idea at the right time and realised their dreams. Regular meetings with clients are an important part of the business. You need to understand clients thoroughly to ensure that your capabilities and offerings best suit those you are serving. These are people who depend on their banks to keep them informed and preserve their wealth. The following chapter presents an overview and touches on some pertinent topics related to this theme.

MAKING SENSE OF CLIENT DIVERSITY

How many kings can we serve? Private banking began in Switzerland almost 300 years ago when Geneva bankers started catering to the financial needs of a few French kings and noblemen. In recent years, wealth management has undergone dynamic growth and the industry is still expanding. At the same time, it must strive to satisfy the requirements of what is often an increasingly sophisticated and demanding group of clients, each one a “king” or “queen” in his or her own right who deserves to be treated accordingly. How can we build a scalable and profitable business model in such an environment? The answer lies in choosing the clients that will be our focus, then aligning our strategy and all our resources to best meet their needs.

In the 1970s, private banks enjoyed a steady influx of clients whose primary concern was finding a safe haven for their assets. The business environment was more stable, and clients were generally not as demanding as today. Rather than taking an active approach to investing, clients were willing to accept the solutions offered. This more passive attitude allowed relationship managers (RMs) to handle a fairly diverse clientele. A bank might have had some teams focusing on different regions, where foreign languages were necessary. International tax planning experts were available to advise clients. But the organisation rarely reflected the diversity, different backgrounds, and needs of clients nor addressed the various requirements of different local regulatory regimes. In the intervening decades, clients and the industry have evolved so as to be scarcely recognisable, and this has profoundly changed the dynamic of the client–banker relationship. Clients have become very sophisticated, able to access all manner of subjects, including financial topics and market information around the clock via the Internet. Clients also can go online to trade any kind of share or complex financial instrument in real time without needing to call their bankers.

To add value and match the right level of service to the proper client segment, today’s private banker must thoroughly understand the client and provide highly personalised solutions. There are more different types of clients than ever, ranging from those with little financial experience to those whose knowledge is on par with that of professional investors. At the same time, many private and universal banks have gone astray by losing sight of the original concept of private banking—the personal touch. Pressure to grow the business has tempted many banks to lower their minimum investment criteria and scale back service. Meanwhile, a number of retail banks have begun improving their services to the point where they can be considered respectable competitors in entry-level private banking. Globalisation and technology have allowed them to enter new markets, and they can begin to serve clients from widely diverse backgrounds within their own countries. But tackling these new regions requires staff who really understand the local culture and the regulatory and tax environments. The opportunities are limitless, but at the same time, the cost of operating the business has increased enormously. This is especially true when costs of complying with various regulatory regimes are taken into account. This regulatory overhead, an absolute necessity, is associated with every new venture, be it to enter a market, introduce a product, or engage in a different area of activity.

Because of these developments, a private bank must first of all understand the whole range of client segments, groups, and types. It must then decide for itself which of these offers the best opportunities and align its strategy and resources to capture its chosen segment. Chapter 6, “Beyond Products—Offering Tailored Solutions” looks at how a bank can match its offering to suit its chosen clients. This chapter focuses on making a case for segmentation, examining various possible ways that clients, while retaining their individual characteristics and needs, can still be grouped into categories of shared interests and requirements. It also explores in more depth the need for “dynamic” and “behavioural” approaches as opposed to static segmentation. It examines the channels available for attracting new clients and concludes with a discussion of the importance of client retention and some of the tools or approaches that can be used to ensure that clients are well served, to ultimately build on the existing relationship.

ARGUMENTS FOR SEGMENTATION

Segmentation is the process of separating clients into relatively homogeneous groups. The greater the number of different criteria applied, the larger the number of separate groups that can be created. Establishing client segments will allow the bank to tailor service and offerings that are best suited to an individual client’s nature and needs.

Segmentation is a well-established principle of modern marketing and is used in the financial services industry as well. The traditional private banking proposal is a completely individualised one; the ultimate segmentation would be into “groups” of just a single client. So what possible role can segmentation play in a private bank? Segmentation is useful in order to make sure that a bank has the right relationship manager assigned to the right client. Every relationship manager with more than one client also needs to segment in order to manage his or her client portfolio and resources effectively. The benefits of segmentation are numerous.

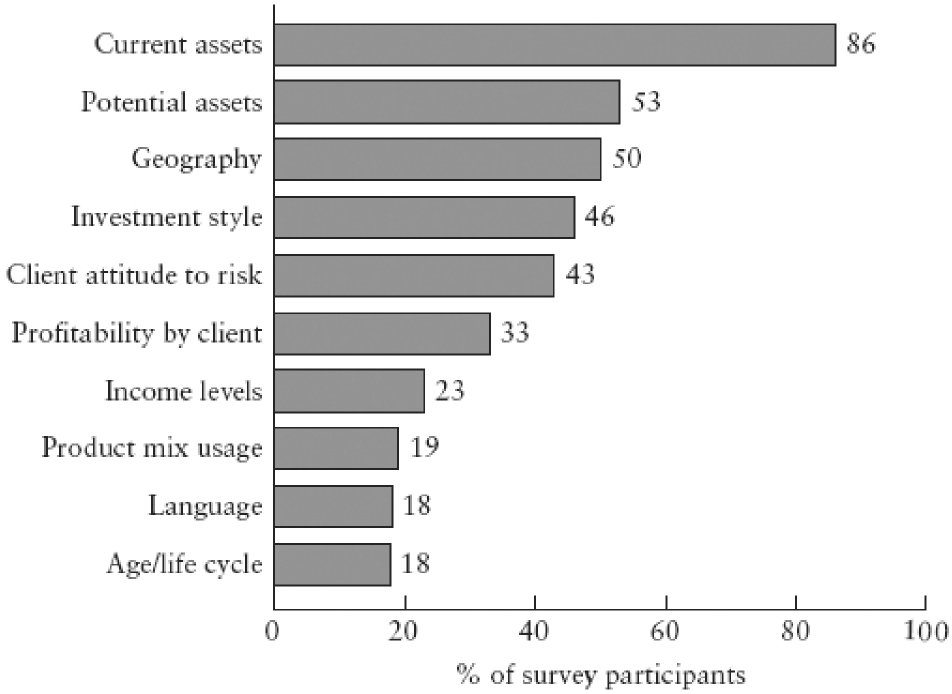
- Clients can benefit if banks or relationship managers use segmenting to improve the client’s experience—in other words, knowing in advance what typical needs or expectations the client is likely to have.
- Segmentation by country of client domicile allows banks or relationship managers to address regulatory and taxation topics more efficiently
- Banks and relationship managers can identify the most profitable or potentially profitable client group, and focus their resources accordingly.
- Banks and relationship managers can also more easily identify networks or communities and improve referral rates by developing special opportunities for particular client groups with similar interests, such as a passion for modern art exhibitions, attending classical music concerts, or golfing at an exclusive venue.
- Banks can raise their competitive profiles by positioning themselves as experts in specific areas.
- Banks can gain time and resources, which can be dedicated to better serving individual clients.

CURRENT SEGMENTATION PRACTICES

Segmentation is still a very “embryonic science,” according to a 2007 survey by PricewaterhouseCoopers.(1) According to the study, the majority of wealth managers still focus on clients with the greatest number of current and potential assets, meaning those who may offer the highest revenue streams. Other criteria such as investment style, age, personal characteristics, and source of wealth (old or new money) were far less prominent among the segments considered by those surveyed. See Figure 5.1.

FIGURE 5.1 Segmentation Criteria Commonly Used by Banks

Source: PricewaterhouseCoopers International Ltd. “A new era: redefining ways to deliver trusted advice.” Global Private Banking and Wealth Management Survey 2009



The study found that some 60 percent of organisations do not differentiate clients by behaviour type. Instead, the vast majority, 75 percent, still treat client risk appetite as the distinguishing feature. Only 62 percent of business managers have specific propositions for certain types of clients. Furthermore, a quarter of organisations surveyed said they did not treat their top 20 clients any differently from the bottom 20 clients. Just 54 percent of products and services, 42 percent of communication and information, and 47 percent of pricing offerings were tailored to specific wealth segments. Finally, when "behavioural criteria" are considered, clients often were just lumped into professional categories such as "entrepreneurs or professionals." All this is worth noting, given that sophisticated segmentation confers a significant competitive advantage at a time when the war to gain clients has never been more critical, and any failure to understand what clients want will mean that clients are lost to competitors.

Let us next briefly review what segmentation criteria can be used.

SNAPSHOT OF SEGMENTATION CRITERIA

There are a number of segmentation approaches that can take snapshots of the client or the market. These provide a static picture, making them easy to use. But a number of such criteria need to be examined in order to truly understand the individual client and tailor the offering accordingly.

The major criteria used here are:

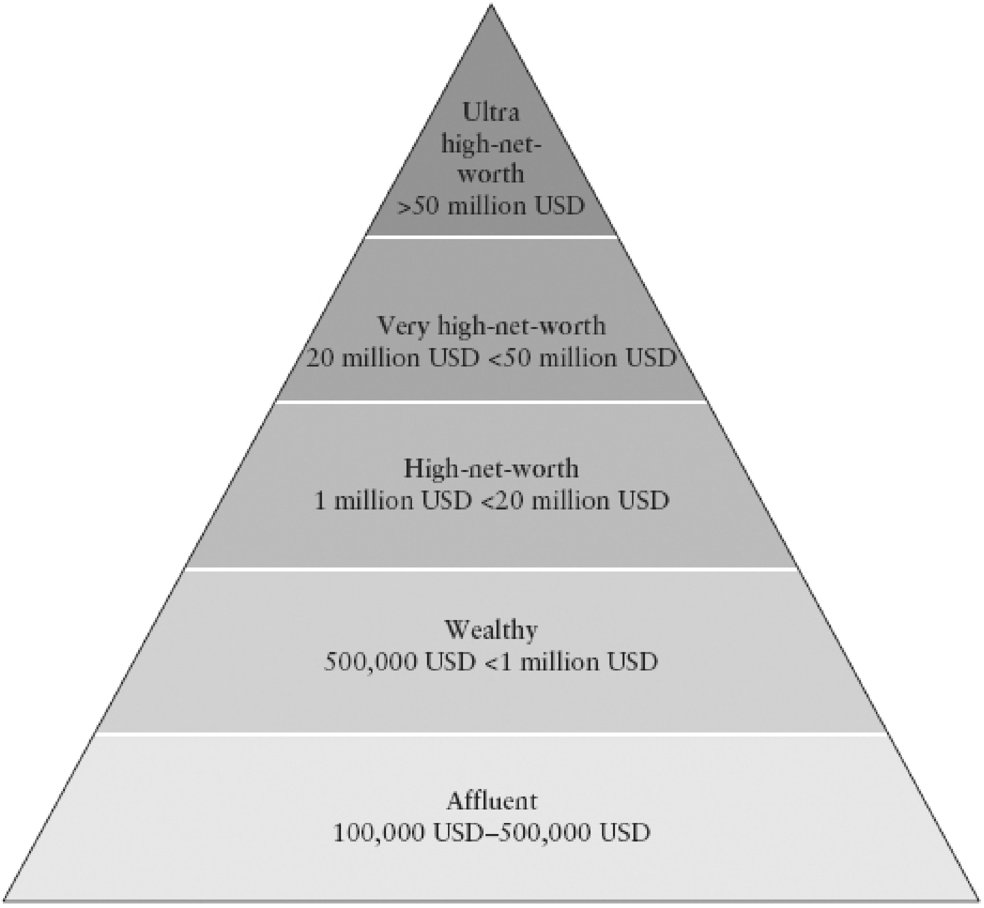
1. Client's level of wealth
2. Client's geographic origin or home base
3. Client's source of wealth

Level of Wealth

When discussing clients in the financial services industry, age and income are the most widely used segmentation criteria. These are popular because the data are readily available, and there is a strong correlation between these and broadly observed investment and purchasing patterns. In private banking, the level of wealth correlates with age and income. Consider the well-known wealth pyramid shown in Figure 5.2. The definitions of the wealth bands vary from institution to institution. They are expressed here in terms of high net worth (HNW) as follows: HNW (€0.84m <€16.84m); very HNW (€16.84m < €42.11m); ultra-HNW (>€42.11m).

FIGURE 5.2 The Wealth Pyramid

Source: PricewaterhouseCoopers International Ltd. "Anticipating a New Age in Wealth Management." PwC Global Private Banking and Wealth Management Survey 2011



Wealth is one of the most fundamental criteria. A minimum level of wealth or at least a potential level of wealth is required to be accepted as a private banking client. In that sense, wealth is the single most important segmentation delineator. It is also used by individual relationship managers to tailor their services, target offerings, calculate fees, control costs, and develop strategies. However, banks begin to organise client teams around such "wealth bands" only when it makes sense, meaning when they have enough clients in any particular group.

There is a common assumption that the higher the level of an individual's wealth, the more profitable that client will be. But in fact, the profitability may well decline as wealth increases, because wealthier clients are often more sophisticated and thus more demanding, and their bargaining power enables them to negotiate special prices and services. Consider the example of an ultra-HNW client who is a keen trader. To meet his expectations, the bank serving him would have to employ a trader exclusively to deal with his orders, and such clients often feel entitled to discounts on fees, based on the large volume of business they bring. A bank also would need to assign additional executive/managerial attention to the client throughout the acquisition and retention phases.

Clients with €0.84 million to €4.21 million in assets are a highly interesting group, being typically diversified and sophisticated enough to try out some of the special structured products on the market. It is possible to deliver excellent service to these clients, without the same range of complexity required by ultra-HNW individuals (UHNWI), including pricing and meeting special demands.

Geographic Origin

While many HNW clients often operate globally, they have clear patterns of needs based on their country of origin. Geographic segmentation once meant, for example, simply assigning a Spanish-speaking relationship manager to Latin American clients. But today, geography can also be a strong indicator of which approach should be used in terms of client investment strategies and their typical needs, allowing a bank to form and refine regional product and service strategies. The following generalisations can be made about clients based on their geographical origins. But as all clients are individuals, these are to be regarded, at best, as simplified guidelines.

Europe
Clients have a stronger focus on capital preservation and tax-efficient investment products, structures, and advisory services. There is keener interest in real assets such as property, ships, and businesses. These clients also tend to have fewer wealth management relationships. Old wealth is more widespread, which partly explains the emphasis on capital preservation. Discretionary mandates are common, but there is a tendency for money to move to advisory mandates as clients seek to become more actively involved in the investment decision process.

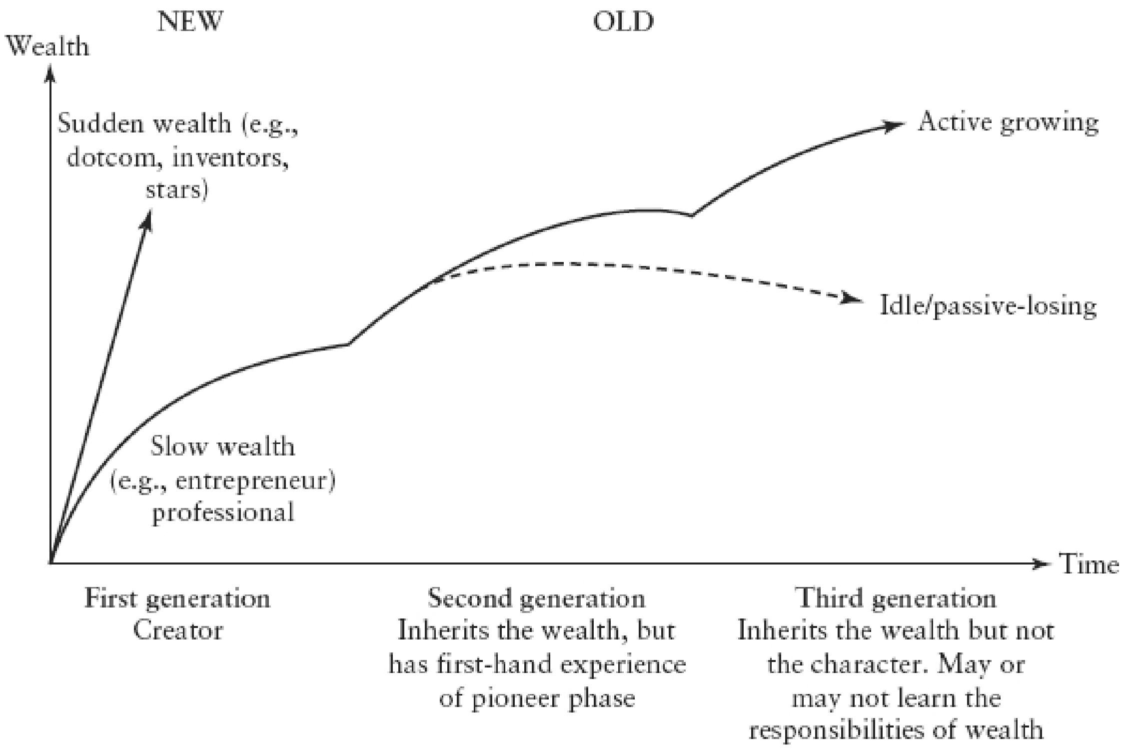
Asia-Pacific (excluding Japan)
Clients in these regions often have built their own companies and are more risk tolerant. Thus, they seek portfolio performance as opposed to wealth preservation. Typically, clients from these countries tend to save more, enabling them to invest a greater share of their incomes. A higher proportion of their wealth might be in real estate and privately held businesses. There also is an emphasis on investment opportunities in their respective regions. Such clients might also seek features of both debt and investment products. For some, leverage is an important theme.
Middle East
Many nations in the region are tax-free environments. Middle Eastern investors have traditionally favoured real estate investments and Islamic banking. However, clients invest in private equity funds, Islamic bonds, and funds of hedge funds. New investments are increasingly directed to Sharia-compliant investments. The profile of wealthy clients is changing from traditional family wealth connected to oil and gas production to wealth generated from other business activities.
Latin America
Traditionally, the focus has been on strong offshore banking relationships with an emphasis on client confidentiality. As the environment in many of these countries stabilises in the wake of what often has been a turbulent economic and political past, onshore banking is growing in importance, as is risk appetite. With interest rates around 10 percent or greater, fixed-income investments and privately held businesses or property are popular. Hedge funds and private equity are gaining acceptance. By and large, clients in these countries tend to be loyal and are willing to stick with a single wealth manager rather than seeking relationships with a number of providers.
Japan
Entrepreneurs dominate the client pool, and most of their assets tend to be reinvested to grow their own business. They are often more conservative with regard to the “rainy day” reserves that they entrust to wealth managers. Demographics may be one reason for this; many of these individuals tend to be older and typically take a more cautious approach to investing. Establishing client relationships is a slow, trust-building process, and strong brands play an important role. Regulatory obstacles make Japan a tough market for foreign banks. Capital export is highly restricted, keeping the focus on onshore banking.
Russia
Wealth in Russia is almost exclusively new, sudden wealth that was created with the advent of a free market after some 70 years under the centralised market system of the Soviet Union. Clients tend to be exacting in their demands, sophisticated, and usually driven by absolute return. Many are focused on security and wealth preservation, especially in the wake of the 2008 financial market crisis. The Russian RTS stock market lost nearly 73 percent in 2008, a meltdown that hit Russian ultra-high-net-worth clients particularly hard.(2) The 25 richest Russians lost a total of about €193.70 billion during a six-month period as markets and commodities prices tumbled.(3) In many cases this also has strained the client–bank relationship, making Russia a volatile business environment for private banks.
India
Indian HNW clients tend traditionally to be successful entrepreneurs who have accumulated wealth at a slow pace and seek wealth preservation opportunities. There is also a new class of young affluent people starting to emerge in the 20- to 40-year age bracket. These people have made money in business and equity investments. Indian clients residing in their home country tend to prefer to hedge investments across classes and sectors. Nonresident Indians, too, are a significant force. They tend to look for global and Indian investment opportunities, often preferring to go to a single source for comprehensive solutions.
China
Traditionally a strong entrepreneurial culture, great wealth has been created in this country, which now ranks third in the world in terms of the number of its dollar millionaires, behind only the United States and Japan.(4) Chinese clients prefer to invest in their own business and/or real estate rather than with a wealth manager, and very often are focused on wealth growth as opposed to capital preservation. Chinese capital flow restrictions are the most significant issue for international wealth managers.
North America
Clients have multiple wealth manager relationships and the emphasis is on a transaction-driven, commission-based model. These clients generally have at least two relationships to separate the advisory and brokerage activities, on the one hand, from the custodian role on the other. Family offices are more common, as is the use of discount and full-service brokerages and money managers. There is a tendency to maintain a clear distinction between business and private wealth, and there is a strong focus on equities.
Brazil
Brazil is Latin America’s largest wealth market. Wealth has grown rapidly, especially when calculated in US dollars, helped by the appreciation of the Brazilian real. Most of the country’s assets under management are held onshore, higher than the regional average. This reflects the strong positioning in the country by global institutions. A large proportion of the wealth is held by ultra-high-net-worth individuals.

Source of Wealth

Source of wealth is another commonly used segmentation criterion. The simplest distinction is between “old” and “new” money. New money has been created or earned by the client, whereas old money typically is passed from generation to generation, as is frequently the case in aristocratic or industrial families. Inherited wealth is most common in Europe, and comprises the smallest group of the wealthy in Asia, the Americas, and Russia. However, this will change within a decade or so, at least in the United States, as aging entrepreneurs whose fortunes were made in the post-war boom begin to pass on wealth to subsequent generations. Consider Figure 5.3. It adds two further refinements to the source of segmentation: one is the distinction between first-generation, second-generation and third-generation wealth, and the other is the speed at which the wealth was acquired—in other words, “sudden” or “slow” new wealth. With regard to succession, grandchildren are at least one generation removed from the pioneering efforts that created the wealth, and so it is often a greater challenge to educate them in the responsibilities that wealth confers. This generalisation should not be taken too far, however. A bank needs to reach out to heirs of clients with financial education and bonding exercises, but it must always bear in mind that potentially vast differences in character, education, and attitude can be encountered in this segment.

FIGURE 5.3 Wealth Waves Showing Old and New Money Effects

Source: Author



The relationship manager also may have to find a way to mediate conflicting desires, accommodating the lifestyle needs of heirs while taking on the duty to educate them in matters of capital preservation. The importance of considering both aims can be seen particularly among private banking firms that have served the European aristocracy. Whatever a relationship manager’s degree of influence might be, the ultimate goal should be to help the heirs to gain confidence in financial matters.

Looking at the time frame in which a fortune is acquired over a longer period of time, clients will often be comfortable with financial topics, and tend to be efficient managers or delegators, as well as perhaps being better able to conceptualise risks and strategies. Regional variations also make a difference. For example, Asian clients (apart from Japan) are often entrepreneurial wealth creators.(5) As such, they are more risk tolerant when it comes to a business that they can see, feel, touch, and control.

Unlike the slowly acquired “new” wealth accumulated through 20 or more years of building a career or business, “sudden” new wealth leaves the client little time to reflect, let alone develop an understanding of the ins and outs of managing a personal fortune. It could be money generated by a private business, or from large performance bonuses, or senior executive salaries. Beneficiaries of sudden wealth may feel less confident about money. They might be sports figures or media personalities who earn vast amounts through royalties or sponsoring contracts. This group is often relatively young and financially inexperienced. Exhausting rehearsal or training schedules also place significant demands on these clients’ time. Add to that the intense pressure of public performances, or other professional obligations. The net result is often a client who needs special insurance services, jargon-free explanations, and adequate long-term provisions. Efforts by some banks in recent years to cater to sports professionals, for example, demonstrate there is a business case to be made for targeting specialised groups of clients.

Those who have accumulated wealth steadily have had time to gain expertise in making financial decisions, while those whose wealth arises suddenly often lack experience, and their appetite for risk might not match their risk tolerance. In general, the more sudden and irrational the wealth's source, the greater will be the client's fear of loss and the consequent need for secure investments that guarantee a specific level of income. The same principle applies to wealth that was created in unstable economies or in countries where clients may fear confiscation, inflation, or war.

The chart showing wealth waves in Figure 5.3 adds an important element missing from most "snapshot" segmentation pictures: the client's story. But even here, the source of wealth doesn't say much about the client's experience and requirements. To gain a better idea about that, we need to consider behavioural criteria to better understand the client's needs.

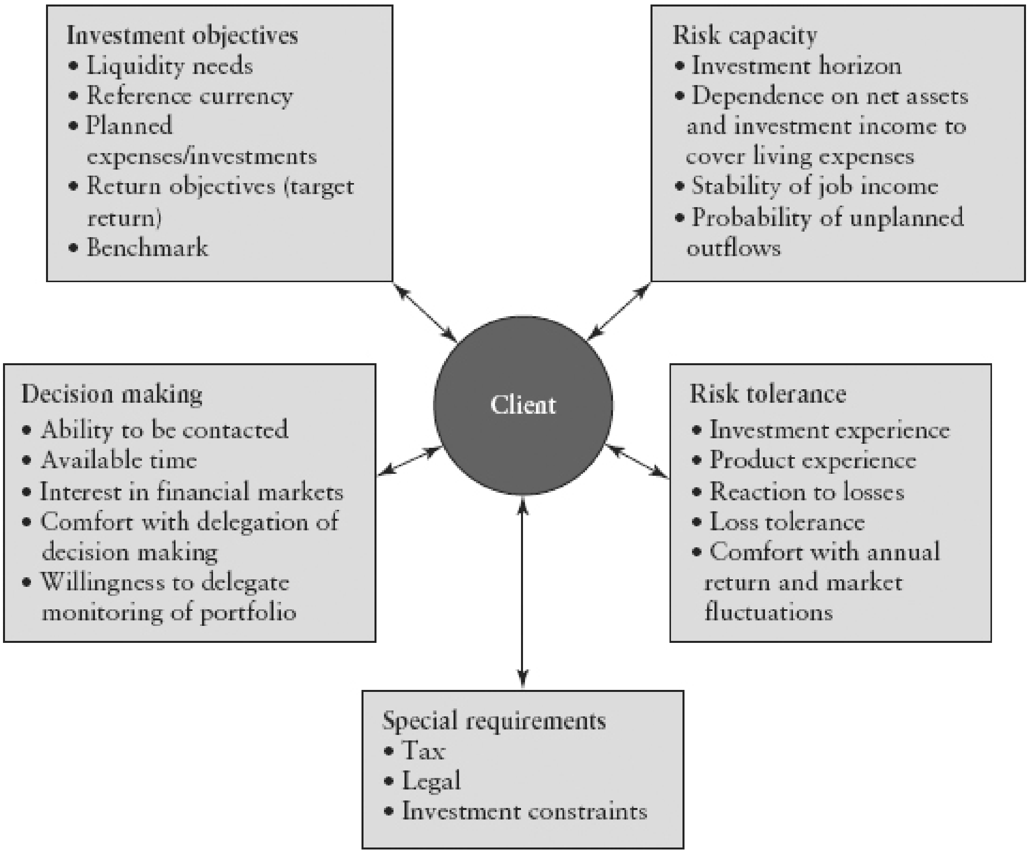
BEHAVIOURAL SEGMENTATION

We can categorise clients according to an array of criteria, including their objectives, capacity and tolerance for risk, sophistication, and any specific investment restrictions or specifications in what can be considered the five dimensions that make up an individual's investment profile, illustrated in the following chart. Although information is available on a client's product mix and investment style, it is also important to predict what a client might do in future, rather than simply labeling him or her on the basis of past behaviour. This means that a good relationship manager is also something of a psychologist, who, to serve the client in the best way possible, must understand the client's personality. Does the client prefer to initiate or respond? Does he or she tend to delegate more or prefer to participate? Is he or she a strategist or an opportunist, an accumulator or a preserver?

INVESTMENT ADVISORY
At Bank Julius Baer, five "dimensions" are considered in the investment profiling process: investment objectives, risk capacity, risk tolerance, special requirements, and approach to decision making.

FIGURE 5.4 Investment Profile

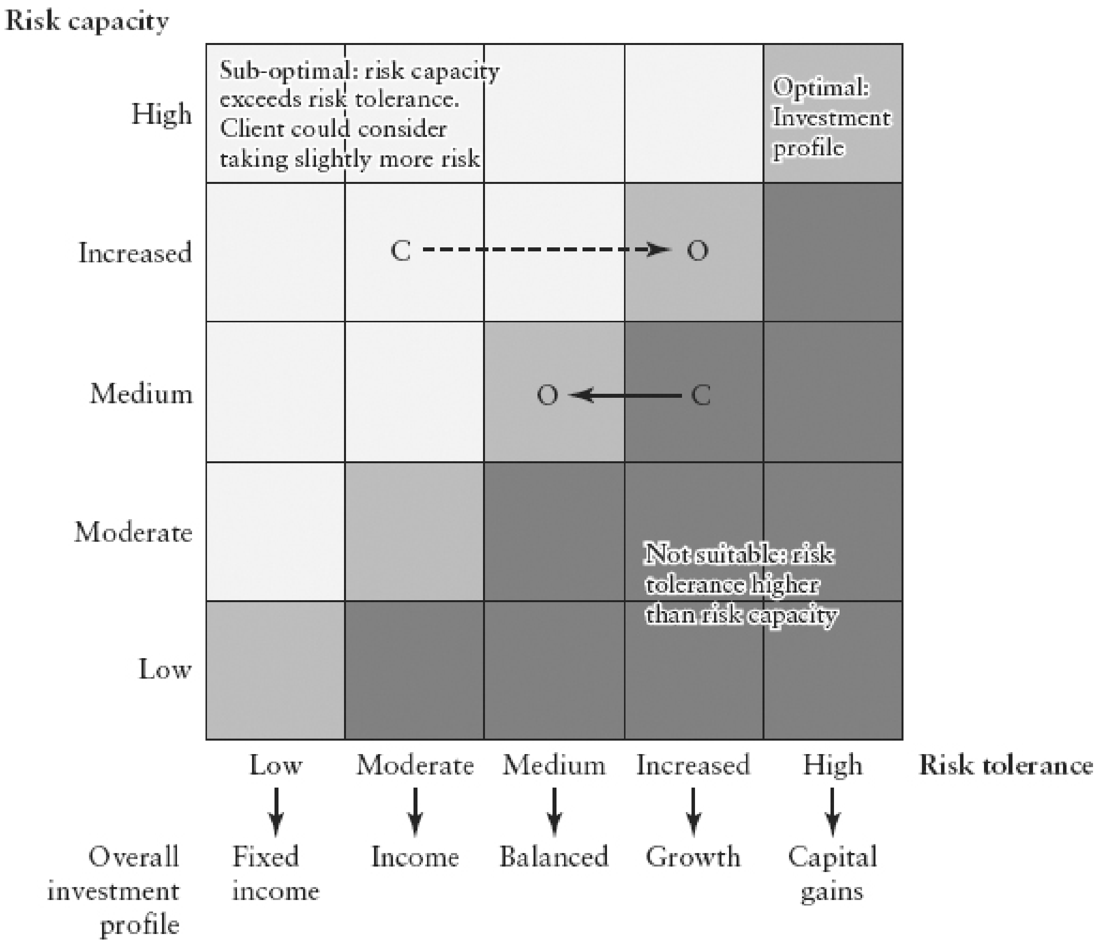
Source: Julius Baer



For each dimension there is a set of specific questions that the RM can pose to the client to assess his or her investment profile. Julius Baer distinguishes here between risk capacity and risk tolerance, based on the perception that some clients' risk tolerance may in fact exceed their capacity for risk. Julius Baer considers it the ethical responsibility of an RM to try to help the client to harmonise these two aspects, or at least to take the more conservative element of the two. Note that the profiling process also takes into account detailed aspects of the client's lifestyle; this includes how available the client is to make decisions, as well as the client's liquidity needs, based on his or her investment horizon, insofar as these relate to the risk capacity and the investment decision-making process.
The matrix shows how the calculated risk "c" should be shifted to the optimal risk "o" position.

FIGURE 5.5 Risk Matrix

Source: Julius Baer

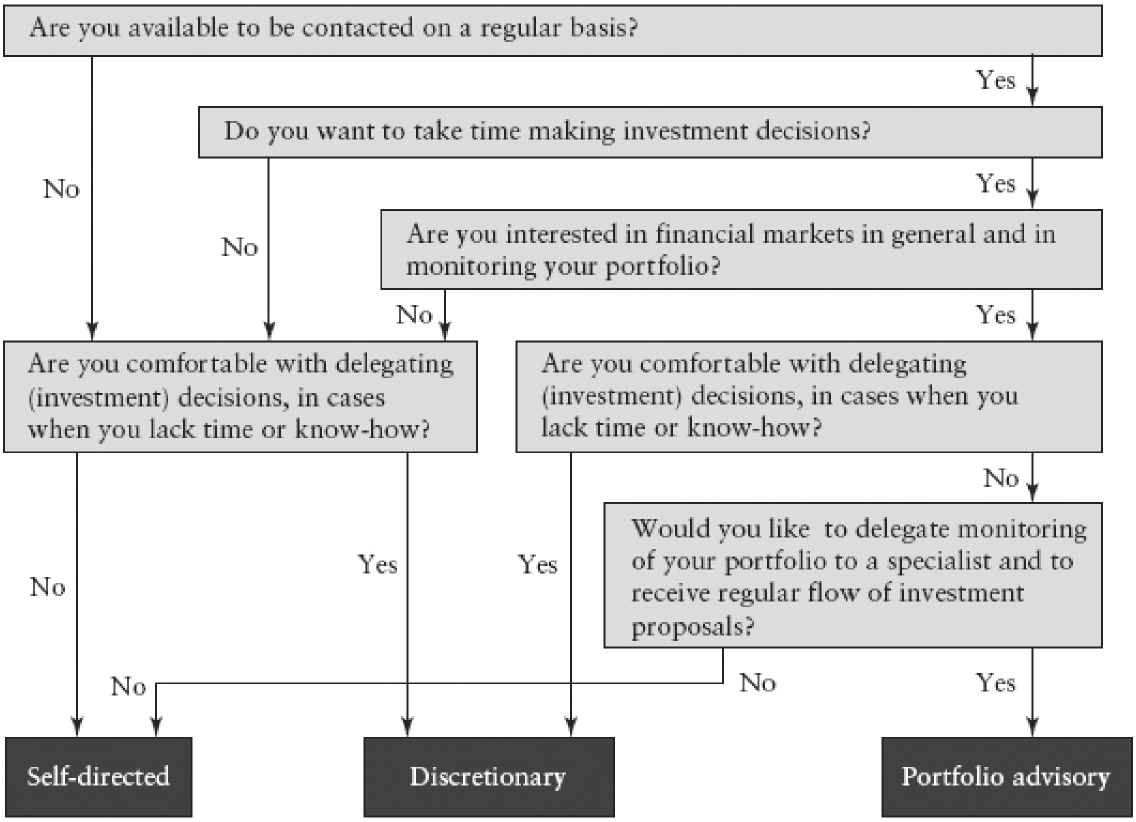


A relationship manager must assess which approach best suits a particular client during their initial meetings. This is done through a series of analyses to determine the client's investment type and risk tolerance, by asking questions and using so-called metrics to gain further details. This information can be weighed when determining which investment strategy and related product set to propose.

Consider Figure 5.6, which shows how Bank Julius Baer assesses the client's decision-making style, using a series of simple questions. This allows the bank to determine whether a client is likely to fit into one of three groups: self-directed, discretionary, or portfolio advisory.

FIGURE 5.6 Determining Clients' Decision-Making Preferences

Source: Julius Baer



Consultants have identified at least three profiles based on behaviour, which can be effective ways to segment clients: are they delegators, participators, or selectors? There is even a fourth category comprising ultra-high-net-worth individuals. Creating this separate category can be justified on pragmatic grounds, as there is some validity to the argument that being an UHNWI is associated with a set of specific needs and behaviours sufficient to justify a separate segment, providing that the bank has a sufficient number of these clients.

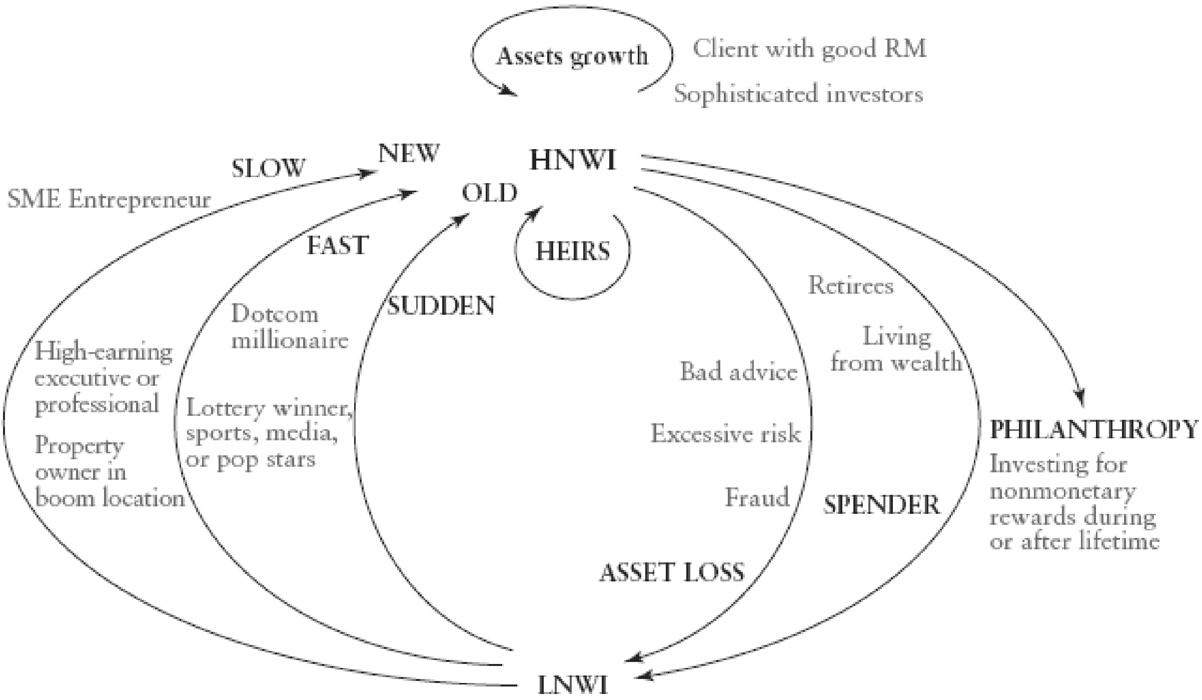
- Delegators desire asset management solutions requiring only slight involvement, in effect outsourcing their responsibilities to the private bank. They need a reliable and empathetic professional advisor, clear responses, effective reassurance, and disciplined management.
- Participators want more involvement in the decision-making process. Investment is an enjoyable hobby to them. They need to be supplied with a good stream of investments from which to choose and want access to what they consider to be privileged information or opportunities.
- Selectors are financially sophisticated investors who pick and choose their products and services. They need to see products and services they consider innovative, along with high standards of delivery and a long-term investment in the relationship.
- UHNWI clients demand higher levels of individualised service and an intense focus on their needs to a greater degree than any other client group. Their expectations change rapidly, and these clients purchase services in a manner that is almost institutional. They demand extremely professional service, complexity management, and networking opportunities.

Segmentation along the Client Wealth Life Cycle: Keeping an Eye on the Bigger Picture

To visualize the wealth dynamics of clients, we can use the Wealth Life Cycle represented in Figure 5.7. On the left side are those who are amassing assets, becoming high-net-worth individuals (HNWIs). On the right side are those who are using up their capital base and are reducing wealth, becoming lower-net-worth individuals essentially (LNWIs).

FIGURE 5.7 The Wealth Cycle

Source: Author



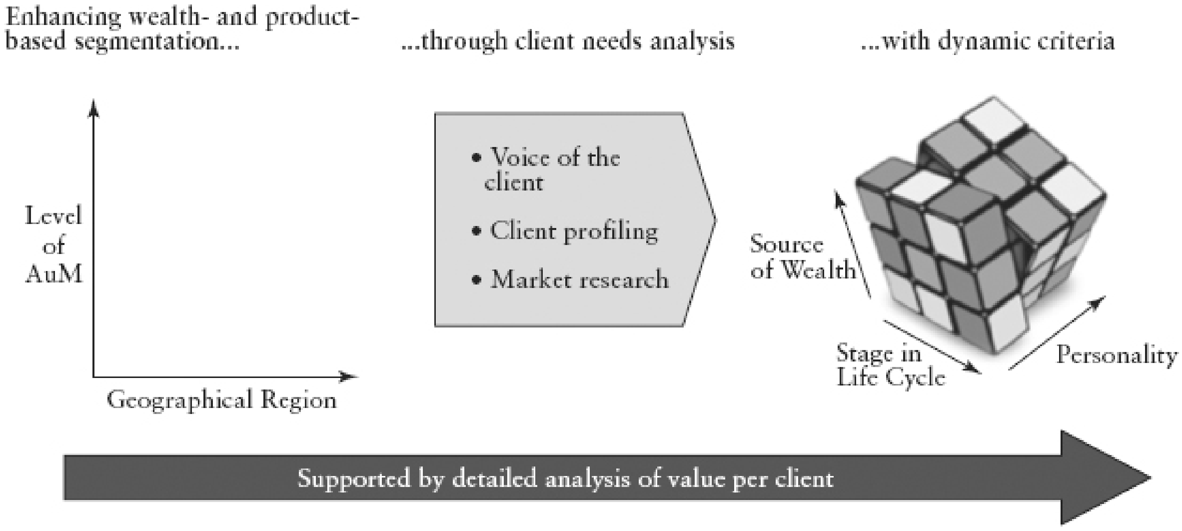
The paths shown by arrows correspond to various routes to riches, and alternatively, to losing or giving up wealth. The longer arrows indicate a slower transformation. Slower increases and decreases in wealth are placed further to the outside. Clients experiencing faster gains and losses are positioned closer to the centre of the diagram. At the top, we see one feedback loop for inheritance and one for asset growth.

On the declining wealth side, we find victims of fraud or bad advice in addition to those who have miscalculated their risks. Rich pensioners, those people living from their wealth, and philanthropists may also see their asset base decline, though this latter group probably will not mind at all. Some experts believe that the future of private banking is incomplete without a strong line in philanthropy consulting, based on the perception that portfolio growth is relatively uninteresting to HNWIs above a certain level and that a bank can therefore differentiate its brand by helping these clients use their wealth to leave a meaningful legacy. The largest banks have recognized this trend and offer specific philanthropy services for their private banking clients, including not only families that in the past might have set up private foundations, but also those with less wealth, who nonetheless would like to take the initiative and contribute to society, address problems affecting the environment, or support other specific causes.

Trying to gain a more client-centric view, it is necessary to move from a static snapshot to dynamic representation, as shown in Figure 5.8. Within the bigger picture, clients are likely to be busy building a business, amassing a fortune, securing or enjoying a lifestyle, while providing for the future or leaving a social legacy through philanthropy. The private banker will be just one of a string of advisors contributing to the flow of ideas or solutions in this process. In all cases, it is wise to remember that clients do not want their “relationship” managed. They want their assets managed. They desire the highest level of service, ideas, and performance, all at the appropriate risk level and without any legal or fiscal complications.

FIGURE 5.8 Increasing Dimensions in the Segmentation Process

Source: Author

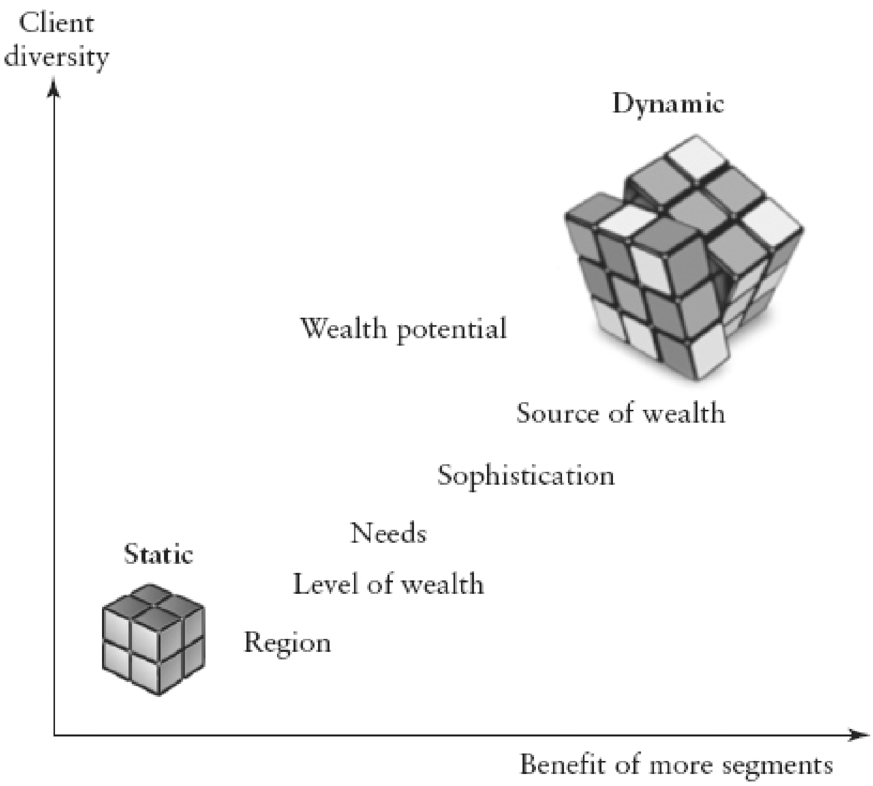


Segmentation requires effort; it needs time and resources for systematic research, looking both at existing and potential clients, as well as markets. It can be costly and time-intensive. This is why the use of segmentation approaches depends very much on how many clients ultimately might be included.

As illustrated in Figure 5.9, the more diverse the client base, the more value can be derived, for both the bank and its clients, from each additional segmentation level, or dimension. If segmentation produces some key insights and "eureka" moments, there also may well be some internal challenges. A bank might need to reorganise its business to effectively use the insights gleaned from segmentation.

FIGURE 5.9 The Relationship between Client Base Size and the Increased Benefit of Segmentation

Source: Author



Finally, one must keep everything in perspective. Each private bank has its individual approach to business. In the end, it does not matter how clients are segmented as long as you align your resources accordingly. The bottom line is to choose the right solution for the client and the business.

ATTRACTING NEW CLIENTS

Having determined which clients you will target, you need to align all the resources of the organisation in order to attract and retain these clients.

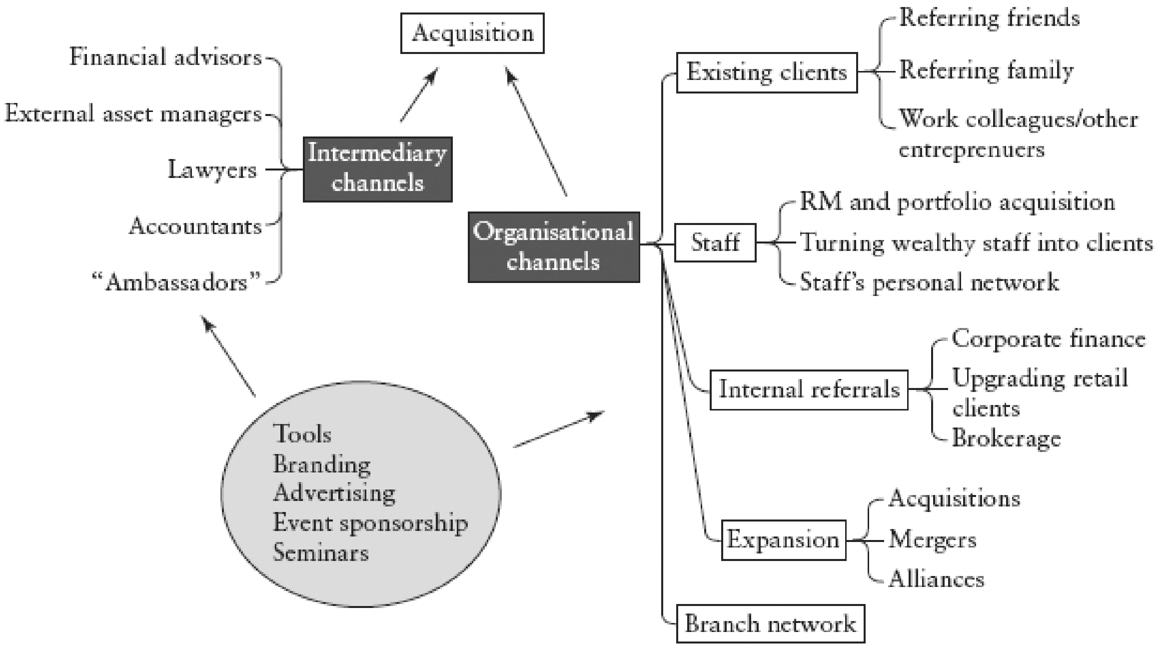
This section covers possible avenues to gain new clients and how various factors can have an impact on the process. It then discusses the importance of client retention and specifies some basic tools to provide an early warning as to whether a client might be contemplating switching to another provider.

Channels and Tools

There are two channels private banks can employ in seeking new clients: Figure 5.10 depicts both the organisational channel and a second channel via intermediaries. Both can serve as ways to gain access to potential clients; in the figure that follows they are ranked from most to least important. A range of tools representing specific activities is shown at the lower left.

FIGURE 5.10 Ways to Reach Out to New Clients

Source: Author



Organisational channels are those that draw in clients by virtue of the organisation's existence. They include current clients, staff, organisational or internal referrals, the outcome of organisational expansions (mergers, acquisitions), and the physical presence of the bank in the form of a branch network.

Intermediary channels are all types of third parties or individuals outside of the organisation that have regular contact with clients on behalf of the bank, be it on the basis of paid commissions or through informal relationships. These channels include independent financial advisors, lawyers, and even famous personalities. Tools such as branding, advertising, and event sponsorship or seminars can be part of both the organisational and intermediary channels.

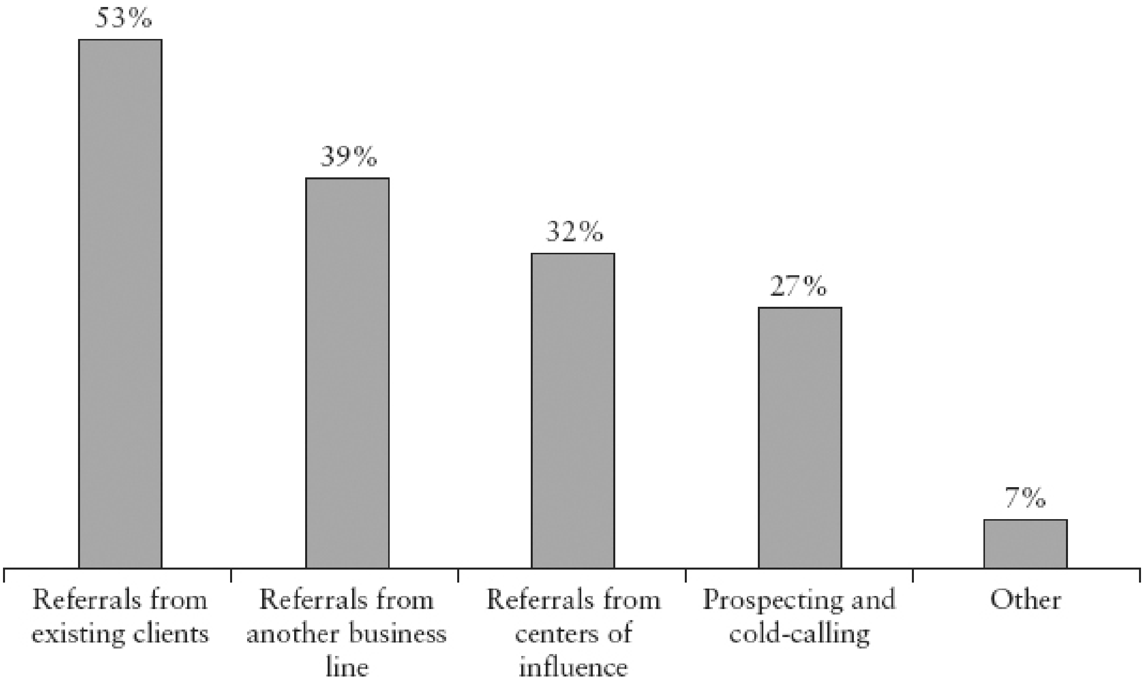
The most rewarding acquisition sources are referrals from existing clients, indicating that they are satisfied with the service. This is a compliment to any bank. In addition, internal referrals and referrals from all types of intermediaries may play a part. The staff channel is also a major source for recruitment of a relationship manager who can bring a portfolio of clients to the bank.

These widely recognised sources are used to a varying degree. Most banks have a formal process for "incentivising" intermediaries. Internal referrals (such as when clients are recommended from another part of the bank) may be encouraged, but on a less systematic basis. This also depends on the bank's culture. Client referrals are generally under-utilised. Few relationship managers have the courage to ask their clients for referrals directly, even if clients would be happy to provide them. Relationship managers, it must be underscored, need to be courteous to clients but perhaps a bit more open in this respect. Indeed, research indicates that most clients are actually happier with the bank than most relationship managers assume. Therefore, these clients are likely to be more open to a referral request than the relationship managers generally would expect.

In a survey conducted by the VIP Forum in 2008, over 2500 advisors across 33 financial institutions were asked to approximate the percentage-amount of referrals (from a given referral source) that would result in new client business. As illustrated by the survey results in Figure 5.11 "Referrals from Existing Clients" convert to new business at the highest rate compared to the other referral sources—53 percent of referrals from existing clients result in new business compared to "Prospecting and Cold-Calling" where only 27 percent result in new client business.(6)

FIGURE 5.11 Percentage of Referrals Resulting in New Client Business (per Different Source of Referral)

Source: VIP Forum. Corporate Executive Board, "Boosting Advisory Productivity: Benchmarks for Developing and Managing World-Class Advisors," Arlington VA, 2008

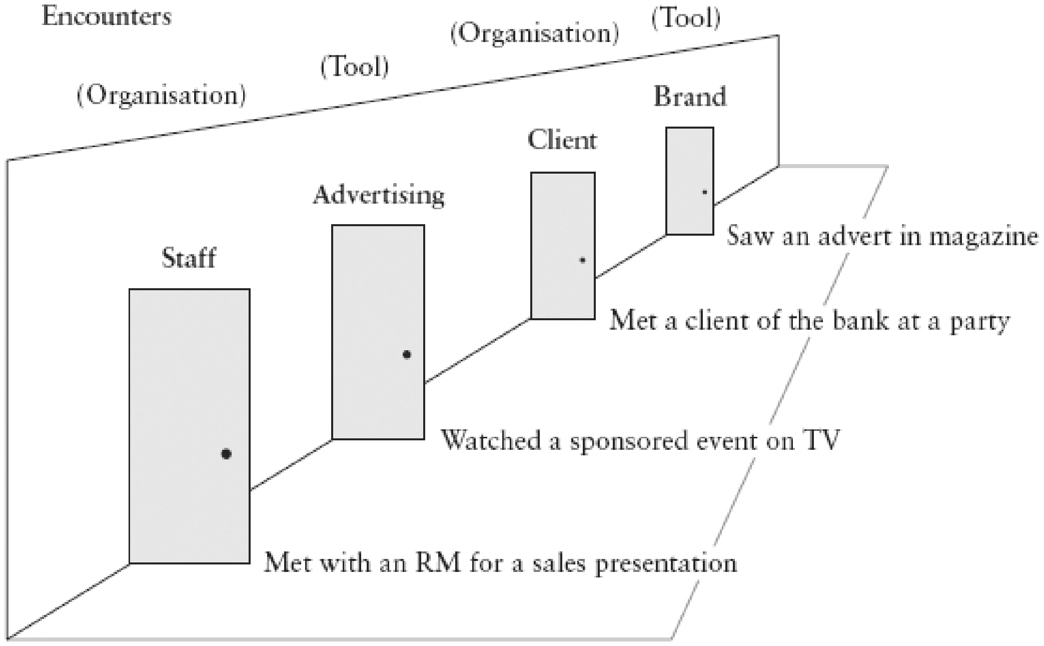


It is tempting to believe that it is feasible to do away with marketing and brand building in order to focus on the most fruitful channels for gaining clients. But marketing managers need not fear. Today it is no longer possible to do without them. A broader approach taken to serve a variety of clients along with increased transparency in recent years have increased the need to position the brand. To reconcile these seemingly conflicting aspects, the client's choice of a bank ultimately comes down to a range of factors. Attributing it to any one single motivator will always be a gross oversimplification.

The client corridor approach (see Figure 5.12), also described in Chapter 8, "Delivering a Superior Client Experience," is a helpful analytical tool that can be applied to better understand the impact of organisational and marketing influences. Out of four encounters that contribute to an individual's journey from being a prospect to a becoming a client, two are based on organisational channels, and two on what one could call tools such as advertising and brand. In reality, there might be an intermediary channel involved, and there would be many more touchpoints or encounters along the way.

FIGURE 5.12 The Client Corridor Visualises and Assesses all Encounters between the Prospect and the Bank

Source: Author



HELPING HEIRS OF CLIENTS TO UNDERSTAND MONEY AND THE BANK: EXAMPLE OF AN ACQUISITION TOOL

Apart from targeting an entire family with sponsorship and events activities, many banks (including Julius Baer) also run programmes specifically designed to build relationships with heirs of HNWIs by offering them the chance to acquire wealth management skills and to network with peers. For example, Julius Baer operates a programme where it invites the 18- to 23-year-old heirs of their largest customers to Zurich for a week. The programme includes leadership, investment and banking skills training, and evening social events. The aim is to give them the skills they need to manage the family assets while at the same time strengthening bonds with the bank.

RETAINING CLIENTS OVER THE LONG TERM

Long-term client relationships make sense for both the client and the bank. A trusted advisor relationship must be built over time, so retention is key to achieving good relationships. For the bank, taking on new clients represents a significant cost factor. For the client, switching banks can be disruptive. Some clients remain with a single bank throughout their lifetimes, a fact that can enhance a valuable relationship.

Client Lifetime Value

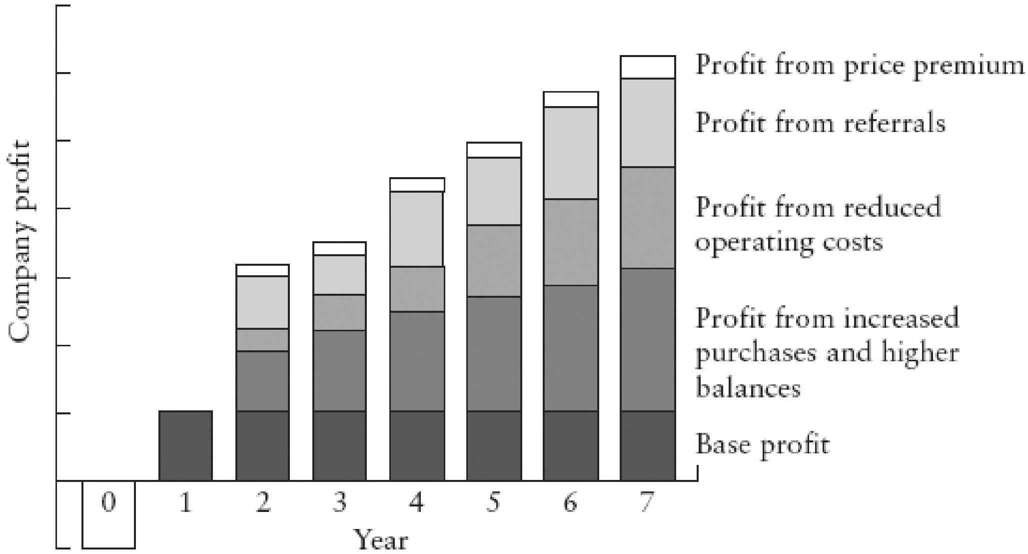
One obviously cannot put a value on a human being. For the purpose of private banking, however, the client–bank relationship creates value for the client and the bank over time; the more successfully the client's wealth is managed, the more profitable the relationship is likely to be for both the client and the bank. The bank might also look at a client as generating a value that goes beyond the current profit margin. To calculate the value of a client in the sense of his or her contribution to a bank's earnings, bankers sometimes evaluate the combination of the client's "market potential" and "resource potential:"

1. Market potential includes the potential yield, development potential, cross-buying potential and loyalty potential.
2. Resource potential views the client as a potential source of referrals, information, cooperations, or synergies.

The components contributing to the improved profitability of the relationship over time are shown in Figure 5.13. As the relationship manager gains the client's confidence, this leads to increased transaction- and asset-based fees, and proportionately lower administrative and distribution costs. At the same time, a satisfied client will generate referrals. If agreed at the beginning when the account was opened, the client may also see some discounts phased out over time, but again this must be made clear to the client at the outset.

FIGURE 5.13 Components of Company Profit Increasing over Time

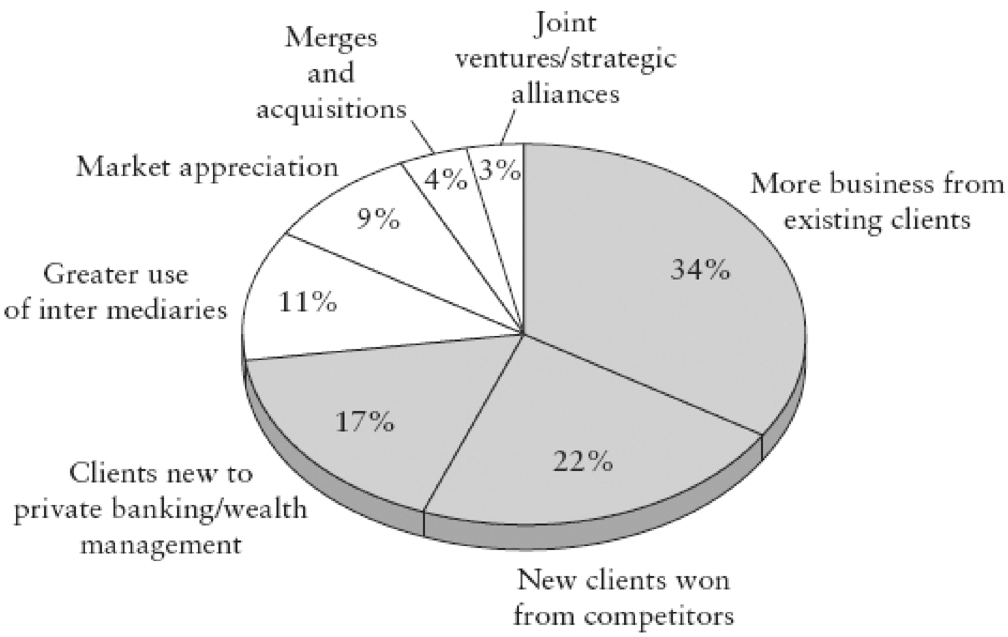
Source: Reprinted with permission from "Zero Defections: Quality Comes to Services" by Frederick F. Reichheld and W. Earl Sasser Jr. Harvard Business Review, September 1990; Copyright 1990; all rights reserved



The benefits of long-term retention are evident in Figure 5.14. It shows that most of the growth of profits—34 percent—comes from the increase in business from existing clients. It also makes an interesting distinction between clients acquired from the competition (22 percent) and clients who are completely new to wealth management (17 percent). PricewaterhouseCoopers's Wealth Management Survey 2007 came to the conclusion that there is still plenty of potential for relationship managers to increase the "share of wallet," meaning the percentage of assets of a particular client managed by the bank. The survey found that fewer than half of the wealth managers surveyed were holding more than 40 percent of their client's investable assets. It would be clearly to the advantage of these managers to hold more of their clients' assets. According to the survey, this proportion is forecast to increase significantly, concentrating almost 80 percent of wealth managers holding over 40 percent of a client's wealth.

FIGURE 5.14 Contribution to Growth in Revenue of Various Sources

Source: PricewaterhouseCoopers Private Banking/Wealth Management Survey 2003



Although it's a zero sum game for the industry as a whole, increasing wallet share is nonetheless one of the easiest ways to increase profitability at individual banks. It also has the advantage of creating stronger bonds between the client and the bank, making him or her less likely to follow a departing relationship manager. The final point to mention is that a larger share of wallet leverages the critically scarce resource—the relationship manager—and as long as clients are satisfied, this also should generate more referrals to bring in new clients.

In sum, it makes most sense to focus directly on achieving the highest level of client satisfaction. If you can please the client by offering him or her solutions to problems and opportunities for strong performance, the client will automatically entrust you with more assets. Again, the key lies in knowing what the client really needs. This takes us back to the subject of segmentation, which will allow us to better understand the client's needs and adapt or shape the strategy, products, and services accordingly. We also still need talented relationship managers capable of understanding clients' needs and expectations and who can breathe life into the relationship.

The Value and Challenges of Bonding

Not only can humans bond, it is also possible for clients to bond with brands. The “Brand Emotional Loyalty Pyramid” describes five sequential levels that the strength of a client’s relationship with a brand can reach: No Presence, Presence, Relevance and Performance, Advantage, and Bonding. A client can only be attributed to one level and must satisfy all preceding level requirements in order to move to the next level.(7)

According to an article by G.R. Hallberg in Ogilvy & Mather’s Newsletter “Emotional Loyalty: The Key to Marketplace Success,” a client at the top level of the pyramid—the Bonding stage—believes that the “brand’s advantages are unique, or shared by few other brands.” One level below are people who believe the brand offers some “quality that gives a reason to buy it over others,” followed by those on the next lower level, who believe the brand is relevant to their needs and provides suitable performance. On the second lowest level of the pyramid are those who are simply aware of the brand and have heard about it or tried it before. Those for whom the brand is unknown or not relevant make up the bottom rung where the client has no emotional loyalty at all.(8) According to a study by IBM Business Consulting Services, most companies manage to shift only 10 percent of their customers to the Bonding stage, the top level of the pyramid. But it is well worth the effort: a shift from level 2 Presence, where a customer is merely aware of the brand, up three notches to Bonding can on average increase the customer’s value to the company by more than seven times.(9) Furthermore the average value of a customer almost triples between the Advantage and Bonding stages.(10)

The nature of private banking means that the strongest bonds tend to develop primarily between the client and the person most likely to be the main point of contact, the relationship manager. This is a strong functional bond as a result of the relationship manager’s unique understanding of the client’s background, business, and financial position; an emotional bond exists as well, formed by the trust developed over time, along with the shared experience of riding market highs and lows. This creates a rather problematic side effect. Losing a relationship manager usually means losing clients. Client experience in conjunction with strong brand management and retention tools have an important role to play in tackling this problem. The Chapter 7, “Why Brand Matters” and Chapter 8, “Delivering a Superior Client Experience” delve into these topics at length. But first it is worthwhile to look at retention tools.

Retention Tools

A tool is a piece of equipment, a system or a process that with the proper resources allows someone to complete a specific task more efficiently. Events and sponsoring can be considered tools in private banking when used by relationship managers to bond with the client and increase the loyalty to the brand. Similarly, events designed to provide a lasting, positive impression on the client’s heirs while developing their financial acumen also can be considered retention tools if they pave the way or simplify retaining assets when the inheritance is received.

Customer relationship management (CRM) systems are tools that improve the quality and presentation of information available to relationship managers to help them manage the client relationship. The ideal CRM system should offer a wealth of timely intelligence regarding the client’s behaviour and preferences, so as to help the relationship manager in offering solutions better suited to the particular client’s needs.

Early Warning Signals

Early warning systems are very useful in allowing the relationship manager to respond to problems that might be developing in a relationship. Signals that something might be amiss include infrequent client contact, poor performance, asset outflows, changes in activity patterns, demanding discounts, switching mandate types, changing relationship managers, complaints, and operational losses.

- Infrequent client contact
  Even if the client seemed quite satisfied at the time of the last contact, infrequent contact is a signal that the risk is increasing that a client might defect. The client’s needs might have changed, or competitors are actively courting the client. Clients should always be contacted at regular intervals, unless they request otherwise.
- Poor performance
  Even when all relevant benchmarks and markets are down, the client still feels the pain of negative performance and needs reassurance at such times. It may also be necessary to propose a change of strategy. More often than not, clients tend to be more risk tolerant when markets are positive, but they become more conservative when markets decline.
- Asset outflows

Clients rarely decide to close an account from one day to the next. They usually drain their accounts over 6 to 12 months before finally closing it. Net outflows or negative net new money (NNM) of more than 25 percent of the client's total assets over six months can be an early warning sign.
- Changes in activity patterns
  The CRM system can be configured to monitor the frequency of transactions and then to respond to any deviation beyond a certain tolerance level if there is an indication that something about the client relationship requires special attention.
- Discounts
  With some clients, demands for discounts could be a sign that the bank's pricing is no longer competitive.
- Change of mandate type
  A client may switch from a managed account to advisory mandate as an appropriate response to changing needs. But this might also be a "quick fix" response to satisfy a desire for better value or a cheaper service. This is almost always a sign that the relationship could benefit from some additional action and attention on the part of the relationship manager.
- Change of relationship manager
  The CRM early warning system should flag all clients who have been passed to a new RM—for example, due to retirement of a long-standing trusted advisor. These clients require special attention and must be reassured about the continuity of the banking relationship.
- Client complaints and operational losses
  A written complaint should always be viewed as a highly serious matter. The action of writing indicates a commitment or desire to fix the relationship with the bank, as opposed to a termination of the relationship and transferring the assets to another bank. With the appropriate response, the bank can turn the situation around and actually increase loyalty.

In any situation where an early warning signal is detected, the response should be conciliatory and positive, focused on finding solutions. The relationship manager should be willing to go the extra mile with the client. This topic is addressed in Chapter 8, "Delivering a Superior Client Experience."

CONCLUSION

Understanding clients is crucial to acquiring, retaining, and developing a relationship in an increasingly competitive environment. Banks need to use segmentation techniques more effectively to develop innovative offerings and to enhance relationships with clients. No matter which segmentation approach is used, the wealth manager will need to employ all resources at his or her disposal to effectively serve clients and to reach out to prospective new ones.

Clients in general have become more sophisticated and are being courted with growing intensity in an increasingly competitive environment. To combat rising costs and other challenges to profitability, private banks need to look at the market in tiers or slices, choose the groups or segments they can serve best, focus on these, and align all of the organisation's resources toward serving their chosen group of clients effectively.

Surveys suggest that current segmentation practices focus too heavily on static snapshot criteria and place too much emphasis on the clients' current levels of wealth. Efficient segmentation does not imply a rigid approach, meaning specific product lines targeted at particular client segments. Segmentation means that the relationship manager is in position to better understand the client. Then he or she can match the client's needs with solutions. An experienced relationship manager can absorb a wealth of information about a client and process it more intuitively and more efficiently than any CRM system is capable of doing. With that in mind, one can conclude that the focus of scalability efforts, rather than just gathering more data on clients generally, needs to evolve toward giving relationship managers better means to choose the best solutions for individual clients, based on what they know about these clients.

Support for a segmented approach should not be regarded as a call to uniformity. Instead, it is driven by the desire to better understand the client while improving the efficiency with which individual services can be delivered. It is about shedding the distractions that arise when one tries to be all things to all people. Once this has been achieved, it is possible to create a truly client-centric organisation that focuses on the client's stage in life and individual needs. It is important to switch to a more dynamic perspective, one that takes into account the client's entire set of needs and how these contribute to a long-term profitable relationship. This benefits not just the bank but also the client. It is a given in an industry claiming to be focused on long-term relationships. It is therefore important to understand and adapt to client needs and changing requirements in the immediate context and align resources accordingly.

As discussed in the following chapter, "Beyond Products—Offering Tailored Solutions," it is not important just to determine the client segments that ought to be the main focus. It is also crucial to find the right solutions to best serve these various groups.

NOTES

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3. Ustinova, A. 2009.“Party Ends for Russian Rich After €193.70 Billion Losses,” Bloomberg News, April 9, 2009.

4. Nelson, Choi N., Leung, F., Tang, T., and Wu, C. China Wealth 2010: Wealth Markets in China, Capturing the Multifaceted Growth Opportunities. The Boston Consulting Group.

5. Ernst & Young. 2010. Greater China Leads Global IPO Activity in 2010.

6. VIP Forum, Corporate Executive Board. 2008. “Boosting Advisor Productivity: Benchmarks for Developing and Managing World-Class Advisors,” Arlington VA, 2008.

7. Hallberg, G.R. 2002. Ogilvy & Mather’s Viewpoint: Emotional Loyalty: The Key to Marketplace Success.

8. See note 7 above.

9. Howlett, N. 2005. IBM Business Consulting Services, Customer Experience Management. “20:20 Customer Experience, Forget CRM—Long Live the Consumer!”

10. See note 9 above.

Chapter 6

Beyond Products—Offering Tailored Solutions

By Guido Ruoss*

Different clients represent the full spectrum of individual needs and requirements, and this influences the products and services that a private bank provides. A client in Asia, for example, doesn’t necessarily require the same product as one in Brazil. Thus, products and services need to take into account this diversity and ensure solutions that are tailored to match each specific client’s needs and regulatory constraints. As a result of the “new paradigm” in private banking characterised by increased transparency and greater compliance in tax matters, cross-border clients are likely to be more open and willing to initiate a genuine dialogue with their banks. Such increased interaction will enhance product development. With regard to products, it might be noted that some have features that are easily replicated and can thus be described as commodities. Products that fall into this category might be outsourced. But it is important to keep control over the process to ensure a uniform, high level of quality.

Looking at some of the most successful investment strategies, a long-term value-driven investment strategy offers the greatest opportunities. Investing in a long-term trend means taking into account developments shaping all aspects of our lives over the coming decade and taking advantage of those countries, sectors, and companies that will benefit from these forces. The important trends are “planet” (i.e., natural resources, agriculture, and renewable energy); “people” (i.e., technology, including social networking and mobile communications, healthcare, and education); and “growth markets” (i.e., emerging markets vs. core markets). It is impossible to approach the discussion of providing clients with investments unless a great many factors are taken into account. These pertain not only to the external aspects affecting investments (markets and the evolution of financial products). Of great importance, too, is how specific products and services are offered to clients, viewed in their entirety rather than on an individual basis. Ultimately the advisory process brings together all the different strands that, when unified, produce a result that, ideally, is specifically tailored to the clients’ needs and goals.

CRISES AS CATALYSTS

In recent years, several crises have rattled markets, although perhaps none was felt so deeply by so many as the financial crisis. Of truly global proportions, it left a lasting impression in the minds of investors. Major losses can occur due to the actions of a single rogue trader or from localised upsets. Markets might be destabilised by mismatches in assets and liabilities or as a result of natural catastrophes. Problems may surface in assets normally deemed safe, such as bonds issued by sovereign nations. Recent decades offer numerous examples of things that can affect financial markets: the Latin American debt crisis in the 1980s, the Asian crisis in 1997–1998, and the collapse of US hedge fund Long-Term Capital Management in 1998, the same year that Russia defaulted on sovereign debt. There was the bursting of the dotcom industry bubble in 2000–2001. Catastrophes such as the devastating earthquake and tsunami in Japan in 2011 or unrest in regions supplying key resources such as those in the Middle East may take a toll, as may fears about possible defaults among European countries. But the turmoil that enveloped markets from 2007 to early 2009 demonstrated the dramatic impact that such an event can have on peoples' livelihoods and personal wealth.

This particular crisis left a deep and lingering mistrust of financial intermediaries among wealthy private clients. As briefly discussed in Chapter 2, "What Is Driving Private Banking?" wealthy clients have become more sophisticated, making them increasingly likely to register displeasure when returns fall below expectations. Most suffered from the problems that culminated in the acute disturbances and dislocations, including the collapse of Lehman Brothers in the autumn of 2008. That not just mainstream asset classes but even structured products originally designed to mitigate losses were hit was doubly unsettling. Hedge funds and hedge funds of funds similarly suffered losses as investors redeemed significant holdings in alternative investments.

There was also a frighteningly systemic aspect to all this. Given the magnitude of these events, it is not surprising in the aftermath of the crisis that some companies in the wealth management industry have begun to reexamine how they approach their main business. For private banks, these events have forced a reassessment of how to best serve clients' genuine long-term needs. With that in mind, this chapter looks at how product and service offerings to private individuals can best be adapted to serve clients in what has become an increasingly complex and challenging environment.

Prior to the financial crisis, organisations serving private clients typically focused on products. In terms of wealth "aggregation," products represent the lowest level of client specificity. Products are often designed without taking into account the needs of each individual investor. In the wake of the financial crisis, particularly after losses in the more esoteric instruments, some banks have begun to reconsider the products they offer and how they might best align their services to serve clients. But it's not only banks that are reexamining their approach. Clients, too, are looking at things in a different light. They demand more transparency and in many cases want to be better informed about the advisory process, which leads to tailored investment solutions.

Private wealth managers in particular have started to reexamine their basic notions regarding products and services. As a result, some are moving from a focus simply on "products" to a more comprehensive emphasis on "classic" private banking services, taking into account a broad spectrum of elements, which include advisory services. They also tailor the advice they offer to ensure it matches each individual client's needs. Banks going this route are consequently deemphasising products in favour of a more individualised service- and advisory-oriented approach. By moving in this direction, these banks are now free to recognise products for what they are—essentially "bundles" of services, each suited to different levels of wealth aggregation, ranging from broad, general categories suited to many clients to extremely individualised offerings matching the needs of just one individual.

It is not only products that are being viewed in a different way. Services, too, can be categorised in terms of how specifically tailored they are to individual clients. Some services are quite generalised, being provided in identical fashion to all clients; whereas other services, by contrast, are quite specific, designed to meet one particular client's needs. Furthermore it is important that changes in the business and regulatory environment are fully reflected in the services offered. Since the financial crisis, for example, there has been a greater demand for capital preservation solutions. Clients today also want investment advice that fits all aspects of their particular stage in life and their personal situation. Besides all of these factors, the ever-changing and in many cases stricter international regulatory environment plays an increasingly important role.

The end result is that today, private banks offering products and services need to think in terms of providing enhanced portfolio management while adhering to strict guidelines governing risk and regulatory requirements. Clients need access to "best-in-class" investment solutions and asset managers rather than simply the usual array of standard in-house products. Furthermore, relationship managers (RMs) need to adopt a structured and comprehensive advisory approach with respect to the solutions and services they provide, to enable clients to achieve their long-term wealth management goals. From the perspective of the wealth manager, it becomes extremely important to define the solutions and services that a bank intends to offer. Once that has been determined, systems, processes, and controls should be put in place to make certain that the solutions and services are the right ones and are suited to each individual client.

HAS VOLATILITY BECOME THE NEW “NORM”?

The crisis in the financial system that began in 2007 and lasted into early 2009 proved to be a major challenge for clients and wealth managers alike. Many markets turned negative, and correlations between markets increased in ways that surprised even seasoned professionals. Consider Figure 6.1, which shows the performance of a number of markets during the period from 2000 to 2012. At the height of the crisis, not only equity markets but also other asset classes such as commodities suffered, under pressure from fears of flagging global growth. These experiences and changes in the markets have led investors, including wealthy individuals, to take a closer look at the way their wealth is managed.

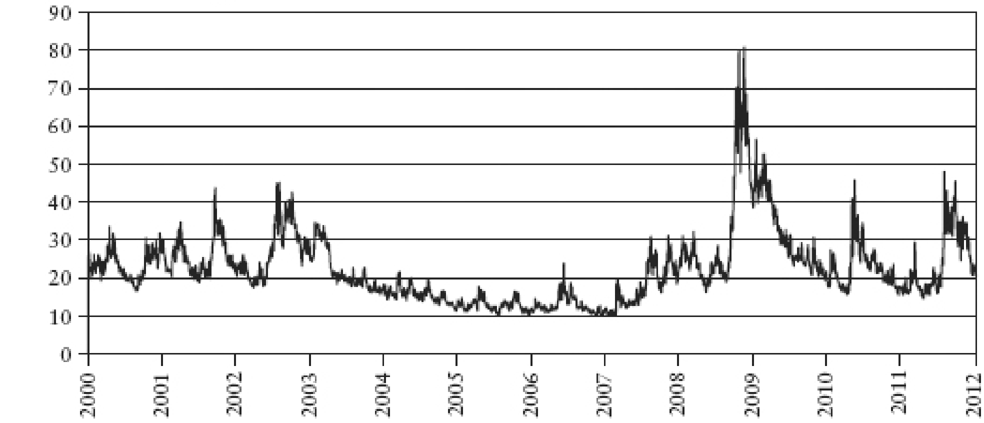
FIGURE 6.1 Historical Performance of Various Indices

Data Source: Bloomberg L.P.

Swiss Market Index

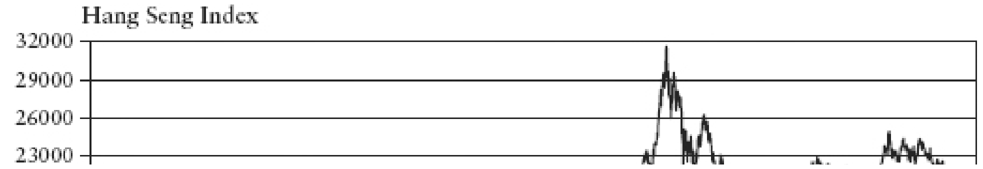
S&P 500 Index

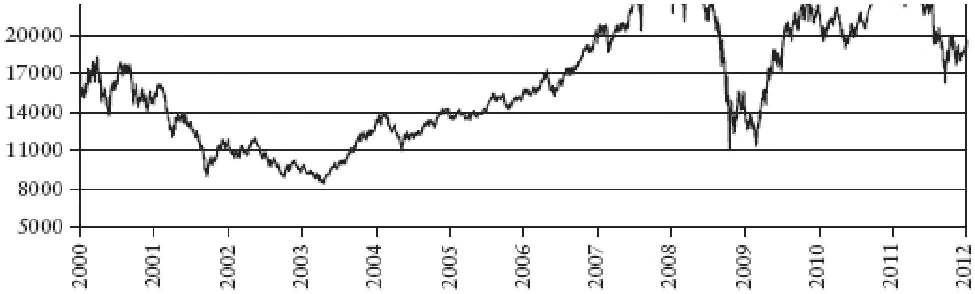
VIX Volatility Index



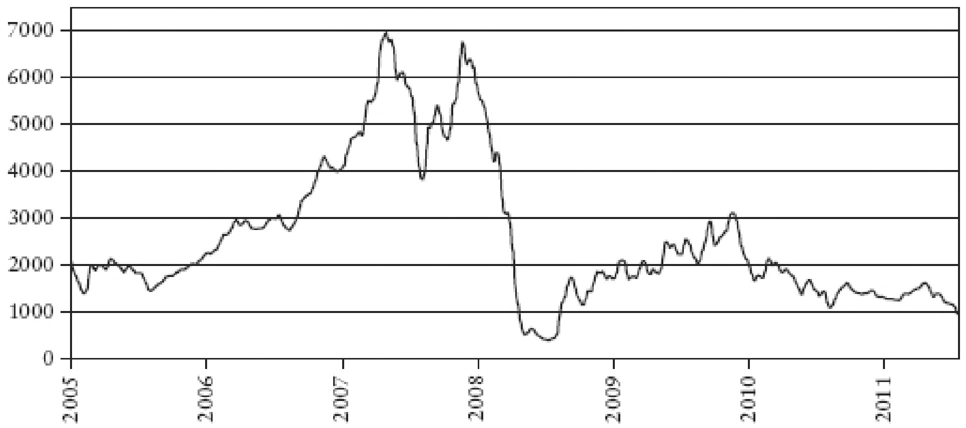
DJ UBS Commodity Index

Hang Seng Index





Baltic Supramax Freight Index

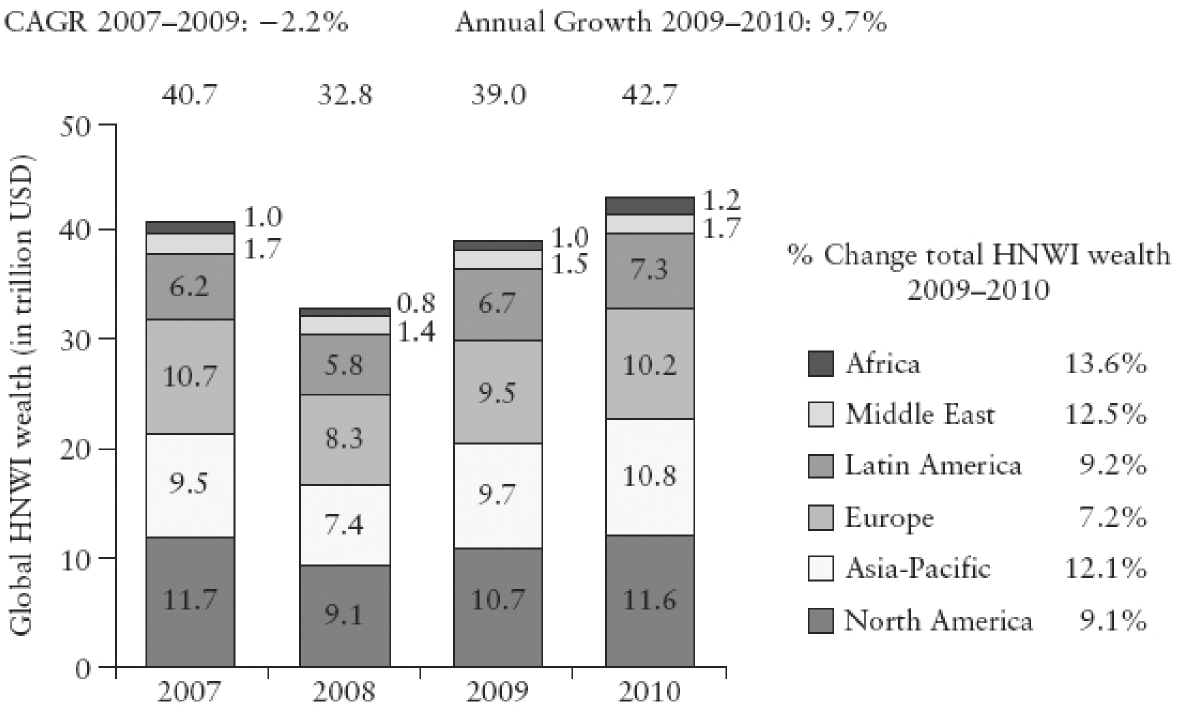


If nothing else, the past decade has been characterised by extreme volatility. After setting an all-time high early in 2000, led by demand for technology stocks, major equity indices fell when the dotcom bubble burst. They then began to rally anew, helped by liquidity provided by central banks, so that by 2007 the S&P 500 Index set a new all-time high. In the subsequent crisis through March 2009, the S&P had lost over 50 percent, falling to its lowest level since 1996. But the market then rebounded, ending 2009 with a gain of 23 percent, followed by another positive year in 2010. That trend continued until the middle of 2011 when markets moved into another period of significant volatility. Movements in Asian stocks were even more pronounced during this period. The Hong Kong Hang Seng Index more than tripled in value between 2003 and 2007, only to fall back to levels last seen in 2004. Shifts in market sentiment were reflected in the VIX Index, the market's so-called "fear gauge," reflecting the volatility of US stocks. It rose from levels of between about 10 and 30 to spike as high as 80 in late 2008 at the peak of the crisis. Meanwhile, fueled by safe-haven demand, government bond prices rose, so much so that in some cases investors accepted even "negative" real yields. Commodities behaved erratically. The Dow Jones–UBS Commodity Index, which had surged in mid-2008, collapsed by year-end, only to start climbing once again as growth resumed, particularly in developing nations. Reflecting a drop in global trade and overcapacity in the shipping industry, the Baltic Freight Index, viewed as a proxy for global trade, slumped during the crisis, influenced by sluggish demand and overcapacity in the industry.

These market developments had a major impact on net wealth of high-net-worth individuals (HNWIs). According to the Capgemini Merrill Lynch World Wealth Report, Latin American clients were least severely hit, while wealthy private individuals in Europe, North America, and Asia suffered most, losing in each case over 20 percent. Wealth has since recovered, as shown in Figure 6.2.

FIGURE 6.2 HNWI Wealth Distribution, 2007–2010 (by region)

Source: Capgemini Merrill Lynch Wealth Management World Wealth Report 2011

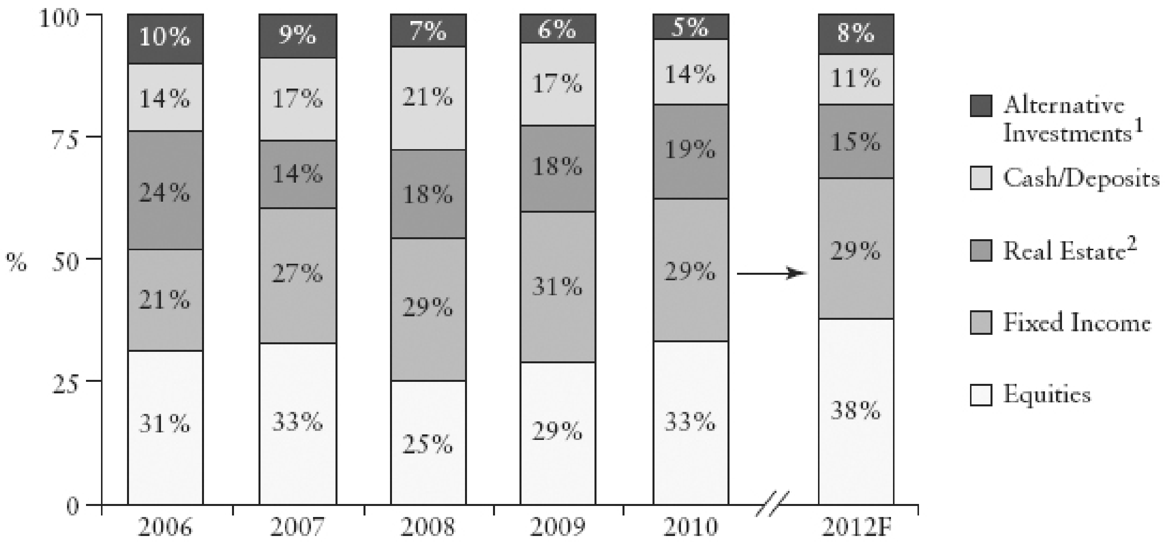


Note: Chart numbers and quoted percentages may not add up due to rounding

When there is trouble in markets, clients usually become more conservative. Figure 6.3 shows how asset allocations changed between 2007 and 2008; there was a major shift to cash and fixed income, perceived as "safer" at the expense of riskier asset classes such as equities, real estate, and alternative investments. This trend reversed in 2010 as risky assets recovered.

FIGURE 6.3 Breakdown of HNWI Financial Assets 2006–2012F

Source: Capgemini Merrill Lynch Wealth Management World Wealth Report 2011



[1]Includes structured products, hedge funds, derivatives, foreign currency, commodities, private equity, venture capital.
[2]Comprises commercial real estate, real estate investment trusts (REITs), residential real estate (excluding primary residence), undeveloped property, farmland, and other.
Note: Percentage may not add up to 100% due to rounding

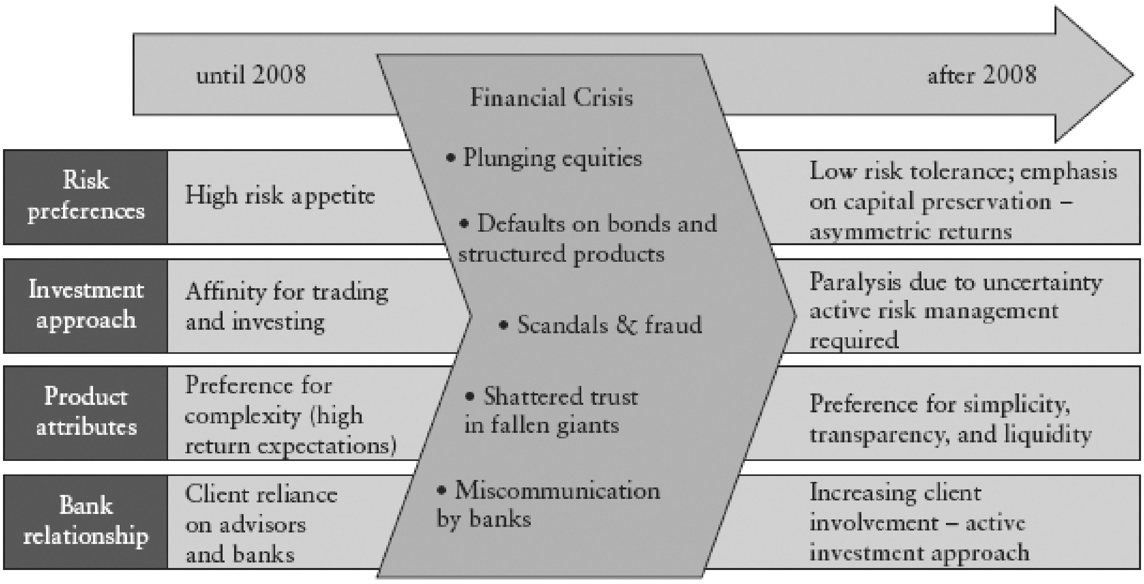
Even though markets have since stabilised, investors remain cautious. Clients who suffered losses are seeking new, simpler, customised solutions to protect real wealth, especially in times of higher market volatility and stress.

THE ROLE OF FINANCIAL SERVICES AND PRODUCTS IN WEALTH CREATION

As discussed previously, the impact of events during the crisis years led to changes in how investors think about products and services. This is outlined in Figure 6.4. This chapter focuses on the two aspects shown in the lower-left corner influencing product choices (a shift from more complex to easy to understand) and banking relationships (clients have become more proactive).

FIGURE 6.4 Clients' Approaches and Attitudes toward Money Management Have Changed after the Financial Crisis

Source: Adapted from Global Wealth 2009: Delivering on the Client Promise © 2009, The Boston Consulting Group



With regard to products, after experiences during the crisis years 2007–2009, it may be a fair question to ask whether financial instruments truly promote wealth creation at all. For a long-term perspective, consider historian Niall Ferguson's book, Empire: How Britain Made the Modern World. It explores the beginnings and subsequent development of government bonds, which, along with an increasingly sophisticated financial system, allowed the British Empire to govern at one point a quarter of the world's people.(1) In his subsequent book, The Ascent of Money: A Financial History of the World, Ferguson looks at the relationship between the development of financial services and how these allowed humans to evolve from hand-to-mouth subsistence into a society enjoying a high level of civilisation and the benefits of technology.(2) Evolution in markets, too, it can be said, is not just a recent development.

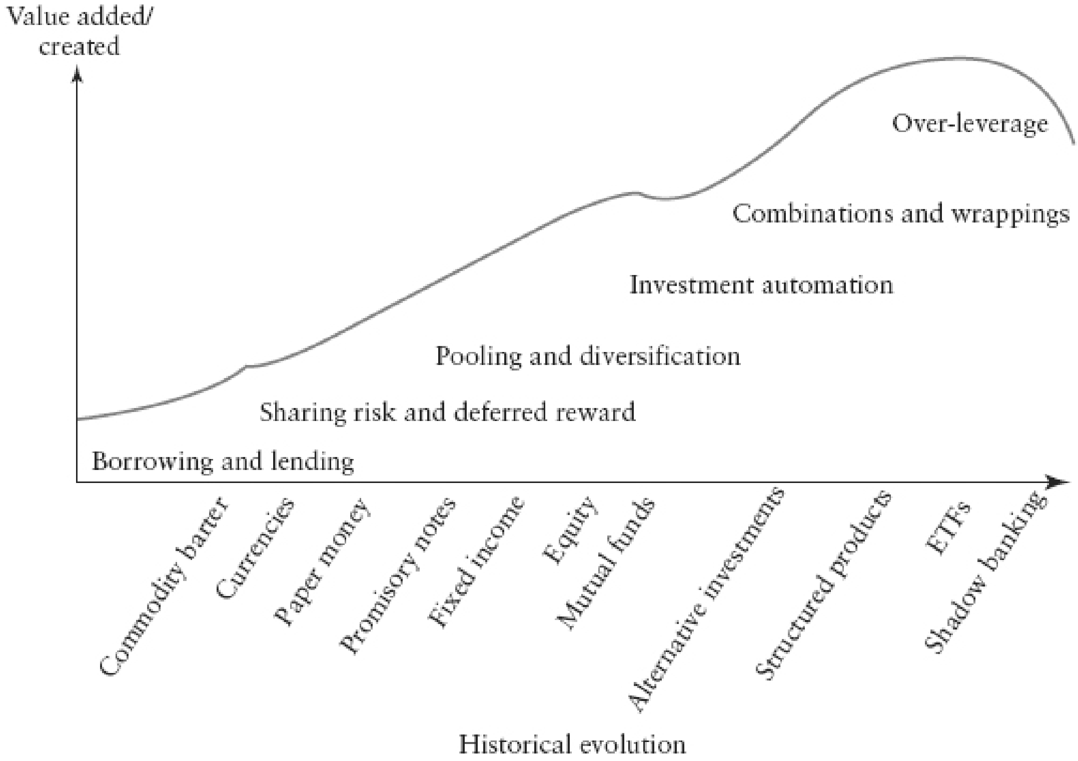
Certainly not just products but financial services have evolved. In early societies, moneylenders tended to prosper not least due to their ability to judge the personal creditworthiness of a particular project or individual. As society developed, banks filled this role, making a profit from lending, often in different currencies. Provided the currencies could be exchanged for goods and services, and assuming that lending rates were a fair reflection of the risk, these financial services contributed a profit to the institutions and also aided the development of economies and civilisation, facilitating the distribution and free flow of capital.

For many centuries major financial systems were based on metal coins, accounts recorded on paper, and straightforward transactions. At least as far as the overall mechanism was concerned, the system was relatively simple and transparent, though perhaps slower and less efficient than today, when cash is nearly always at hand and transactions flow across the globe. With benefits have come new risks. Thanks to increasingly sophisticated technology, financial transactions are now conducted at extremely high speed. Today a trade can be executed in less than the blink of an eye.* Transaction costs also have fallen radically. The vast increase in global trade and capital flows have also have added a new level of complexity.

As shown in Figure 6.5, crises are a common feature of markets. What might begin as a good idea catches on and there follows exuberant participation by a widening circle of investors. Wealth becomes concentrated in one asset class until at last the bubble bursts. The speed and magnitude of such events today pose new challenges. What will be the next crisis? It is safe to assume further crises will arise. And in any case, due to the modern high-speed mobility of money and the amounts involved investors also are likely to see much more volatility. Indeed as already suggested by the events of the past decade, volatility is the new "normal."

FIGURE 6.5 The Evolution of Financial Products

Source: Author



As the system has evolved in terms of services, so, too, have financial products increased remarkably in terms of both their widespread use and complexity (see Figure 6.5). Markets during recent years have been flush with liquidity, due in part to leverage in the system and cheap money available. The entire financial system has grown more interconnected with a variety of players, including investment banks, hedge funds, private equity funds, and structured investment vehicles (SIVs). Entities such as hedge funds traditionally have not been subject to the same oversight as banks in their dealings with the general public. These have in the past contributed their own share of shocks to the market.

Part of the crisis that began in 2007 can be explained by highly complex mortgage and asset backed products. For example, securities based on seemingly innocuous household mortgages were “repackaged” and sold without considering the risks of liquidity or market value in the event of an extreme market dislocation. In pursuit of ever-higher returns, increasingly complex financial structures were created, stacking one product atop another. The result was an inherent instability and ignorance of what the real risks were, or even in some instances a cynical disregard for them. A bubble is characterised by a herd mentality. As in a game of financial musical chairs, every player follows the next, each hoping that they, at least, will not be the one left standing when the music stops. All bubbles eventually burst. The one that did so in 2008 left private investors angry and disappointed.

To sum up, the development of financial products might be considered at best to be an evolution and at worst a system of trial and error. On the one hand, financial products are indispensable. Who would like to live in a world with no insurance? Who would prefer to pay cash for a home they purchased? But at the other end of the spectrum, there is always a new product that can be promoted to produce miraculous returns, at least for a limited period of time. Of course, there are no miracles in investing. The financial industry has played a key role in the establishment of modern civilisation, but history and logic show that it is simply not possible to create lasting wealth with no risk, nor without the patience required to obtain deferred rewards. Individuals can get rich quickly if existing wealth is redistributed in a zero-sum financial transaction—for example, buying a winning lottery ticket or inheriting money. Societies as a whole can only increase their total wealth by increasing the value of goods and services. True wealth creation should be a process that benefits greater society, even though it is impossible to say how advances and discoveries ultimately will play out.

All these developments pose numerous challenges for private banking. The recent crisis especially has changed how clients approach investing. Banks, too, must change the way they approach clients. It is no longer enough to offer clients a disjointed selection of products and services. The individual client’s needs and goals must be met by looking at the bigger picture.

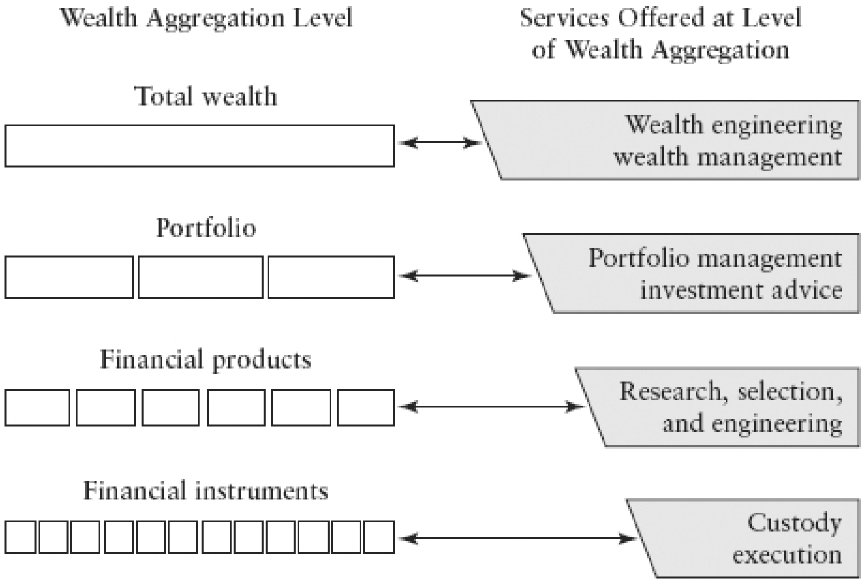
ADAPTING TO A CHANGING ENVIRONMENT

How should wealth managers realign their activities to best suit clients' needs in an environment characterised by a greater mistrust of banks and the products they offer? Clients' main goals are wealth preservation and real wealth creation. Thus, the industry should start by focusing on "investment solutions" rather than simply pushing numerous unrelated products. To do this, it is useful to approach the discussion by looking at the industry from the point of view of the total offerings to individual clients.

As shown in Figure 6.6, wealth can be thought of in terms of "groupings" or "aggregations." These are represented in ascending order from the least client-specific types (financial instruments) all the way up to those most directly related to a client (the client's total wealth). Likewise services can be ranked from the most general, least client-specific such as custody and execution to the most individualised "wealth engineering" and wealth management. Based on this approach, levels of wealth aggregation (left) and services (right) are ranked to correspond according to each level of client individualisation. It is useful for a bank to think along these lines when considering where to put its resources. This perspective is also important for clients, because it represents how the approach might be viewed from the perspective of single clients.

FIGURE 6.6 Aggregation of Wealth from Most Granular (lowest level) to Most Comprehensive (top) and Corresponding Level of Individualisation

Source: Dr. Ulrich Schilling, Employing Multi Agent Systems in the Performance Process of Private Banking Services, Difo-Druck GmbH, Bamberg 2007



Wealth Aggregation

Looking at wealth aggregation as represented in Figure 6.6, one thing becomes clear. There is a progression in terms of "bundling" of wealth of individual clients. At the bottom, on the least client-specific level are financial instruments, which in turn can be combined to make up a financial product. A combination of products and instruments constitutes a portfolio. At the top and most complex level is a client's total wealth, consisting of a combination of portfolios, along with all other assets and liabilities, such as real estate, mortgages, art, and so forth. As illustrated, at each level there is a corresponding set of services matching the degree of client specificity, ranked from the simplest forms such as custody and execution all the way up to total wealth management. The aim of representing services in this way is to present them as a function of individual client solutions rather than simply as a general array of unrelated products and services. This approach allows a wealth manager to see where the greatest potential lies in terms of adding value to the services offered to individual clients.

The complexity of the wealth groupings depicted in Figure 6.6 increases at each aggregation level. The higher the level of aggregation, the greater the value that can be created for the client. And the more specific the level of aggregation, the closer the bank needs to be to the client to offer these services. In private banking, it is thus important to think of the entire context of an individual client's needs, as opposed to single products and isolated services. The core value proposition is a tailored, individualised solution. Not only does this approach make more sense for the bank aiming to derive greatest value from the resources devoted to individual clients. For the client as well, his or her genuine needs become readily apparent only when viewed through the lens of this type of "aggregation," ranked according to how individualised a service or product offering should be.

At the lower levels of aggregation of financial instruments and products, the discussion as far as individual clients are concerned is essentially one involving services that are more or less interchangeable. A given equity, for example, or bond or fund is the same no matter which bank executes the trade. Assuming safe custody, the value of cash or other instruments does not change because of who is holding it. It is worth noting, however, that this is precisely one area where the assumptions usually taken for granted broke down during the 2008 financial crisis. In that period, not even the safety of custody accounts could be taken for granted, as Lehman Brothers' default illustrated.

Past market shocks highlight that it is key to help clients to establish a truly diversified portfolio. It is thus vital to include in any decisions the client's total wealth position. A bank must avoid pushing products and adopting a too narrow focus, attempting to capture unrealistic returns that should never have been promised in the first place. With that in mind, the following section examines levels of aggregation. It is followed by a look at services presented in a similar fashion.

At the higher levels of aggregation, there is an almost infinite range of combinations offered to the market in terms of financial products and investment solutions. Navigating this sea requires a clear understanding of the fundamental principles of investment, which first and foremost means there is no ideal product. There is only an optimal match between a particular investor's investment objectives, risk tolerance, and needs and the investment products—or better, the solutions offered.

Overview of Aggregation Levels

Financial instruments include cash, stocks, bonds, and other assets. Financial products, which tend to be more complex, are an aggregation of financial instruments including an element of service put into some sort of marketable package for distribution purposes. More complex still, a portfolio is a collection of financial instruments and/or financial products managed as a unit. At the highest level of complexity, total wealth refers to the sum of all the assets and portfolios held in all those banks with which the client maintains a relationship. (For information and an overview of the most common types of products and further information on selecting funds, please refer to Appendices 1 and 2 at the end of this chapter.)

- Financial instruments
  Cash, evidence of ownership of an asset or entity, or the contractual rights to deliver or receive an asset of some sort are traditionally thought of as financial instruments. Based on that definition, this category includes the most basic units of wealth, such as cash and currencies along with stocks, bonds, and derivatives such as options, forward contracts, and futures.
- Financial products
  Financial products represent a higher level of wealth aggregation, consisting of financial instruments bundled together with an element of service into marketable packages for distribution purposes. These are the main categories of financial products and include mutual funds and other investment products. This category also includes hedge funds, exchange-traded funds (ETFs), funds of funds, and structured products.
- Portfolio
  A portfolio is a collection of financial instruments and financial products that are managed as a unit. At the financial instruments and products aggregation level, the focus is on the characteristics of a particular asset. But at this level the main focus, rather than being on individual instruments, is on how these work in combination, and how they interact in terms of their risk/return characteristics and cash flows.
  The previous chapter discussed the increased sophistication and the active role taken by clients in managing wealth, requiring a comprehensive approach to advice. Portfolio-level advice is growing more important due to the general volatility and complexity of today's financial markets. Regarding portfolios, the better a client's overall investments or assets and liabilities can be pictured as a unit, the more comprehensive the approach that can be taken in advising the client on how to reach or achieve the long-term goals, while taking into account the individual's short-term constraints.
- Total wealth
  HNWIs often have a number of different portfolios that are overseen by different wealth managers. Rarely will a client entrust his or her total wealth to a single bank or RM. However, it is still possible to discuss "total" wealth management when the client involves the RM in matters that extend beyond a single financial portfolio to include different types of assets held in different jurisdictions. A client may have primary and secondary residences, land, or businesses. These holdings may be subject to a range of different tax and regulatory regimes. At the total wealth level, the goal is to optimise all these holdings to offer the client the best overall solution. This means addressing questions of wealth protection and capital appreciation, as well as financial planning, retirement, succession, and philanthropy.

Summary of Aggregation Levels

To sum up, it is important to regard the particular products and services offered to clients not as single, unrelated units. Instead they are parts of a bigger picture. Taking this approach means that the client has the benefit of getting more than just an offering that is a sum of separate parts. Individual products that may not be right in terms of the overall needs can be avoided.

Not only is it important to view an individual client's wealth from the aggregate side, ranging from the most granular type of products and instruments all the way up to the broadest level of total wealth. The services applied at each level also play a key role.

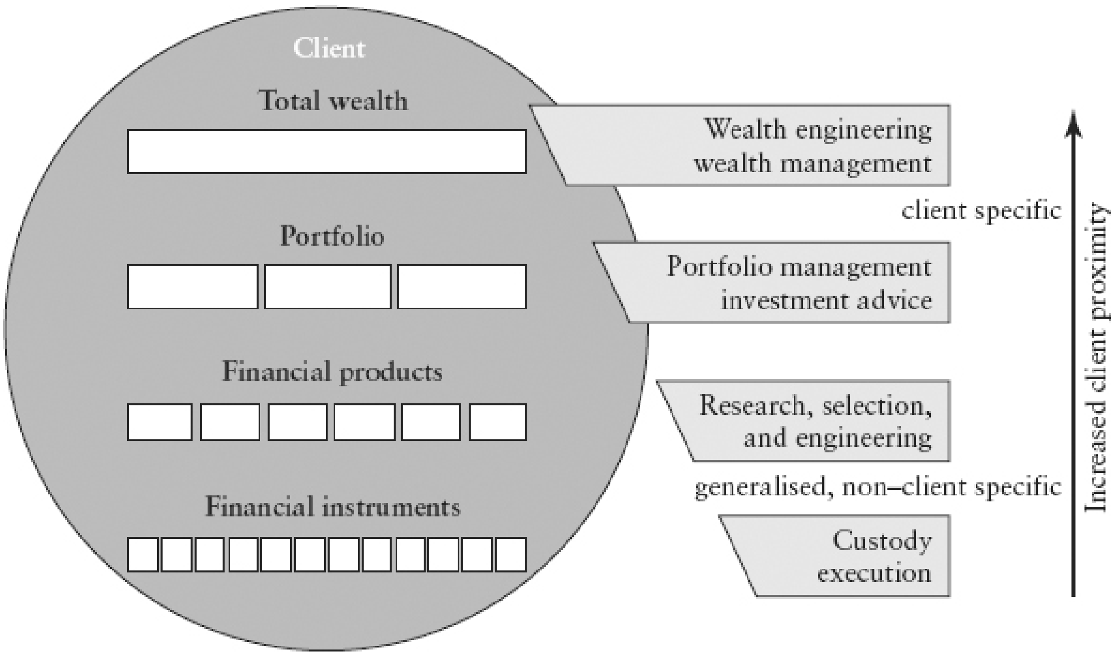
Wealth Services

As already noted, private banking services can be divided into two categories—those that are not individualised and those that apply in a specific way to individual clients. Those services that are not client specific, meaning those that are conducted in most cases without reference to any particular client and may be considered in some ways as commodities, pertain to a broad class of individuals with little modification no matter which client is involved. As wealth is increasingly aggregated, the focus becomes ever more a function of an individual client's personal needs. Like products, services can be depicted in terms of client specificity, ranging from least to most individualised. This relates to how customised they are with regard to an individual client.

At the top of the scale are those central value propositions offered by private banks to serve clients' unique needs, services that directly touch the client. To illustrate this, Figure 6.7 depicts the same overview as Figure 6.6, but this time with the client added to the picture. It is now clear which services are closest to the client. As shown in the chart, for each service level there is a corresponding level of wealth "aggregation." At the lowest level, the least complex aggregations (financial instruments) correspond to the least client-specific services (custody, execution). As the complexity increases, the service becomes more individualised and client specific. Looking at products and services in such manner allows a bank to serve a client in an individualised and comprehensive way. It also allows the client to receive a tailored and "bespoke" solution. For clients it is important to note, however, that not all services are available for each wealth category.*

FIGURE 6.7 Some Services Have a Direct Relation to Individual Clients, Whereas Others Are Less Client Specific

Source: Dr. Ulrich Schilling, Employing Multi Agent Systems in the Performance Process of Private Banking Services, Difo-Druck GmbH, Bamberg 2007



Overview of Service Levels

Because services can be classified according to the wealth aggregation level that they target, it is possible to arrange these on a scale from least to most individualised. On the least individualised level, services for financial instruments involve mainly custody and execution. On a somewhat higher level (because financial products are tailored more specifically to clients), this category includes research, selection, and specific solutions incorporating structuring of particular products. Moving still higher, at the portfolio level, services become more tailored to individual clients. When total wealth is taken into account, the focus is even more client specific. Here wealth engineering and wealth management expertise and services come into discussion.

Some services could be outsourced. For example, because custody and execution are usually not targeted to individual clients, the bank could outsource them. Portfolio management and investment advice, however, including fund and product selection, wealth engineering, and investment management, are more client specific. A private bank has to excel in these. They are the services that create the most value for the client and consequently also for the bank.

The following presents a description of those services that are common in private banking, ranging from the least client specific to those that are very specific, tailored to a single individual.

Custody and Execution

Custody and execution are not tailored to individuals per se, and there is little opportunity in these areas to add client-specific value. While services at this level are highly important and must meet exacting standards, they are basically the same wherever they are done and are not directly influenced by geography. These services must be excellent and exacting, but they are not very close to the individual client, nor are there many insights to be derived as to how these can enhance individual client satisfaction, apart from ensuring zero tolerance for error. Any mistakes in this area (for example, the wrong figure entered in a trade) can turn out to be extremely costly for a bank.

- Custody
  Custody services refer to the safekeeping of assets such as equities and bonds and the related administrative procedures. Besides buying and selling assets, the custodian needs to monitor and collect payments of interest, dividends, and coupons, while keeping the client informed of the rights and responsibilities associated with holding these assets, including proxy voting done on the client's behalf at shareholders' meetings. There may be a need to manage currency transactions.
- Execution
  Execution is the process of completing an order to buy or sell a financial instrument. When offered as a standalone service, it refers to any type of financial transaction that does not fall into a custody agreement. The European Union's Markets in Financial Instruments Directive (MiFID), introduced in the Chapter 4, "Forces Shaping the Regulatory Environment," requires that a firm take all possible steps to ensure the best execution of a client's orders. Best execution means more than simply obtaining a price in a transaction; it encompasses the choice of an execution channel that offers the best combination of price, speed, likelihood of execution, and likelihood of settlement.

Research, Selection, and Product Engineering

The level of aggregation represented by research, selection, and product engineering is one step closer to the client than the services just described. It thus offers slightly more potential to add value. It is still quite possible to engineer and select best-in-class products here, as well, without targeting any specific client in order to draw up a short list of investment recommendations.

- Research
  Banks usually have a research department to comment on different asset classes, and provide buy and sell recommendations as well as insight on macroeconomic developments. The information will be presented to clients, usually by the relationship manager. This area also includes so-called groundwork research that may or may not lead to new intellectual property, ideas, or methods. It also encompasses market research that serves as the basis for investment decisions and strategy.
- Selection
  This process includes fund selection. General guidelines might be applied here, governing, for example, how large a fund should be (e.g., at least more than €84.22 million in assets). The fund should have an established track record (more than three years tends to be a standard minimum). Performance should meet a certain level (such as top quartile of the relevant peer group). Further information on the process used to select individual funds can be found in Appendix 2 at the end of this chapter.
- Product engineering and financial engineering
  Financial products usually are simply aggregations of instruments. This means that there is a relatively low barrier of entry in this field, and the number of new structured products that can be created can easily outstrip the number of clients in a given bank or institution to buy them. Product engineering or structuring is the

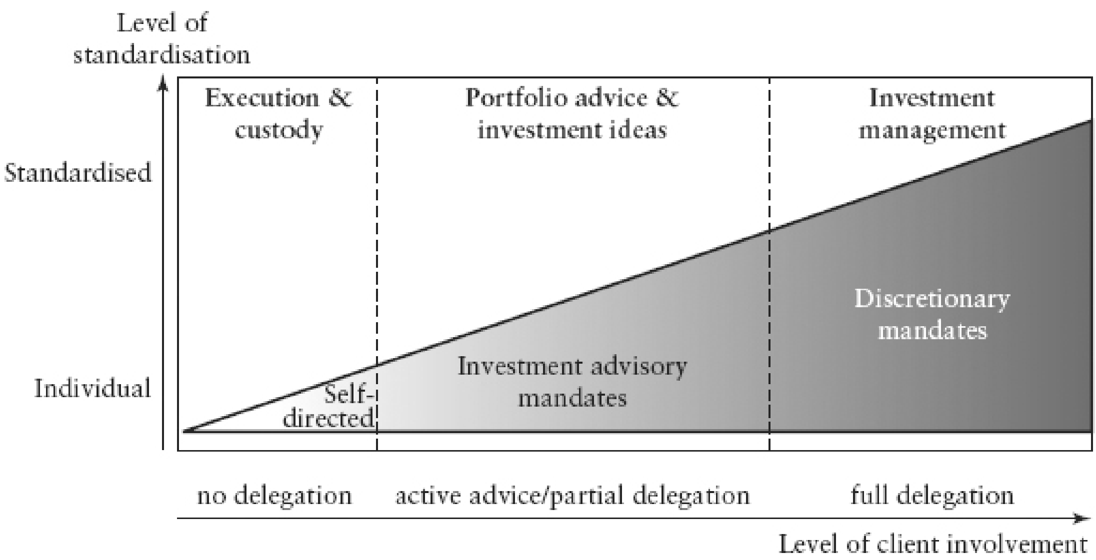
process of combining financial instruments and services to create a product with a particular benefit. If it is a one-off combination, it can be described as a “tailored solution.”

Portfolio Management and Investment Advice

Some services such as custody and execution, as well as research, can be treated as standardised processes that are not generally tailored to fit specific clients. Moving higher up the chain toward more client-specific functions, it becomes increasingly important to keep all aspects of an individual client’s situation in mind. This includes the client’s objectives and goals. In this category services start to be considered client specific and are directly linked to the individual client. As shown in Figure 6.8, they include both managing portfolios and offering investment advice.

FIGURE 6.8 The Most Self-Directed Clients Typically Rely on Standardised Products and Services, Whereas Clients Delegating Investment Responsibility Require a More Individualised Approach

Source: Julius Baer



These categories can be further delineated. Where portfolio advice is concerned, the level of client involvement goes from discretionary mandates, where clients are least involved in the process, to the advisory services, in which clients receive advice but take an active role themselves in the investment decision-making process (see Figure 6.8). The level at which the client is most involved is termed “self-directed.” Clients in this category are not actively advised by the bank and make their own investment decisions. They rely on the bank primarily for execution and custody services. The categories are described in detail here in Figure 6.8.

- Discretionary mandates
  Under a discretionary mandate, the client authorises the bank to make day-to-day investment decisions within the context of an agreed-on risk tolerance and investment strategy framework. The bank is contractually authorised by the client to make transactions in the client’s name and on the client’s account. The strategy and performance are periodically reviewed with the client and necessary changes are implemented. Investment decision making is fully delegated to the bank.
- Transaction- and portfolio-based advisory services
  A distinction can be made between transaction- and portfolio-based advisory services. In the case of transaction-based advisory services, the investment advice is designed to allow the client to exploit short-term opportunities in the market by suggesting investment ideas based on the bank’s market outlook, while recommending the appropriate stop-loss levels. Portfolio advisory services and mandates are for clients pursuing a structured investment process. Portfolio advisory mandates differ from discretionary mandates in that while portfolio advisory services are provided, the client makes the ultimate decisions on transactions. However, the client’s needs, time horizon, risk tolerance, and performance expectations are analysed the same way as in the discretionary mandate framework.
- Self-directed clients
  These clients usually make their own decisions without delegating any tasks regarding financial investments to the bank. They have a dedicated relationship manager. The bank provides execution and safekeeping of securities and performs the reporting on all accounts and securities as well as an overview of asset allocations and a performance analysis. The bank provides research and investment ideas to the client but offers no investment advice or investment recommendations.

Wealth Engineering and Management

Wealth engineering and wealth management are the services that take a bank closest to the client. These services require an in-depth relationship and are where most value can be added for clients. Therefore, every relationship manager should aspire to win the client's confidence through successful investment advice and high-quality services, not only to ensure a successful result but to ensure greater opportunity to be entrusted with matters pertaining to total wealth management.

Wealth engineering and management involves the comprehensive analysis of a client's needs to enhance all dimensions of the client's total wealth. Services in this category include, for example, offering clients assistance when relocating and/or buying and selling property, planning for retirement and inheritance planning, escrow services, philanthropy, and offering clients credit. Some of the most common examples are described as follows:

- Real estate services and relocation planning
  There are two types of investments in real estate: clients may wish to buy or sell their own residences, or they may also purchase property purely as an investment. Apart from regulatory aspects, such as whether a foreign national can purchase real estate without a specific permit, transactions may have tax implications. A bank might help clients to find property and serve as a discreet intermediary in real estate transactions. A banker might also know the local market better than the client.
  Relocation planning services (finding property, getting permits, insurance, coordinating the move) also can assist clients to gain a clear idea about their goals and options in order to maximise the benefits of a relocation move. Real estate services focus on all aspects of owning or investing in residential or commercial property. While it may make more sense for the bank to outsource real estate services to specialists, the emotional link between a client and his or her primary residence or residences is strong, which makes it a good idea for an RM to be in position, as needed, to offer competent advice and solid solutions in this area.
- Retirement planning
  Retirement planning for HNWIs can be complex. Very often, wealthy clients have real estate in various countries, and they often have cash flow needs in a variety of currencies; their cash needs tend to be large. Wealthy retired clients need an active asset/liability management, structuring their assets to generate cash flow to meet liabilities without eroding their asset base. Common to all clients is the need to establish low-risk investments that generate sufficient income to cover their expenditures during the portion of their lives in which income from daily work typically declines.
- Succession planning and will execution
  Wills and testaments take the bank into strongly emotional territory. Succession planning aims to reconcile an individual's wishes regarding the estate with the needs and general circumstances of the heirs. Making matters more complicated, HNWIs often have assets in different countries, and their designated successors may be living in different jurisdictions, too. The fact that more than one country is involved might mean higher costs (e.g., due to taxation), and may require more time-consuming transactions allowing for transfer of legal ownership and control of assets.
  When a relative has passed away, clients feel understandably vulnerable. A relationship manager's ability to offer sound advice and support during the period of the execution of a will, done sensibly and judiciously, can build strong bonds and bridges to the heirs. It also becomes a matter of practicality, providing the relationship manager truly has a trusted advisor role and is familiar with the financial complexity involving an individual client.
- Philanthropy
  Philanthropy services involve all types of advice related to planned giving, including establishing and managing private foundations and charitable trusts. Philanthropy has long been a popular service for ultra-high-net-worth individuals (UHNWIs). But it is gaining ground in lower wealth brackets as well, as banks seek to expand comprehensive service offerings to differentiate themselves from the competition.
- Credit services
  Credits, loans, or mortgages can be considered products. The actual process of approving credit, however, especially when the loan is made against assets owned by the client and held by the bank is essentially a service. Such loans are often known as Lombard loans when made against marketable securities or bonds. These loans require an increasingly sophisticated credit department, given that banks look to expand the universe of acceptable collateral.
  "Lending establishes trust and a sense of partnership, potentially the single most important factor in client satisfaction," according to a study by Oliver Wyman.(3) Wealth managers can generate a significant portion of revenue from lending, but based on this report, not all of them make use of it to full potential. According to Oliver Wyman, "big banks typically are most willing to lend, leveraging their balance sheets, captive funding bases and risk management expertise. Pure private banks and investment banks tend to lend less and in some cases not at all. It adds that "these players should reconsider lending." Besides bringing in additional interest

income, lending can be a powerful form of client bonding. It can also reduce asset defections, (e.g., in cases where a client might otherwise opt to withdraw and liquidate assets to cover cash flow needs). When a portion of the client's portfolio is the collateral for the loan, there is a significant inducement to stay with a bank.

Summary of Wealth Services

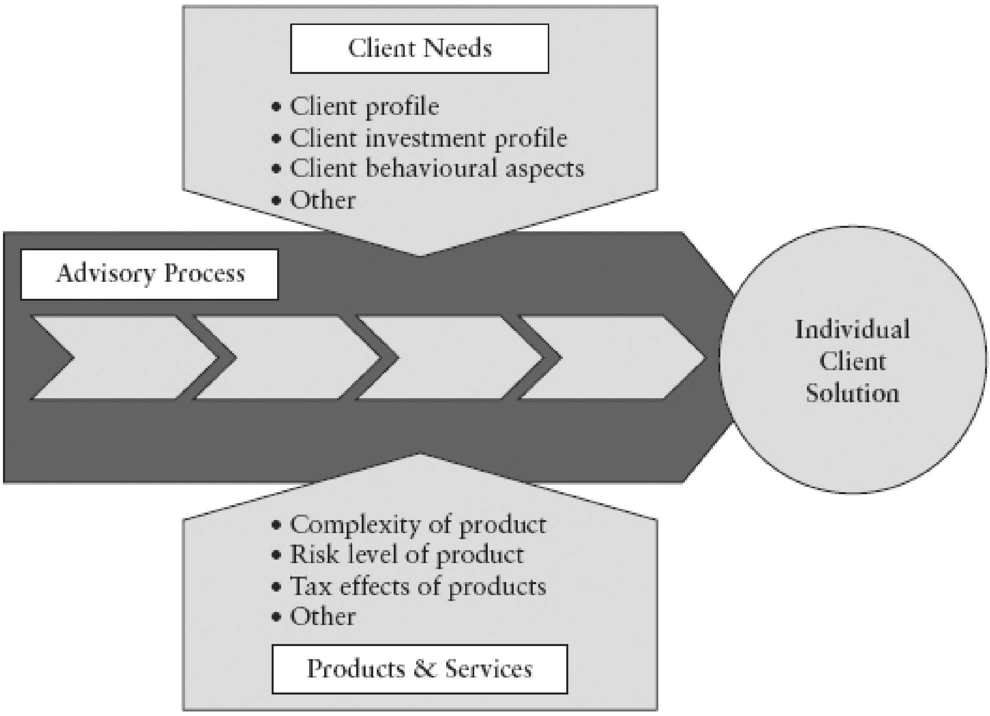
Services can be non–client specific, or more specifically tailored to meet individual clients' needs. A private bank must excel both in client-specific services (e.g., portfolio management and investment advice, wealth engineering and management) as well as in the areas that are by their nature not tailored to individual clients (e.g., custody and transaction services). Given that these "non-specific" services must be excellent in any case but are typically largely anonymous and interchangeable, the greatest additional benefit to a private bank can be derived by focusing on client-specific services. In this regard the advisory process matches products to clients' needs. Some private banks have branded advisory processes, which are designed to heighten client involvement in the advisory process through explicit structuring of the process. The next portion of this chapter discusses how to best match client needs with the products and services provided by the bank.

MATCHING CLIENT NEEDS TO PRODUCTS AND SERVICES

The advisory process provides the ultimate link between clients on the one hand and investment solutions on the other (see Figure 6.9). Advisory services are thus a critical part of the overall picture. For clients, even those who are self-directed and manage their assets by themselves, having a good advisory service is important. For discretionary clients relying on the bank to choose products and services, getting it right is essential. Structured advisory processes are important tools for improving client experience and service excellence. They help to ensure regulatory compliance. For banks, advisory processes also serve an important role. They strengthen the bonds between the client and the brand. The advisory process puts the focus on the entire bank (as well as the brand) as opposed to simply highlighting the efforts of a single relationship manager.

FIGURE 6.9 The Advisory Process Is the Essential Link between Client Needs and Products and Services

Source: Author



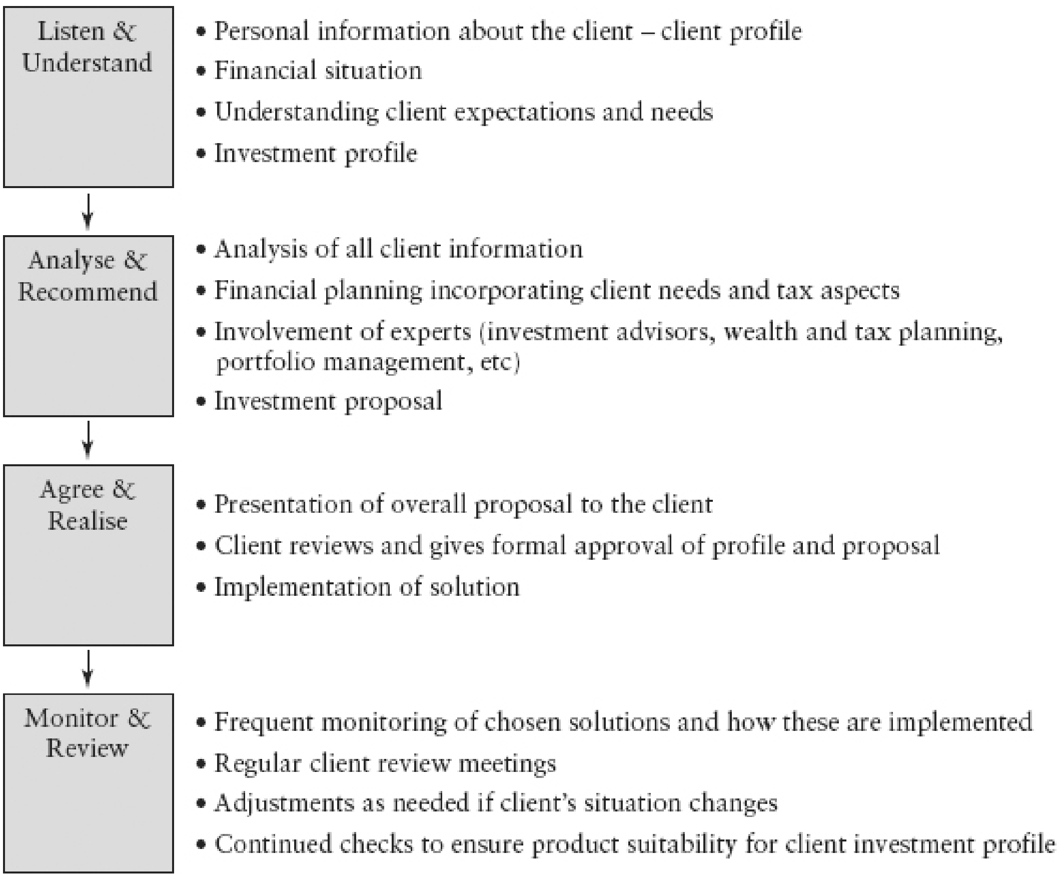
The Advisory Process

The steps in an advisory process generally begin by getting to know the client, understanding his or her individual objectives, needs, and risk profile, as well as dealing with numerous other factors that will determine how the person makes decisions, communicates, and responds. This is an ongoing task that will evolve over the life of the relationship and ensures that the process is truly a personal one. Understanding the client's particular problems and goals constitute the next key step in the relationship. These could include new family situations such as marriage or divorce, inheritance issues, changing financial situations tied to selling property or a company, or any other factor that could affect investment decisions. As this process is also likely to be continued over the entire relationship, communication channels must be kept open. In addition, clients need to be kept informed of their options relating to their particular situation, evaluating these as necessary. The client can then make the best decision suited to his or her particular situation.

A good advisory process includes regular feedback to evaluate the results of the decisions. An example of such an advisory process is shown in Figure 6.10.

FIGURE 6.10 Example of an Advisory Process in Private Banking

Source: Julius Baer



Which products meet the needs of which client segment? This is very much a function of the requirements of the individual client and his or her stage in life, as well as numerous other factors ranging from the client's approach to risk and risk tolerance, age, cash flow needs, future liabilities, level of wealth, domicile, and so forth.

Figure 6.11 offers a simplified overview to determine which individual offerings are best suited to a particular client group or a single client, drawing them from the full product range. In each case, the relationship manager together with the advisory process provides the crucial link in the process, bringing together clients with products and services. Using as a guide a format such as the one depicted, a bank can train relationship managers to provide a standardised advisory approach. Ultimately, however, it comes down to each relationship manager to deliver a service unique to the individual client at any given moment in time. The process must be continuously adapted given that both markets and individual clients' needs change.

FIGURE 6.11 Matching Products and Services to the Clients' Needs

Source: Author

Proximity to client: Low → High

Product/Services	Clients: Affluent	Clients: HNWI	Clients: UHNWI
Custody	N/A	N/A	Global custody
Execution			Direct access
Fund selection	Online fund tool		Tailor-made selection process
Product engineering	N/A	N/A	
Investment advisory	Transaction-based mandate	Portfolio-based mandate	
Portfolio management	Fund mandate	Semi-customised mandate	Customised portfolio
Relocation planning/real estate services	N/A	N/A	
Retirement planning	N/A	Focus on entrepreneurial background	
Succession planning	N/A	Only for entrepreneurs	
Escrow services	N/A		
Philanthropy	N/A	N/A	
Loans	Lombard		Sophisticated collaterals
Credit services	Degree of diversification and quality of collateral →		
	N/A	N/A	Airplane, ship, etc. financing

CONCLUSION

One significant change affecting the industry has been the strong growth in the number of financial products and services available to investors. Not only have these products increased in number, they have grown in complexity. At the same time, clients, especially in light of the losses suffered during the financial crisis, require a comprehensive approach to wealth management. The developments affecting clients, market disruptions, and growing complexity, along with changes in the legal environment, are forcing banks to think carefully about their focus. The future belongs to banks that can position themselves by having a sophisticated advisory process in place, which allows the particular client's needs and goals to be translated into a tailor-made, compliant investment solution. Transparency will be a top priority, driven by increasing regulatory pressure.

The range of products and services has increased partly as a result of declines in transaction costs. This was possible due to advances in technology, which enabled more and more niche products to be created and distributed globally at very low cost. At the same time, the trend toward increased bundling has created a layer of opacity that can ultimately lead to inadequate risk management and was a major factor in giving rise to problems that led to the financial crisis that peaked in 2008. In response to such trends, private banks increasingly are seeking transparent and secure ways to improve the risk/return profile of the products they offer. Furthermore, more regulatory pressure means that banks will have to address the issue of advisory liability, which in future could become a greater business risk. The legal obligations arising from the client relationship will become an increasingly important aspect when it comes to organising the wealth management business. The level of advice given to the client in each case will be governed by a service agreement or umbrella contract. This will in many ways be considerably different from the general terms and conditions used by banks today.

The burden will be on banks to clarify the client's risk tolerance and ability more thoroughly, based on a carefully structured advisory process. Custody agreements will be available for self-directed clients. In these cases the bank will provide current accounts and a securities depot. The rest will be up to the client. The bank will most likely give no investment advice and make no recommendations and will thus not assume any liability.

In advisory relationships the bank will give portfolio and investment advice via structured advisory processes. In the future, as regulators increasingly consider it the duty of the bank to protect the client, advisory or semi-advisory umbrella contracts will appear that clearly define the limits of the liability of the bank when giving investment advice.

Finally, there are discretionary mandates where the client delegates the selection and final decision regarding investment choices to the bank. Discretionary mandates are likely to become more aligned with the client's goals. Going forward, it is probable that the industry will see more diversified and robust portfolios that employ a more active asset allocation together with an active risk management layer to ensure long-term capital preservation. Furthermore, some banks will adopt a more goal-oriented approach to solutions encompassing an active asset/liability management for wealthy clients.

NOTES

1. Ferguson, N. 2002. Empire: How Britain Made the Modern World. Allen Lane/Penguin Press.

2. Ferguson, N. 2008. The Ascent of Money: A Financial History of the World. Penguin Press.

3. Oliver Wyman. 2008. "The Future of Private Banking: A Wealth of Opportunity."

APPENDIX 1: OVERVIEW OF THE MOST COMMON FINANCIAL PRODUCTS

Financial products take into account instruments including those described herein that have been combined to meet certain goals. These can make it easier to invest, but here it is important that all parties involved understand the products before buying or selling them.

Basic Products

Even some of the simplest forms of financial products can be considered as "aggregates" or "packages" that can be applied to make them more practical and assist in marketing. Aggregating or packaging describes how various financial components are combined to produce a single product—for example, a deposit account combines different elements: cash, payment of a fixed interest rate, certain fees and charges, and legal rights and privileges.

Funds and Related Investment Products—An Overview

Funds, as a general class, pool the assets of many investors to achieve the principal aims of diversification and economies of scale. The cost of research and management overheads can thus be spread across a greater number of investors, and individuals gain access to investment opportunities and expertise that they might not otherwise be able to obtain. Funds differ mainly in terms of the access rules—public or private, the minimum investment, the regulatory framework, and the investment strategy (style, sector, region, asset class, etc.).

Mutual Funds

A mutual fund is a company that sells shares in its own stock to the public and uses the investments to pursue a particular investment strategy by buying equities, bonds, money market instruments, and so forth. Mutual fund shares can be traded, and the value varies with the performance of the fund. Mutual funds offer the advantages of convenience, diversification, and professional management, most often with a low minimum investment level.

ETFs, ETNs, and other Exchange-Traded Vehicles

Exchange-traded funds (ETFs) are investment vehicles that are traded on stock exchanges like equities. They are designed to track the performance of a particular index or basket of instruments. ETFs are usually considered passive investments, which makes them cheaper than mutual funds to manage. While fees associated with these instruments are lower than mutual funds, investors who trade ETFs actively must figure in trading costs. Besides ETFs, there are exchange-traded notes (ETNs), which resemble ETFs but pay returns in a fashion similar to bonds, and exchange-traded commodities (ETCs) that track commodities prices.

Hedge Funds

Hedge funds are sophisticated funds that are permitted to engage in a wider range of investment and trading activities than mutual funds. They are known for using strategies intended to make money under different market conditions, including down markets, and for using methods that might be employed to enhance returns, sometimes also taking unconventional risks.

Hedge funds are usually limited partnerships with the manager as a general partner and the investors taking limited partnerships. Fees are performance related; hedge funds may charge a management fee of around 2 percent and a performance fee of typically 20 percent. Access is limited to certain types of investors, generally those who have experience in financial products and a certain amount of wealth. There are often restrictions on the entry and exit periods. Because they typically enjoy more freedom and less regulator scrutiny, these funds may be barred from publicly advertising their products. In the European Union, a new version of existing rules has been introduced, for the first time enabling hedge funds to set up so-called UCITS-compliant structures, allowing them to market certain products to a broader public. Under the latest version of the rules, the so-called Undertakings for Collective Investment in Transferable Securities (UCITS) funds can, for example, invest in derivatives, making it easier for hedge funds to offer UCITS-type funds. As a result, some hedge funds based outside of the EU are repackaging versions of their funds to meet the guidelines. These variations can be marketed to a broader audience within the EU. But by joining the already significant volume of UCITS funds, hedge funds must ensure that these products meet strict guidelines covering, among other things, structure, management, and documentation, as well as what funds can and cannot invest in. They also must work to generate competitive returns.

Funds of Funds

A fund of fund is any type of fund whose strategy is to invest in other funds, as opposed to investing directly in financial instruments. While funds of funds promise increased diversification, they are considered more expensive because of the various layers of fees. Furthermore, when used as components of a wealth portfolio they may lack transparency, making it harder to know exactly how diversified a portfolio containing several different products might truly be.

Private Equity

Private equity refers to investments in firms that have not yet listed on the stock exchange. Investments in private equity are usually therefore highly illiquid. Private equity investors hope for large gains when the company they invest in is sold to another company or when the company lists its shares on the stock exchange.

Structured Products

Structured products are prepackaged investment strategies in the form of investment vehicles issued mainly by banks. They can be used for capital protection, diversification, or risk management, although usually there is no guarantee on such products. They may provide yield enhancement, allow participation in market trends, and satisfy a desire to obtain leverage (i.e., aiming to get a higher return for the same amount of investment).

APPENDIX 2: KEY CRITERIA IN THE SELECTION OF FUNDS AND FUNDS OF FUNDS

Funds are a form of aggregation that makes it easier for investors to diversify their investments. It is important to note that the universe of funds is vast, and finding the right fund to suit an investor’s needs is an integral part of the process.

Rating

The first step in fund selection is classification to rate funds. Funds need to be classified into categories based on organisational aspects of the particular company managing the product, the investment approach taken, the currency of the fund or share class, length of the track record, and historical performance. Within each class, funds are identified within their category relative to peers based on a variety of factors, including how the fund is organised, the investment process, the managers, and the fund's historical performance.

Organisation

It is important to know how the firm managing the fund is organised, its long-term viability with regard to retaining management talent and sustaining business activities. People who are good at selecting funds do more than read published reports and brochures. They visit the fund managers and talk to them directly to assess the firm's culture, management incentives, and regulatory and compliance arrangements.

Investment Process

This needs to be well defined and consistently applied. The fund selector will look for competitive advantages at the process level, such as unique modelling capabilities or unusual perspectives or depth of analytical resources. The investment process also should offer an indication of whether the fund's premises that determined historical performance are still valid. While it is impossible to predict a fund's future performance, management fees are a known quantity that can be minimised if two similar propositions are being considered. Besides the management expense ratio, the fund's pattern of trading expenses can affect overall performance.

Investment Professionals, Fund Managers

Those overseeing the fund need to be experienced in the fund's mandate or strategy, and within the team, there needs to be a pool of significant experience. The team should possess complementary skills and enough personnel to ensure that the fund managers are not distracted by other mandates, including sales or client responsibilities. While the management track record is no guarantee of future performance, a consistent performance over at least three to five years and a consistent strategy are favourable indications for the future.

Historical Performance

The performance is compared to a benchmark, often based on an index that includes the same exposures as the fund's investments or on a reference interest rate. Performance can also be judged relative to peers. It is important to study risk-adjusted performance and to look at a time frame sufficient to truly judge performance—for example, three to five years. Finally, one needs to look at the factors to which performance is attributed and apply plausibility tests. In other words, there has to be a plausible correlation between any performance in excess of the market, volatility, and the purported strengths of the investment managers.

*I asked Guido Ruoss to contribute this chapter due to his special expertise and knowledge in these areas as Head of Business & Product Management of the Investment Solutions Group at Bank Julius Baer. Second and even more important to me is our shared belief that innovative and client-centric products and services form an integral part of a modern private bank offering. Author.

*According to an article published in the Financial Times, the pace of execution of orders on exchanges has gone from seconds, to milliseconds, to microseconds, and even to nanoseconds. Feb 24 2011, Financial Times: "Trading Monitoring Goes into Nanoseconds."

*For a detailed overview, refer to Figure 6.11.

Chapter 7

Why Brand Matters

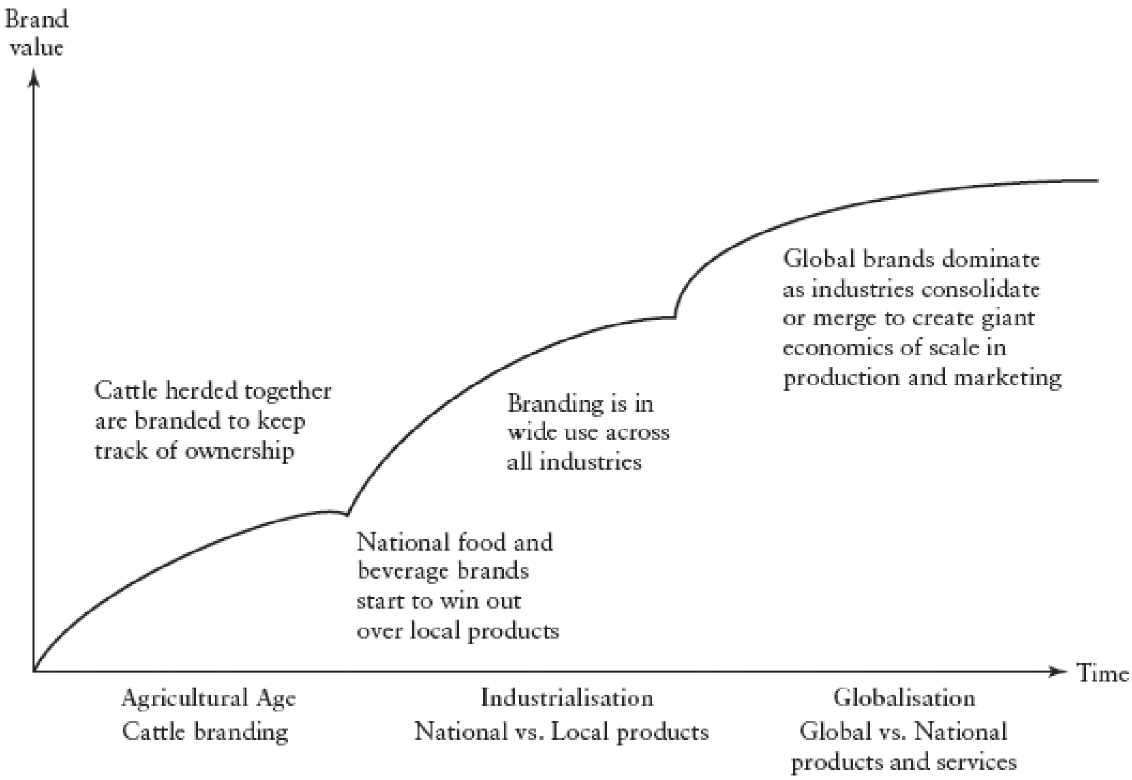
One of the building blocks of any brand is trust. A brand is what ultimately expresses the personality of a company. For financial services companies, because the product itself and its delivery are intangible elements, the brand plays an even more important role. Private banks in the past tended to pay little attention to marketing and branding. This has changed today. One reason is that there are more companies in the industry, allowing clients to be increasingly selective. Branding sets a bank apart from its peers and sends a message that the promise of competent and high-quality service excellence will be met. Our industry also has grown increasingly global in its approach. A strong brand is one of the things that unites a company operating in many different regions of the world. It is therefore important to examine the reasons why brands have even come to be used by private banks, which is a recent development, compared with the history of branding.

THE ORIGINS OF BRANDING

Branding in its earliest form was already practiced in ancient Egypt. Marking the hide of an animal to signify ownership proved to be very practical. Once branded, cattle belonging to different owners could be herded together (a shared investment) and still be easily separated for sale (profit-taking). Where free-range grazing was common, such as in the American West and Australia, branding evolved and owners began to register their brands to prevent duplication. During the industrial age, branding became increasingly common for products. Modern branding really took off in the latter part of the 20th century, as its principles were applied not only to products but to services. Companies realised consumers can emotionally relate to brands (see Figure 7.1, Three Waves of Brand Evolution).

FIGURE 7.1 Three Waves of Brand Evolution

Source: Author



In the meantime, brands have become extremely valuable assets. In 1988, when Philip Morris purchased Kraft for six times what the company was worth on paper, the price was justified partly by the perception that what Philip Morris really was getting for its money was a number of famous brands, including not just Kraft but also others familiar to American households such as Velveeta (a cheese product), Miracle Whip salad dressing, Philadelphia cream cheese, and Parkay margarine.(1) Globalisation has taken local versus national competition to a whole new level.

Companies specialising in brand management have developed sophisticated ways to assess the value of a brand. Table 7.1 shows the estimated shareholder value attributable to the brand across various industries. In financial services, altogether 30 percent of shareholder value could be attributed to brand value. This development has been led by pioneers such as Citigroup, HSBC, and UBS, which pursued global expansion strategies that have included a strong brand agenda.

TABLE 7.1 Shareholder Value Attributable to Brand Strategy across Different Industries

Source: Doyle P., Brand Management, Vol 9., No 1, 2001. 20–30 September (from data supplied by Interbrand), reproduced with permission of Palgrave Macmillan.

	Tangible Assets	Brand	Other Intangible Assets
Energy	70	0	30
Industry	70	5	25
Pharmaceuticals	40	10	50
Retail	70	15	15
IT	30	20	50
Car Manufacturing	50	30	20
Financial Services	20	30	50
Food	40	55	5
Luxury Goods	25	70	5

As brands have become more important globally, they sometimes have provoked a cultural backlash, becoming the target of heated debate. Modern consumers today are fairly knowledgeable about branding and understand that their choices are influenced by them. But a company can still appeal to their emotions, thus influencing customer choices through branding, providing it is done in a transparent and honest way. In this sense, branding has come to symbolise a relationship or a reputation. It takes years to establish trust, yet this trust can be destroyed in a single instant. A major misstep or crisis, even if it affects only competitors, can cause collateral damage. Losses resulting from actions of individuals such as a rogue trader may cause serious harm to the reputation of the whole financial industry. Building a strong brand also takes discipline, as well as a lot of time and massive investments. But done properly, the rewards of branding can be great.

THE FUNCTIONS OF A BRAND

Modern brands are bearers of an image and express qualities such as trust, allowing clients, potential clients, staff, and others to distinguish the characteristics associated with a particular brand from others in the same industry. Brands create the impression that the product or service associated with them has certain qualities or characteristics that make it special or unique. A brand is therefore one of the most valuable elements in communicating what the brand owner can offer in the marketplace.

Brands exist because consumers are faced every day with an overwhelming number of choices. Making the wrong choice entails a risk. Brands represent predictability and reliability. This is one reason why branding in the food and drink industries has proved so successful over the years. If all colas were the same, who would care whether they purchased Coca-Cola or a discount soft drink? Throughout the world, Coca-Cola represents more than the enjoyment promised by the invitation to come to the “Coke Side of Life.” As a recognisable brand, it is a known beverage, offering security in a sea of competing, unfamiliar choices. An analogy can be made to private banks, which began to take brand management seriously during the good years when markets performed well and the main risk lay in missing out on gains. The greatest potential for branding today exists primarily due to heightened concerns about risk. As industrial nations struggle back from recession and face enormous fiscal debt burdens and the threat of inflation, risks cause clients to opt for the security and trustworthiness of known brands that project a personal and sensible approach.

But even in banking, how can one tell the difference between two financial institutions when both offer the same third-party products? At certain levels, products and even financial advice can be considered a commodity. The rules for a balanced portfolio don’t change because one is speaking with a large universal Swiss bank or a large universal US bank, even though there may be some minor differences in execution. If the product is not unique, external packaging and the service delivery become increasingly important, creating new opportunities for brands. In an age when suppliers and producers of parts and products may increasingly be separated from the companies selling to consumers, brands survive despite the fact that those products or services are indeed intrinsically complex and differ in ways too subtle for many clients to efficiently evaluate and compare. In such cases, brands allow companies to differentiate themselves—sophisticated versus simple or exclusive versus accessible. A brand is a way to offer orientation to those facing what otherwise would be an overwhelming sea of choice during times of great uncertainty. The brand allows the origin of a product or an offering to be identified and ordered within a manageable set of categories, including those derived from previous experience.

There is also a social function at work. Brands define cliques and offer individuals opportunities to identify themselves with ownership of or access to a particular image. If there is a marginal difference in quality sufficient to sway the client's decision in favour of one brand, the brand owner will be able to command a premium. In other words, strong branding also confers greater pricing freedom.

Finally, because a brand's power is directly linked to previous experiences with that brand, there is no such thing as an instant brand. Building a brand takes time.

In summary, brands exist to simplify choices when:

- An overwhelming number of choices exist.
- The wrong choice entails a risk.
- Differences are latent—they're evident only long after the purchase is made.
- No real differences can be identified, such as in the case of commodities.
- Differences are so complex they cannot be effectively evaluated by clients, customers, or others outside the company without expending a great deal of time and effort.

WHY IS BRAND SO IMPORTANT IN PRIVATE BANKING?

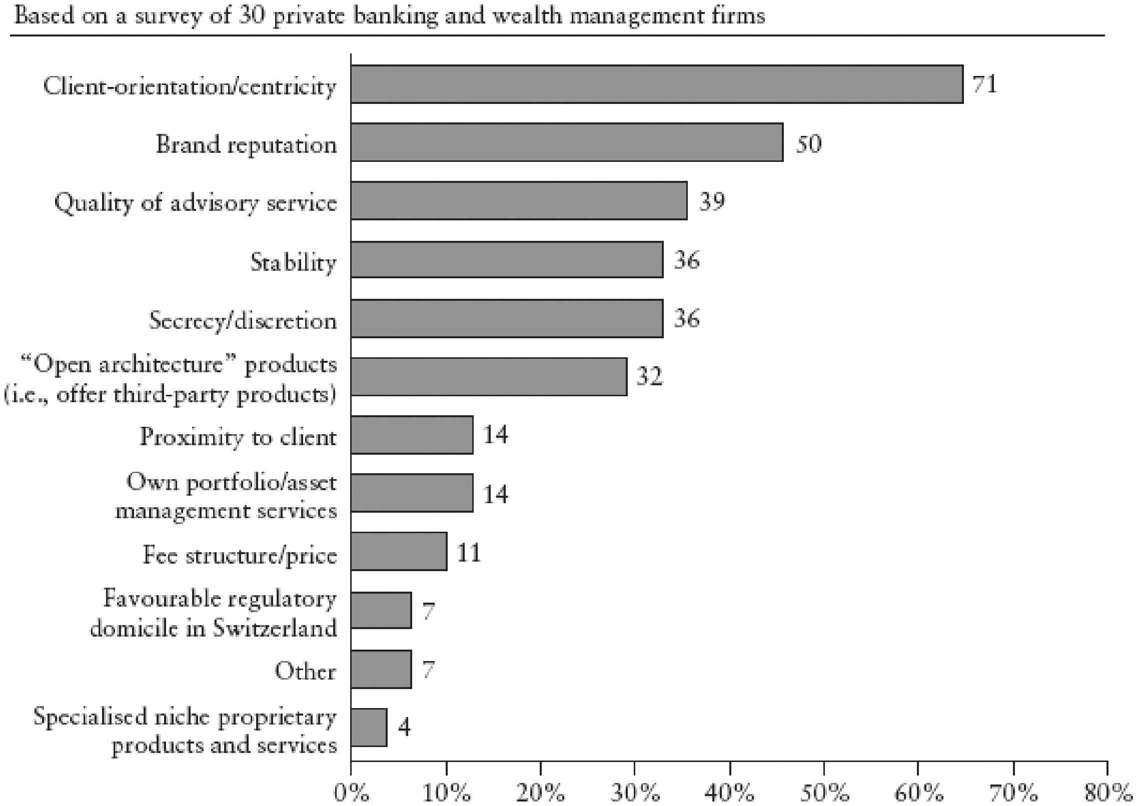
Increased competition and declining client loyalty are profoundly changing the market and business environment for private banks. Brand building offers a way to counter these trends. Brands allow companies to differentiate themselves from peers and leverage positive associations to build trust and loyalty.

A brand is far more than just a name or logo. It embodies values and standards that constitute the banner under which a company creates and organises products and services to foster and fulfil client expectations. The brand image is a symbol containing all the information and expectations associated with a company. The brand experience is what the brand delivers in terms of interactions, ranging from seeing an advertising billboard to direct encounters with the company. While names and logos have been around for quite some time, professional branding in private banking is a fairly recent development. This chapter explains why branding has become so important. It also discusses why effective brand management can add value for shareholders, clients, and employees, especially in times of crisis.

A Swiss study found that brand reputation was the second most important aspect of a private bank's value offered to the client (see Figure 7.2), after client orientation. Those institutions surveyed indicated that "brand reputation" was of greater importance than elements such as quality of the advisory service and fee structure.(2)

FIGURE 7.2 Most Important Aspects of a Private Bank's Value Proposition

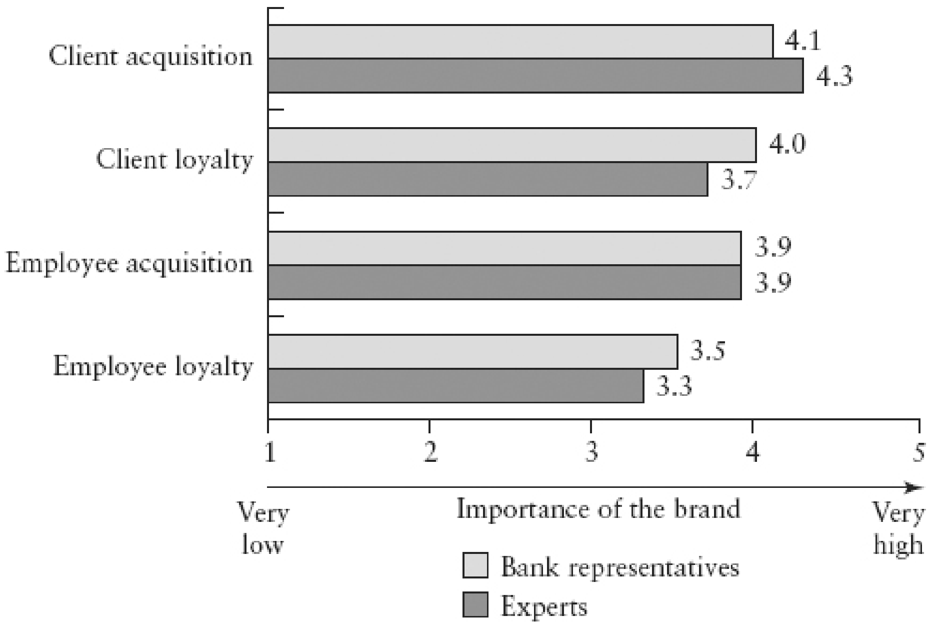
Source: KPMG, University of St. Gallen. Private Banking in Switzerland—Quo Vadis? 2009



According to research by Gwen Walbert,(3) an expert in bank marketing, it was only recently that most Swiss private banks gave much thought to active brand management. As late as the 1970s, one of Switzerland's leading private banks, Geneva-based Pictet, lacked even a logo. The sign on its door said simply, "P. & Cie." But things have changed. By the late 1990s, many Swiss private banks had adopted an active brand marketing strategy. By 2005, around 30 percent of Swiss private banks were found to be making greater efforts to actively treat a complete brand strategy as part of the central focus of their corporate strategy, according to Walbert in a study published in 2006. Based on the findings presented in Figure 7.3, brand experts and bank representatives were consistent in ranking brand as highly significant, in attracting both clients and employees. Awareness of the importance of brand is today firmly entrenched in the private banking industry.

FIGURE 7.3 Importance of Brand in Client and Employee Acquisition and Loyalty (Based on a Sample of 68 Bank Representatives and 11 Experts)

Source: Gwen Walbert. Der Erfolgsfaktor Market im Private Banking aus Sicht des Markeninhabers. Dissertation, 2006



Walbert went on to examine the implementation of brand management principles among Swiss private banks in great detail, arriving at the conclusion that private banks have much room for improvement. So, what is holding the industry back? The following points, according to Walbert, provide some insight:

- The nature of brand management is misunderstood. Senior managers often mistakenly perceive brand building as a creative exercise related mainly to advertising.
- Banking services are often complex and abstract, making it more difficult to effectively implement branding.
- Some Swiss private banks may rely too much on “location branding” (e.g., “Swissness”) without sufficiently differentiating themselves beyond this single feature.
- The Swiss offshore banking culture is characterised by modesty, secrecy, and discretion, making it hard to reconcile with efforts to strongly differentiate a particular brand.

Despite these hurdles, it is useful to highlight some of the most important aspects of brand building; including the origin of brands, why they are needed, what banks can learn from premium brands, and why consistency matters more than creativity. It is important also to look at brands’ personality, or “DNA,” and how brand positioning works in practice, along with what is commonly referred to as “behavioural branding.” This refers to reenforcing the brand’s values among those most closely associated with it—namely the employees. In private banking, the employee very much is the brand. The final part of this chapter is dedicated to examining other channels and activities where a greater awareness of the brand DNA is vital—sponsoring, events, and corporate social responsibility (CSR).

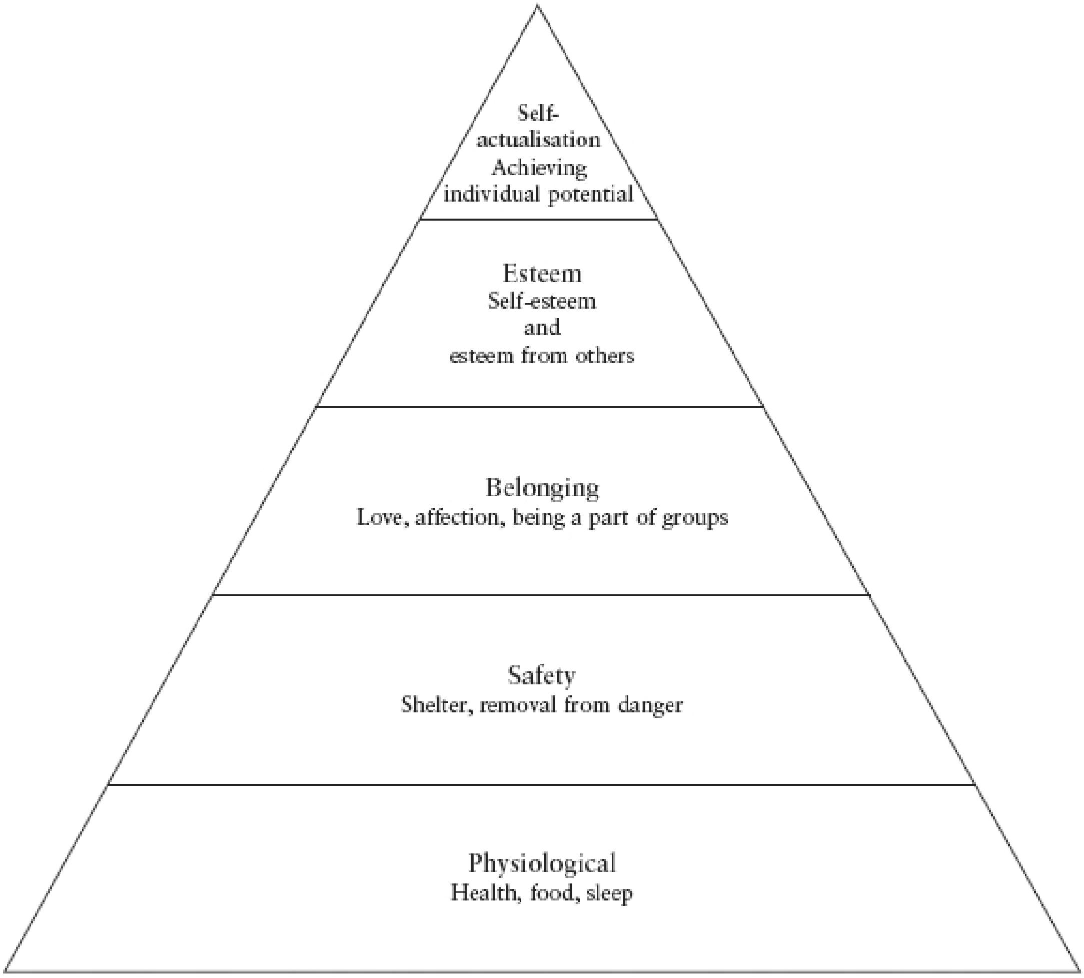
HOW PREMIUM BRANDS THRIVE

Premium brands can be considered high-performance systems that have taken the rules of branding to the extreme, balancing added value inherent to the product with the value and prestige associated with the brand. Private banks and companies associated with premium brands have many things in common. They serve the same client group and are positioned in the high-quality segment of their respective industries. Valuable insights can therefore be gained from how premium brands approach branding.

Consider Figure 7.4. Premium brands target a world where bills always are paid and food is always on the table. Similar to private banks, companies associated with premium brands cater to the two top levels of the pyramid based on psychologist Abraham Maslow’s hierarchy of human needs: self-actualisation and self-esteem. At this level of the pyramid, premium brands target human needs that go beyond the basics. No one really needs to own a handbag costing as much as an automobile, or an automobile that sells for the price of a single-family dwelling. On the upper levels of the pyramid, however, some clients seek meaning and fulfilment in symbols of prestige and accomplishment, including through ownership of famous-brand products. In private banking, clients at stratospheric wealth levels want portfolio growth not because they need the money but because they would like to have the sense of having accomplished something in their lives, allowing them to leave a legacy—for example, a hospital, a museum, a research facility to develop new medicines, or a charitable foundation.

FIGURE 7.4 The Hierarchy of Human Needs

Source: Author based on Maslow hierarchy of needs



Looking, for example, at the luxury goods industry, a number of key characteristics and mechanisms can be identified that are used to define the brand:

- Highest level of quality
- Pride of origin and tradition
- Consistent positioning
- Exclusivity
- Carefully managed evolution

Premium brands operate globally but strive to keep the connection with their origins. IWC is not just a watch—it is a Swiss watch. Versace is an Italian fashion house. Hermès is a maker of top quality leather goods and other luxury items based in Paris. These brands carefully cultivate the image of a location rich in tradition and heritage.

Premium brands maximise quality and communicate this benefit. Only the best raw materials are used. Processes are carefully optimised. Top designers and craftsmen work hand in hand to create products that excel in all respects.

Consistent positioning means to be true to the brand's identity and operate in accordance with the natural rhythms of the business and product life cycles. Premium brands are unperturbed by short-term events and never confuse their clientele with unexpected repositioning, as sometimes happens in retail and consumer markets. A true premium brand would seldom, if ever, compromise its brand by lowering its prices significantly to attract sales.

Exclusivity also plays a part. Much of the appeal of a premium brand stems from careful "boundary management" or a policy of exclusion. Belonging to the elite of those who can afford a given brand has a powerful pull. The less accessible, the more attractive the brand becomes to the owners and potential owners included in this select group.

Unadulterated innovation and spontaneous creativity rarely bear fruit commercially, because the adoption of innovation requires a paradigm shift of thinking or behaviour that, at least in brand terms, is closely linked with the company the brand represents. Aware of this, premium brands carefully manage their evolution and cultivate their image. Drawing on their own heritage, they introduce changes in increments, in order to subtly exploit new techniques and trends, while remaining fresh and relevant in the process. They introduce creativity in small doses in order not to risk alienating their established clientele.

Although some might argue that banks are in the business of making money and keeping it safe for clients rather than selling luxury watches or shoes, it is a fact that premium brands and private banks tend to target the same clientele. The affinity between such brands and private banks also is evident in the common efforts to target resorts and towns frequently visited by wealthy individuals such as, for example, in Switzerland—St. Moritz, Verbier, Crans-Montana, and Ascona.

BRAND BUILDING REQUIRES DISCIPLINE AND CONSISTENCY

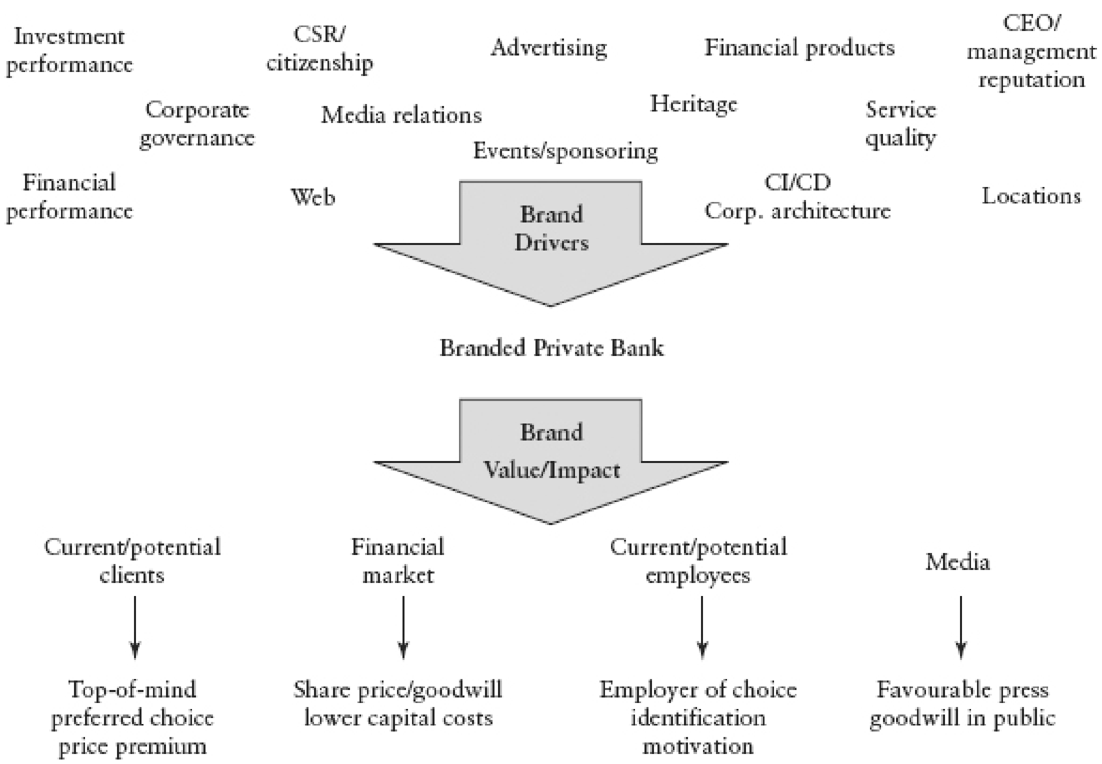
Branding is not rocket science. Neither is it strictly about creativity. Branding is about discipline and consistency. It requires major investments over many years.

When one considers the star designers and creators of premium brands, one understandably might associate brand management only with creativity. But this would be incorrect. Branding is about discipline. Professionally creative people understand this, while amateurs often confuse improvisation with creativity. Branding may involve being creative, but it takes place within a very strict framework. Adherence to self-imposed rules maximises the effect. For example, Julius Baer launched a brand campaign based on the theme "Unknown Masters."* Its focus went beyond conventionally famous people, to discover those behind the scenes whose extraordinary craft, skill, and discipline have enabled others to excel and achieve fame. While the person featured as a "Master" changes from advertisement to advertisement, the tone and presentation is always the same and the photography consistent. There is no instantaneous satisfaction here. But the campaign appeals to a sophisticated audience, with subtlety and substance, by consistently implementing and reinforcing brand values.

Branding is also much more than advertising; it is a sum of the various parts, meaning that all aspects of the business process and company performance contribute to the brand's impact, as shown in Figure 7.5. The brand value is derived from the ability of a brand to sway clients in favour of the company, create goodwill among investors, motivate employees, and generate favourable press.

FIGURE 7.5 Brand Drivers and Impacts

Source: Julius Baer



BRANDS HAVE PERSONALITIES AND "DNA"

To manage a brand, it is imperative to first understand its heart and soul. These qualities are the core concepts that drive the creation of products and services and the relationship with clients. The evolution of the brand and the company behind it is expressed in the concept of the brand's "DNA."

If a client can develop a psychological relationship with the brand, can the brand be personified and identified in terms of its character? If the brand were a person, what would he or she be like? What clothes would that person wear? What sort of voice would that person have? What music would that person listen to? These questions reflect the soul of the brand. The heart of the brand has to do with its vision—what one could call raison d'être or mission. A company exists to create value for the shareholders, but the company's brand needs a purpose or a goal beyond this. To simply increase market share does not go far enough. If a brand can answer the question of what the market would lack if that brand did not exist, it is well on the way to knowing its purpose. Strong brands are more than market players—they define the market in some way. The name Ford alone for many once defined the essence of the automobile. Today, simply recalling Google, Microsoft, or Apple sums up many people's daily interactions with technology, just as McDonald's is synonymous with fast food and franchises. All of these companies were founded and led by charismatic visionaries who gave their companies a specific sense of purpose. A brand needs to embody the purpose that once inspired the founder, allowing it to evolve so that it can develop new products, services and markets.

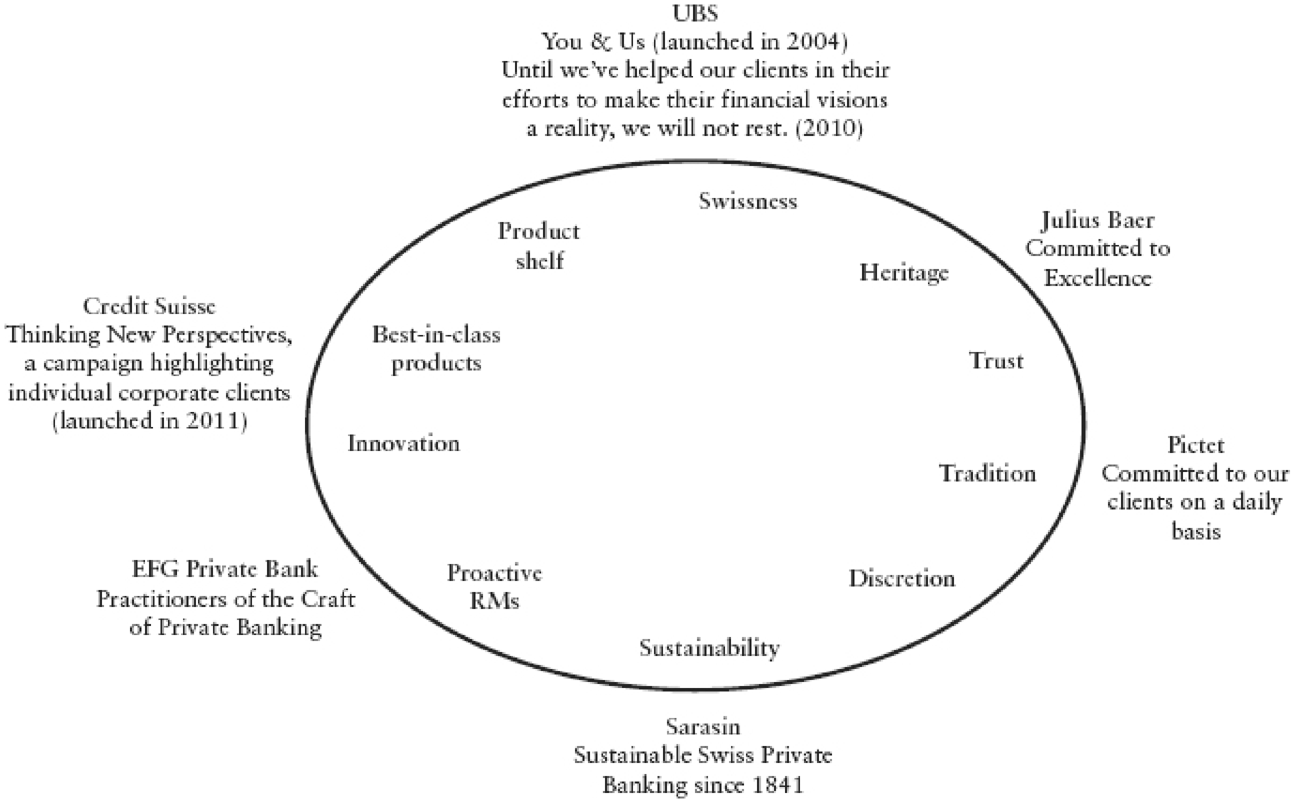
Examining the history of a brand, it is possible to identify its DNA; this reflects the collective perception of the brand based on the earliest first impressions, memories, and expectations associated with it. These might include a successful product that defines all others in the same line—for example, Tupperware® became synonymous with parties to sell these products. In many cases, the perception of the brand is strongly linked to these early associations.

Besides the seminal milestones in creating the brand's "DNA," there are the current associations that relate to the most recent experiences where one might have encountered the brand. These include client experience, taking in a range of advertising and public relations, aspects of corporate social responsibility (CSR), performance, and overall satisfaction with the brand. In addition to seeking to evolve, a brand needs to stay true to the features that first attracted customers. The DNA, the heart and soul of a brand, define the brand's potential future path. Going beyond the boundaries set by the DNA of the brand will weaken its image and confuse clients. This may happen if a company introduces products or services that radically deviate from its core identity. In 1950, the company founded by Marcel Bich and his partner Edouard Buffard introduced the BIC® ballpoint pen, an undisputed revolution and unique success story. But when the company ventured into perfumes in 1988, these flopped. The company has stopped selling perfumes except in a very few markets.(4)

Brand positioning means carving out a niche—establishing the name, logo, values, and standards that differentiate the company from its competitors. A private bank brand must be a premium brand. This means that brand communication, from creation to advertising, will necessarily be done at the highest level. A brand should help to differentiate a bank from its competitors, perhaps with values such as those illustrated in Figure 7.6. But how does this work in practice, and what resources does it entail? As with all premium brands, creative professionals must be employed who are capable of developing ways to set the company's offerings apart from those of its peers and managing the related advertising campaigns. But branding, as previously noted, is not about creativity in the conventional sense. It is about being consistent and true to one's identity. For example, one needs a photographer capable of rendering the brand in incredible images that express its "soul" and able to do this not just once but over and over again.

FIGURE 7.6 Swiss Private Banks and Their Key Values

Source: Corporate websites



One example of using the brand's DNA to advantage is the "Unknown Masters" campaign used by Bank Julius Baer. Starting with the bank's brand values "passion, care, and excellence," "excellence" was rapidly singled out as having the most potential impact, even though it also was the most challenging to express. By adopting the "Unknown Masters" approach, the bank was able to convey excellence implicitly rather than explicitly while subtly upholding the importance of discretion. The "Masters," the experts featured in the campaign, are perhaps known to connoisseurs but operate out of the limelight in tireless fashion to achieve excellence in their respective area of expertise. For example, by highlighting the voice coach of a famous opera star, or the acoustic engineer for cars produced by a well-known automotive company, emphasis is on the results achieved by that person's efforts, rather than the person themselves. In these advertisements, the Masters explain their understanding of excellence in their field in a manner that underscores the bank's own values. On the corporate website, the bank quotes these individuals at length, allowing them to tell their stories in their own words and explain how they achieve excellence. This reflects the sophistication of the bank's advisory process. In other words, the message is, "you can't reduce good advice to sound bites." Finally, the visuals express the brand's identification with both simplicity and luxury. (5)

PRACTICAL CHALLENGES OF GLOBAL BRAND BUILDING

For global brands, everything has to work flawlessly and seamlessly across cultures and continents. The solution is the oft-cited but difficult-to-put-into-practice adage to "think global, act local," creating a brand with universal appeal and ensuring that it is suitably adapted to each regional market.

Alain Zimmermann* recalls the experience of rolling out the Julius Baer brand in Asia:

When we began planning a Julius Baer presence in Asia, we faced a lot of questions, starting with the name. How will the Chinese cope with the pronunciation? After a lot of debate we decided, based on the brand DNA and the bank's traditions, that we would definitely keep the name. Working with experts, we developed a Julius Baer descriptor in Chinese characters to accompany the logo. This process included obtaining clearance from a Feng Shui master.

The importance of checking the local cultural implications of everything relating to the brand must not be underestimated. Well-known to those in Asia, for example, the number 4 commonly is associated with bad luck, whereas 8 connotes luck or good fortune. Therefore, a brand must avoid an address or telephone number containing a 4. Aside from names and numbers, every image used and every written formulation needs to reflect the core brand values and DNA applied to the culture that is being targeted.

The brand also requires equally professional implementation in terms of establishing it in the public eye, using excellent media planning and advertising to ensure that the company gets the full impact and derives all the benefits. When building a brand, the common approach is to apply the media strategy to entire markets or regions. But the fact that advertising used by financial services companies is strictly regulated in many countries makes this a difficult proposition for a private bank. International publications such as The Economist or the Financial Times reach many markets, but the price tag for advertising in them is correspondingly high. To be able to build a brand properly, a bank must be either a large global player or a boutique focused on a single market. It is very difficult for those positioned between two opposite ends of the spectrum to succeed in this area.

What about television? In certain markets such as Europe, television advertising is often considered unsuitable for private banking and some premium brands, because it is perceived as a retail medium. In Asia, by contrast, some experts believe that television advertising is a must: it conveys financial muscle, success, and trustworthiness. These are essential attributes necessary to attract clients and potential employees. This name recognition is thought to be important in cultures where it matters that one's immediate circle of friends and relatives have heard of and are impressed by the name of a bank or potential employer. Hence, brand building here is critical. But private banks' approach to television focuses on large international broadcasters such as CNN, CNBC, or Bloomberg Television, as opposed to national TV networks.

AN EXAMPLE OF SUCCESSFUL BRANDING
UBS is undoubtedly one of the strongest global wealth management brands. The group was created in 1998 with the merger of Swiss Bank Corporation (SBC) and the former Union Bank of Switzerland. Over the next few years, the bank's rapid expansion made it the largest manager of private wealth in the world and the second-largest bank in Europe. In 2004, the bank adopted a unified image under the banner of "You & Us," applied across all its divisions. UBS focused very successfully on a single brand strategy as it sold its interests in various private banks that it believed no longer fit culturally and strategically. The bank, and the brand, faced major challenges during the financial crisis. After it emerged from the crisis, in 2010 UBS introduced a new branding campaign, "We Will Not Rest," featuring famous people who have set milestones to become modern heroes and cultural icons. The campaign underscores UBS's commitment to its clients and their goals, while placing emphasis on the future.(6)

IMPORTANCE OF BEHAVIOURAL BRANDING

Brand management in private banking has both an external and an internal dimension. In businesses that rely on service, including private banking, it may rightly be said that the bank's employees are the brand. They embody the values and deliver the service in a manner that either satisfies and builds trust in and satisfaction with the brand or in the worst case, destroys brand value.

The essence of what may be described as private banking's value proposition is the way it manages assets of an individual or defined group or those of a wealthy family. This is done by a trusted and discreet relationship manager (RM). The bond between an RM and his or her clients can be so strong that clients sometimes are more loyal to the RM than to the bank. Clients may prefer to move with the RM if she or he changes employers in order not to break this bond. Having said that, clients today also have grown accustomed to having multiple private banking relationships and their investments have become more intertwined with the systems and products of the bank. This has weakened the bond to the RM and has created an opportunity for the brand to help to secure clients' loyalty. Clients who really believe in the brand are more resistant to the temptations of a rival brand. So, one might add, are the employees.

This factor makes it even more worthwhile to invest in and strengthen employees' perception of the brand. The Ritz-Carlton®, for example, immerses new employees in the brand values and requires all of them to complete an annual training certification for their position. Apart from the training related to the position, the group drills employees in its service credo: "We are ladies and gentlemen serving ladies and gentlemen."(7)

Internal branding is also vital because a positive experience is generally attributed to the individual employee whereas a negative experience is attributed to the brand. A brand-conscious employee is less likely to behave in a manner that is contrary to corporate values and is more likely to give the brand credit where credit is due.

Internal branding can be achieved by applying the principles of brand management to the available internal communications channels. These include employee magazines, virtual communications, and training via the Intranet along with offering real activities ranging from workshops and seminars to staff leisure opportunities.

ALTERNATIVE BRAND CHANNELS

Today, it isn't only advertising and employee behaviour that project brand image and experience; a company also must manage everything from interior design to its online reputation, public relations, sponsorship, and corporate social responsibility (CSR). Each of these areas poses a unique challenge. To benefit the brand, sponsorship needs to be very carefully and explicitly aligned with the brand's DNA. To be authentic, CSR has to be clearly separated from the branding process and any marketing considerations.

The Internet as a Challenge to Controlled Branding

One cannot discuss modern branding without mentioning the impact of online social networks, blogging and other interactive networks. The corporate Goliaths that once controlled their image through access to television and the print media have found that consumers can today in no time respond with email campaigns and YouTube or Facebook postings, and within a matter of hours or minutes, these comments can snowball and resonate around the world.

Corporate Social Responsibility

No one admires a phony brand. This means that corporate social responsibility initiatives have to be inspired by genuine concern about an issue, as opposed to simply being an extension of brand marketing. Of course, CSR activity, whether it be environmental auditing or charity donations, should be true to the brand. If one of the brand values is tradition, then the company must demonstrate a long-term commitment to CSR. For a private bank, one prized quality is discretion, so charitable activities should remain discreet. But discretion should not be confused with secrecy. One can do good and talk about it. But the key challenge is to be motivated by a genuine desire to achieve something positive.

USING BRANDS TO GAIN CRITICAL MASS FOR GOOD CAUSES
Corporate responsibility can take many forms. Here are two examples of efforts that build on the brand's appeal to offer positive impetus to projects that benefit others, whether in terms of sustainability or assistance to support youth projects.
Example 1: Sustainability at Sarasin
Bank Sarasin has been a pioneer in the issues of CSR and sustainability since at least 1989, when it first began to include environmental criteria in some of its asset management mandates. In 1993, it fitted its Basel headquarters with what was at the time the largest solar panel installation in the region. The following year, it launched its first investment fund focused on "eco-efficiency." In 2000, it set up its first sustainable investment unit as a separate department. It began communicating its commitment to corporate social responsibility by publishing an annual sustainability report starting in 2005, and in 2006 the bank received a special commendation for sustainability from the Financial Times for its track record of leadership and innovation. In 2009, it switched all private client asset management mandates in Switzerland to "sustainability" and set up a "group-wide sustainability management system."(8)
Example 2: Initiative to Help Youth at Julius Baer
Julius Baer has a foundation that, among other activities, donates to projects that help disadvantaged young people. This might involve donating equipment or materials for particularly talented children from poor backgrounds or paying for rehabilitation programmes for those who have committed crimes. The people assigning the grants have nothing to do with marketing or branding, but they work within a framework established when the foundation was set up in 1965. Engagements are limited to Switzerland, and the foundation aims ultimately to encourage maturity and self-reliance among participants who receive the support.(9)

Sponsoring

Today sponsorship is a widely recognised element of brand management, used also in retail banking, and includes major events such as popular football (soccer) matches and tournaments. Sports lose none of their universal appeal as one's net worth increases. A private bank could easily cater to the elite tastes of their target group by providing VIP facilities and functions tied to major sporting events. But a private bank needs to look for a natural marriage with its brand's DNA. Is the sport associated with privilege, exclusiveness, confidence, trust, tradition, and discretion? The arts also offer an attractive opportunity for private banking sponsorship, as they represent the upper level of the Maslow pyramid (see Figure 7.4). However, a bank seeking to position itself by sponsoring the arts faces a number of dilemmas. There is significant competition from a great many sponsors. Tastes also vary more strongly in arts than in sports; one can attend a game and interact socially even if one is not passionate about the sport. But if you don't like the music, you cannot start a conversation during a concert. Television coverage of sports events provides more visibility for the logo to be seen than is possible in coverage of most art events. But while a sports stadium is a suitable venue for banners advertising sponsors' brands, such a display would be entirely out of place in an opera house.

POLO, AND "WHAT MONEY CANNOT BUY"
After an in-depth evaluation, Julius Baer chose to sponsor polo in 2007 and subsequent years. It meets all the criteria for a globally recognised exclusive activity with a long history and tradition. Playing polo involves a good deal of skill and coordination. "It is a dynamic game that requires teamwork and long-term commitment. And it is an ideal event for entertaining clients and their families," according to Julius Baer's former marketing head, Alain Zimmermann. When choosing a primary sponsorship, one needs to be an early mover. Polo's associations offer a platform to communicate with clients, for example in Dubai, where Julius Baer was one of the sponsors of the four-day Cartier International Dubai Polo Challenge held at the Desert Palm Polo Club in 2011. Thomas Meier, Julius Baer's CEO for Asia and the Middle East, said polo's popularity in the region was an important consideration: "We wanted to get exposure in this market, and of course this is one of the biggest sports here.'(10)
Julius Baer also offers a programme entitled "What Money Cannot Buy." In the context of long-term sponsorship of the Lucerne Festival, a series of piano concerts are held in the city's ultra-modern culture and convention centre. Against the stunning backdrop of surrounding Alps on the shores of Lake Lucerne, the bank organises exclusive dinners. Clients who are true fans of the genre or the performer are invited to dine with the artists after the event, establishing an exclusive experience for a select group of clients that cannot be acquired with money. Through the same programme, other exclusive meetings between high-net-worth clients and masters in specific areas can be offered. Recognising one client's passion for watchmaking, a relationship manager organised an afternoon for the client in the workshop of one of Switzerland's top watchmakers. The master of haute horlogerie gave this valued client a once-in-a-lifetime experience as he revealed the secrets of his award-winning grand complications. This also fit perfectly with the bank's "Unknown Masters" concept described previously in this chapter.

CONCLUSION

Brands can make difficult choices look easier when clients are confronted by oversupply or face heightened risk and when differences are not always obvious (when products are commodities), or are so complex that it is hard to decide which is the most suitable. Brands also can serve to distinguish between service providers, conferring prestige upon clientele who identify themselves with these brands. Premium brands allow their owners more freedom with regard to pricing, while limiting any radical attempts to change an image or service and product line overnight. Private banks are long-term entities, accustomed to thinking in terms of decades and generations rather than single-year product cycles. Despite these banks' traditional values of modesty and discretion, branding has emerged as a vital tool, allowing them to differentiate their offerings in an increasingly crowded marketplace.

Private banking can draw inspiration from classic premium brands. Building on heritage and proud of their origin, premium brands appeal to the privileged few by providing the ultimate in product quality and superior service. Premium brands' careful approach to any changes in terms of their positioning can be applied equally well to private banking. Radical surprises should be avoided. Trust is optimised when change occurs as a gradual evolution.

Building brand image is a long-term activity that requires more consistency than creativity. Creativity in brand management essentially means the ability to find fresh and striking variations on familiar themes to continually express the values traditionally associated with a particular brand. By doing so, expectations are generated among clients that must be reinforced by the brand experience, including how the employees conduct themselves along with all the other points of contact between the client and the company. As discussed in Chapter 8, "Client Experience," if the brand experience is positive and resonates with the expectations generated by the brand image, the brand will not fail to satisfy, and a loyal following will result.

NOTES

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*Bank Julius Baer introduced the "Unknown Masters" campaign in 2007 and continued it until 2011.

*Alain Zimmermann originally came from the luxury industry, where he was active in marketing for many years for watchmakers such as Cartier and IWC within the Richemont Group. He joined Julius Baer in 2006 and left in 2009 to become head of a well-known watchmaker in Switzerland.

Chapter 8

Delivering a Superior Client Experience

Of all the factors that influence client experience, human interaction plays the biggest role. This dimension, the interface with and between the people who represent the institution, is critical. This is also one of the most difficult parts to manage. It is nearly impossible to replicate certain experiences, time and time again, providing the same quality and consistency. In addition, each client is different, and so is each situation. It is imperative for a bank to adapt very quickly to changing situations. While this could seem to be quite difficult to manage, a structured approach and a toolbox to define, implement, measure, and eventually improve client experience is presented in this chapter.

THE EVOLUTION OF CLIENT EXPERIENCE

Client experience means delivering on the qualities promised by the brand. It has become a catchphrase common to nearly all industries. It embodies a number of intangibles, making it hard to define, let alone replicate. Given the nature of subjective expectations and perceived qualities associated with it, can client experience truly play a role in private banking? The fact is, clients today expect much more than just a reliable and trustworthy partner. A brand that is not only associated with good and dependable service, but that also appeals to the senses and emotions is more likely to succeed, no matter what the business. Private banking is no exception, and private banks can hence ill afford to ignore changes affecting how people have come to view companies and the services they provide.

Ask just about anyone how to define what client experience is, and you will likely get a fairly standard response, probably describing something about a particular company, the performance of its products, and the manner in which these are delivered. For a bank, the answer might encompass a range of various subjects and impressions—for example, how friendly a particular relationship manager (RM) is or the quality of the coffee served. Both tangible and intangible elements and comments about people, products, and processes are likely to be included.

The concept of "customer experience" was first widely introduced in an article in the Harvard Business Review. Published in 1998, "Welcome to the Experience Economy,"(1) by B. Joseph Pine II and James H. Gilmore describes the transformation that has taken place in the customer culture. No longer is it enough for an enterprise to simply excel at its core business. Companies also need to enhance the quality of interactions with existing and potential customers, engaging them on different levels through experiences providing a value as real as that of any service, good, or commodity. In 2007, Christopher Meyer and Andre Schwager went a step further, identifying client experience as “the internal and subjective response customers have to any direct or indirect contact with a company.”(2) They also reasoned that simply measuring customer satisfaction doesn’t say how to achieve it. Customer experience is based on personal and subjective impressions that may not even be directly associated with the company’s actual offerings, making it very hard to measure. This could be daunting to a person more comfortable with facts and figures. But as a great number of products and services increasingly appear interchangeable, we can no longer afford to neglect the reality of this realm.

Clients also are starting to demand more for less, as products become increasingly commoditised and the Internet gives everyone access to nearly limitless information and opinions, including those about businesses and services. Customer experience is one of the most important factors determining whether or not a company succeeds. This holds true for all industries. “When a customer has a good experience with a company, and decides on the basis of that experience to give more future business to it, the firm has gained value at that very instant, with the customer’s change of mind,” according to Don Peppers and Martha Rogers.(3) For them, client experience has become the key factor separating the winners from losers. But obtaining the elements necessary to obtain positive results is never going to be easy. “Building great consumer experiences is a complex enterprise, involving strategy, integration of technology, orchestrating business models, brand management and CEO commitment. It’s harder than you think,” stated US consultant and author Jeneanne Rae, who specialises in innovation and design strategy.(4)

The fundamental developments and trends remain the same whether we speak of products or services, customers or clients.* A company aiming to acquire market share and build brand loyalty must look beyond its customary products and services to manage the totality of encounters. For private banking, the question becomes how to achieve a high level of positive client experience in the area of managing clients’ wealth. How can a business focused on the individual make client experience scalable without losing sight of the fact that every client must be treated as unique?

INSPIRATION FROM THE LUXURY HOTEL INDUSTRY

Again, looking outside one’s own industry can reveal interesting insights. Anthony Lassman, founder and owner of Nota Bene, managers of bespoke travel and lifestyle for an affluent and highly discerning private membership, says upscale clients using these services can develop long-term brand fidelity: “High-net-worth individuals live in a different world. They can be very demanding and impatient, but if you deliver, they tend to be very loyal.”(5)

Many of the major trends affecting industries and businesses, including private banking, are forcing companies to focus on client experience to differentiate themselves from competitors. However, as Lassman puts it, “when we look at the trend towards customised products, we need to remember that high-net-worth individuals always have been able to buy customisation in the form of private tailors, personal fashion designers, specially commissioned works or special editions.” At private banks, relationship managers also try to go the extra mile and organise various bespoke solutions for their clients. The difference now is that clients have come to expect personal and superior treatment not just from the individuals that they personally hire but increasingly from employees of corporations.

These trends are occurring at the same time that global standardisation is becoming the norm, a development that has deprived globetrotting of much of its former magic, says Lassman. “In the past, flying to Asia took me to a different world. Now I am surrounded by familiar brands, especially in the luxury hotel sector. Once, every hotel had a unique flavour. Now that is very hard to come by. The industry today is dominated by huge chains focused on guaranteeing that the business traveller is offered a consistently high standard of service, providing a predictable environment for work and play.”

He adds that the system succeeds due to strictly enforced standardisation. This poses a problem for corporations—namely, how to achieve standardisation while empowering individual employees to provide truly personalised service. “Everything from design and décor to vendor service level contracts are defined and regulated down to the last detail. But all this will be meaningless if the staff don’t get it right,” says Lassman. For example, when arriving at a hotel, it makes a difference whether guests are offered a beverage and a comfortable seat immediately upon arrival or only after they’ve presented their credit card and passport. Or, if a guest needs directions, does the concierge take the initiative and perhaps organise a courtesy car? “A hotel needs regularly to go the extra mile in order to delight the guest,” says Lassman.

The existence of luxury hotel chains proves that it is possible for global companies to organise a workforce that is capable of consistently delivering superior experience on an individual, personal level. And yet we’ve arrived at another dilemma: achieving what is possible soon becomes merely the client's "expected standard."

In the following pages, we shall look at how client experience originated; the technological, social, and political trends behind its evolution; and its growing importance in nearly all industries. In private banking, it has created a new context in which wealth managers compete; for those who understand it, it can offer a number of opportunities.

THE MEGA-TRENDS DRIVING CLIENT EXPERIENCE

Organisations don't change without pressure. This often comes from external factors, including global competition, commoditisation of services, the need to reduce costs, compliance and regulations, and new technology. It is not just about achieving growth. It is in many respects a battle being waged to retain margin and market share. Facing these imperatives, every company needs to formulate an objective client experience strategy.

Powerful external factors are forcing companies to increasingly value the importance of initiatives designed to enhance client experience. That was one conclusion of the IBM Customer Experience Study 2005, conducted worldwide by IBM with OgilvyOne.(6) Based on interviews with consumers, companies, and experts, one key finding was that there is an oversupply of most products and services. People can choose amongst multiple offerings from scores of rival providers. Just getting attention in such an environment has become a challenge. Competition now takes place on a global scale. Organisations face more rivals than ever, some operating with lower costs. Increased travel, international media coverage, customer confidence, and the ability to purchase goods and services online mean consumers no longer need to stick to familiar brands. Nontraditional rivals also are new on the scene. Companies can be challenged by mega-brands spanning many industries. For example, today travel agents and tour operators no longer compete just with each other but with a whole range of other booking services offered by nontraditional providers, even supermarkets—not to mention a range of services that has sprung up via the Internet, which allows simple price comparisons and bookings. Online services have radically changed many industries. Even in wealth management, there is a similar move afoot among some providers to use the Internet in a more targeted way. In one instance, a well-known Swiss private bank, through a fully owned subsidiary, allows clients to manage their assets online, offering standardised investment solutions catering to those with smaller amounts to invest. The new bank started in 2010 and aims to have as many as 5,000 customers with total assets of 750 million francs within three or four years after launch.(7)

Products also are subject to increasing commoditisation and cost pressures; the gaps between different products are closing faster than ever, and a continuous drive to reduce prices and costs makes it increasingly difficult to stand out from the crowd. Consumer sentiment may be less easily swayed by new features. Customers may also perceive little difference (other than price) between competing products or services. In financial services, it may happen that some products and services appear almost identical. If clients start to feel that the performance of more innovative offerings is mainly a function of the market as opposed to a single institution's efforts to enhance its services, the competitive advantage is lost. Compliance also raises many issues: the more demanding the regulatory environment, the narrower the range of business and product models permitted.

Meanwhile, new distribution channels and technology throughout all industries offer clients a range of conflicting choices, together with a confusing array of alternatives. Even when the underlying products are identical, technology allows marketing executives to discover new ways to bundle pricing and products, making it harder to measure like against like. Try comparing two competing mobile phone operators' pricing schemes, for example. Or, for that matter, try to compare the latest structured financial products offered by two different banks.

Finally, relentless cost pressures are forcing companies in nearly all sectors to lower the prices of their services. This is often achieved by increased use of automation or by outsourcing some services. If the benefit far outweighs what might be lost through immediacy and the personalised human touch, then such innovations will be welcomed. For example, people would never give up 24-hour access to cash provided by automated teller machines (ATMs). But reaching a voicemail or recorded message is almost universally perceived as annoying. No one expects a bank to be open around the clock, so the ATM constitutes a delightful advance. But delight in progress and technical innovation turns to dismay at the sound of a recorded message; most people prefer to reach a human being on the telephone, not an automated recording.

The upshot is that companies are being forced to rely more on client experience to differentiate their offerings and to attract and retain customers. In fact, companies rank client experience high among factors crucial to revenue growth, placing it ahead of controlling costs through operational efficiency, based on the IBM/Ogilvy study on customer experience.

But how did the idea of client experience originate? How does it work? What social, political, and technological developments paved the way for its introduction?

UNDERSTANDING CLIENT EXPERIENCE

The evolution of client experience might seem an intuitive process. After all, everyone buys things and most people have an impression of the provider. But for a long period, there was no standard way of evaluating what made the experience positive, nor any systematic way to keep track of what worked. As modern technology provides consumers with an ever-increasing array of choices and new markets open up to global brands, it is imperative to understand how expectations and perceptions change.

The Impact of Technology

The concept of client experience within corporations developed through a series of technological advances that allowed companies to better understand clients, communicate more personally, and ultimately offer customised products to the masses.

Customer relationship management (CRM) is considered to be the forerunner of client experience. In the 1980s, thanks to advances in computer processing power, an increasing number of businesses were able to gather and use information about customers and their spending habits. Companies tried to harness the data to take advantage of cross-selling opportunities. Customers were segmented and then received targeted offers through advertising campaigns relying on direct mailing. Over time, complex loyalty programmes arose. These typical marketing activities are still widely practiced today. Frequent flyer clubs are one of the earliest attempts to combine insight about a client's spending patterns with financial incentives and an experience component, which was represented by the frequent flyer lounge, seat upgrades, and other mileage rewards.

The arrival of the Internet provided a major boost to this approach. Companies were suddenly in position to track not just a client's spending habits but his or her personal interests. This growing market, supported by more powerful computers and new integration techniques, allowed software designers to dig deep into the data to study patterns and preferences in real time and come up with some astonishingly powerful and personal marketing tools. Google AdWords and Amazon's book suggestions are two common examples of how CRM has come of age and is setting new standards. Clients now expect companies to be able to respond very specifically to their current needs and interests rather than simply providing a modest incentive based on what they bought in the past. At the same time, the ease of storing and using information has raised worries about the intrusiveness of data mining. Clients have grown fearful that their privacy is being invaded, and the threat of data security being compromised is common in both public and private life. Businesses therefore have the duty to balance knowledge about clients with the imperative of safeguarding their information.

Powerful production management and logistics software also paves the way for companies to begin offering so-called build-to-order (BTO) products. In 1976, when buying a new car, it was necessary to go to the local dealer and choose from among what might have been five models on offer, in perhaps three colours and with two options. Today, it is possible to go online and research 20 brands. Once a buyer decides on a particular model, he or she can configure it to exact specifications. The car manufacturer will not begin to build the car until receiving the order. This is possible only because of technology that enables advanced supply chain management and just-in-time logistics. These techniques have developed under relentless cost pressure and the need to minimise risks and capital tied up in inventory. Aiming for more customisation also is a trend in banking, where it is now possible to offer highly personalised services, such as individually tailored structured products, to investors.

To summarise, processing power allowed the evolution of CRM. The Internet has put power in the hands of individuals, flattening the market by offering increased access to information and, in the end, accelerating the pace in nearly all aspects of business.

The Impact of Social and Political Changes

Economic developments in recent years, especially in countries such as China and India, have helped to unlock enormous potential in many areas. Luxury brands and services targeting the masses proclaim what seems almost to be a new basic human right—to be a pampered and highly fashionable client. Economies hardly thought of as dynamic only a couple of decades ago today are leaders in economic growth. Globalisation has contributed to the rise of a new affluent class. For people in many countries, the standard of living continues to improve. With the growth in wealth in what today are still termed “emerging” economies has come the need for universally recognised symbols of success.

The changes resulting from globalisation also have affected Switzerland. Twenty years ago, the majority of the shops on Zurich’s prestigious Bahnhofstrasse were uniquely local businesses. Only a few stores offered a single global brand. Today, the situation is the opposite. The majority of the shops and boutiques are purveyors of global brands, while local businesses constitute the minority. A stroll through Zurich takes you past exclusive hotels, restaurants, cafes, and shops, all featuring stylish interiors, staffed by polite employees speaking several languages. To survive in such a cosmopolitan centre, businesses have been forced to focus on delivering a superior client experience. Clients’ mentalities are also changing. There was a time when luxurious goods and services were available only to a privileged minority of wealthy individuals. Shops or service providers tended to dictate the terms. The vast majority of consumers had relatively little choice. The old adage “the customer is always right” or some variation thereof (e.g., der Kunde ist König) had yet to be accepted as a universal business philosophy. Whether or not customers were satisfied, as long as they had no alternatives and mobility was limited, they remained customers. Where else could they go?

That, of course, has changed. Globalisation and the advent of a customer service culture have affected private banking and are continuing to have an impact in terms of competition and service. In the past, political instability in many countries made them unattractive places to deposit wealth. Life back then was easier for Swiss private bankers. Clients seeking traditional values associated with a Swiss account, including safety and privacy, were not much concerned by what today would be considered the client experience factor. No one expected banks to offer clients a luxurious welcoming lobby. In fact, Swiss banks even today avoid expenditures that would be considered extravagant, indiscreet, immodest, or wasteful.

Yet things have changed, and banks have made concessions to client comfort. One reason is the growing competition, including the number of centres springing up around the world where clients can go for wealth management services. Clients are much freer to choose where and with whom they bank. The greater choice increases competition, as clients can just as easily bank in Singapore as in Zurich. The range of services required today is in many ways much different from in the past, often taking place in real time while maintaining standards common to the luxury industries.

HOW A BRAND BUILDS ON CUSTOMER EXPERIENCE

Zurich’s old stock exchange now houses a Nespresso® boutique—a fine example of the way that global brands have spread and how products and lifestyle have converged. The Nestlé-owned coffee brand promoted by actor George Clooney takes Starbucks’s “luxury for the masses” concept upmarket; besides boutiques and coffee machines, the coffee capsule system allows coffee to be purchased in elegantly sealed single portions, which can be offered to guests in what looks like a chocolate box. Every aspect of the brand is designed to create a superior client experience, from the design of the machines to capsule recycling, elevating the once humble cup of coffee to a veritable art form and conferring upon consumers the experience of being not just a coffee drinker but a true coffee connoisseur.

In summary, we now live in a world with luxury brands for the masses. People from all walks of life can afford access to services that treat them royally, even if only for an occasional weekend at a spa. Within this context, the manner in which private banks aim to serve their clients also has changed. A particular class always inhabited a world of luxury where excellent service is a standard feature. But now, these privileged clients are joined by another group whose expectations regarding the minimum quality and standard of services deemed acceptable has changed considerably.

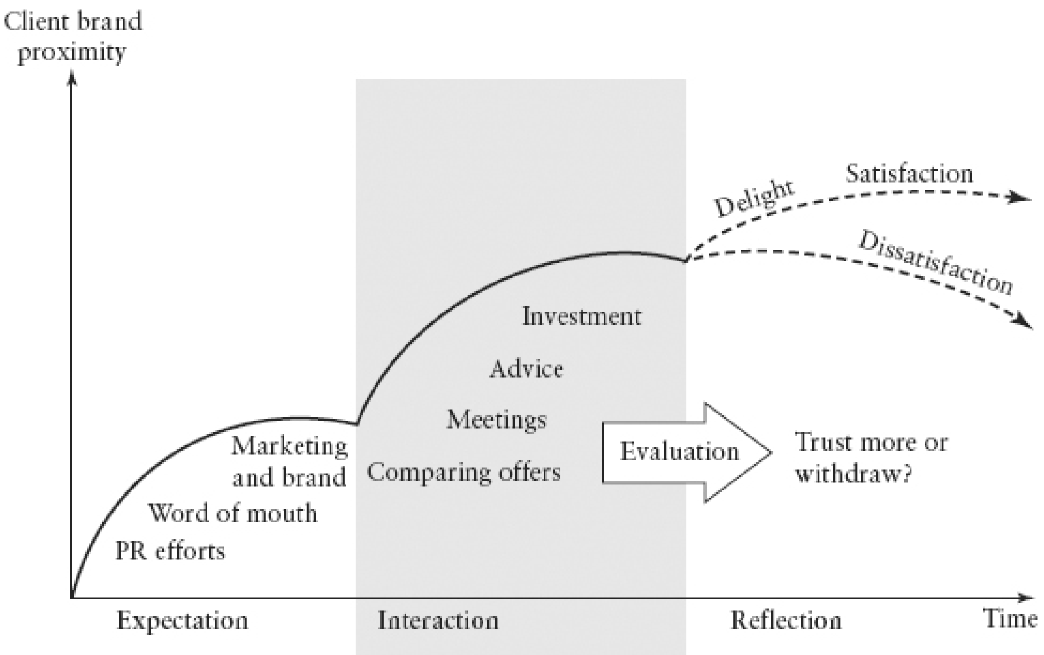
PHASES OF CLIENT EXPERIENCE

Client experience can be analysed in three phases; one needs to understand each of these separately, while recalling that in the client’s mind, these individual processes may actually overlap.

Expectation, interaction, and reflection make up the three distinct stages of client experience, as shown in Figure 8.1. During the first phase, expectation is created, as detailed in Chapter 7, “Why Brand Matters.” This is done through marketing and public relations. Initially, a great deal of information will get lost as general noise, but repeating the message and providing information from sources considered authoritative will eventually register to form impressions. That is why word-of-mouth marketing also is such a powerful medium and is included in the expectations phase. The recommendation of a trusted friend or advisor is many times more effective than a media campaign.

FIGURE 8.1 The Phases of Client Experience

Source: Author



The prospect may decide to respond to try the brand offering and become a client of a bank, entering the interaction phase. As the client subconsciously compares his or her own expectations with the bank's actual delivery of products or services, emotions of delight, satisfaction, or perhaps even dissatisfaction may arise. With time, as expectations are heightened, delight might subside and there is a risk that the client, whose expectations continue to grow, will no longer be satisfied. The client's response can occur on two levels: functional or emotional. Did the product work as expected? Did the investment yield the promised return? Was the account statement correct? On the emotional level, the client assesses all the intangible elements of the interaction with the bank, from the impression of the reception in the foyer to meeting the relationship manager. How genuine were the smiles? Did the relationship manager find the right tone when posing questions regarding due diligence or investment needs?

After the interaction phase, the client taps into perceptions and memory and reflects on the experience. This reflection phase brings the subconscious evaluations to the fore, and the results of the interactions then form a basis for whatever future actions and encounters will take place.

CREATING "DELIGHTFUL" EXPERIENCES

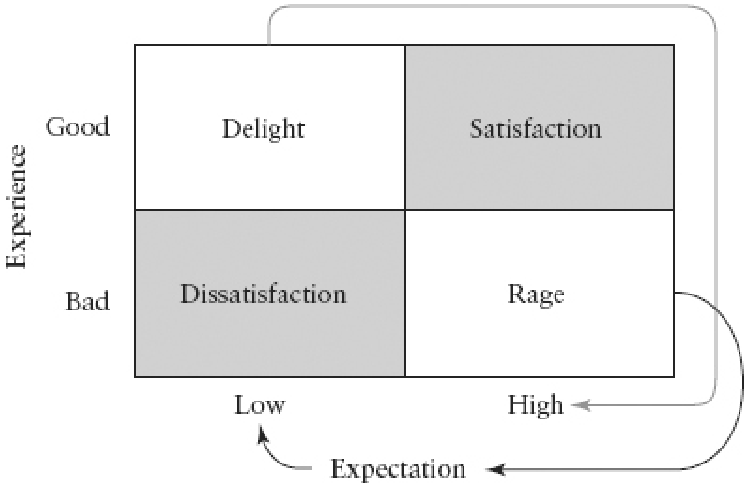
A delightful experience is more than just a heightened version of a satisfactory one. Satisfying clients is the very least a business can aim to achieve. Without it, you don't have a business. But without going a step further to delight clients, you don't have a brand!

We all go through life with a set of expectations, which may be fulfilled, leading to satisfaction. If they are denied, they cause disappointment. Happy people are good at formulating realistic expectations and responding proactively to disappointments. Those who are frustrated tend to have difficulty in setting realistic expectations and are not proactive or solution focused in dealing with setbacks or upsets. But both satisfied and irritated customers have one thing in common: they talk about their experiences. Delighted customers are far more likely to talk about their experiences, more likely to come back with further business, and are less price sensitive.(8)

In recent years, experts have highlighted what commonly are referred to as the concepts of customer "delight" and "outrage."(9) Consider Figure 8.2. It illustrates the relationship between expectations prior to an experience, the experience itself, and the resulting emotional outcomes: delight or satisfaction, rage or dissatisfaction. A low expectation followed by a good experience is considered delightful, whereas having high expectations that meet with a bad experience is enraging. The key to delight is having few expectations. Herein lies the problem for management: you can delight or surprise a client with a gesture only once. As soon as a client or customer experiences delight from the proffered airline upgrade or a free product offered in retailing, he or she will become accustomed to it and have heightened expectations for the next encounter. This time around the stakes will be higher, too. If done properly, one can achieve only satisfaction at best. But get it wrong, and there's a risk of enraging the client. The challenge for every brand manager is thus to discover ways to deliver incremental improvements in order to continuously delight clients.

FIGURE 8.2 How Past Experience Affects Client Expectations

Source: “A Model of Dissatisfaction, Outrage, Satisfaction, and Delight,” in Barry Berman. “How to Delight Your Customers,” in California Management Review vol. 48, no. 1 (Fall 2005), pp. 129–151. ©2005 by the Regents of the University of California. Reprinted by permission of the University of California Press



CREATING A CLIENT EXPERIENCE STRATEGY

While much of the information discussed so far has been general in nature, the focus in this section is mainly on private banking. It is clear that companies must deliver a superior client experience to set themselves apart from the competition. The approach outlined here offers tools and strategies that can be used with the aim of delivering a superior client experience.

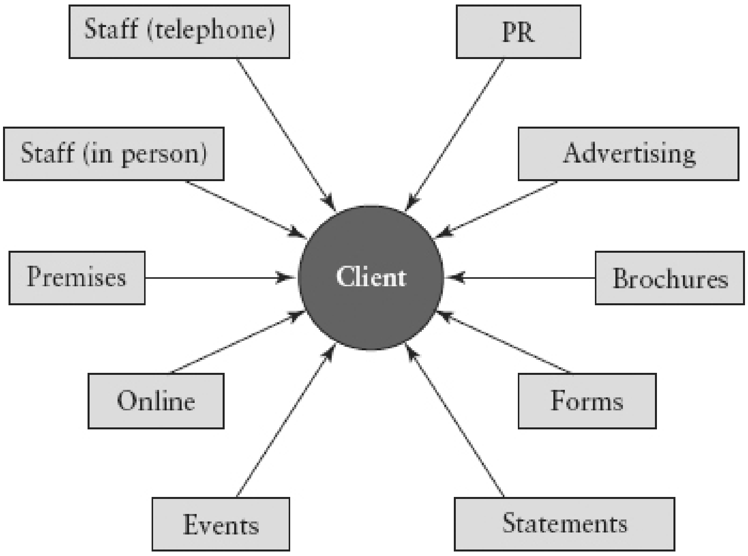
Touchpoints

A systematic overview of all client touchpoints is the simplest way for a bank to identify discrepancies between expectations and experience and to enable it to close the gap.

A touchpoint refers to every single encounter that a client has with the bank, whether through interactions with staff; through products, services, or personal communications; or through information and impressions gained from advertising, mass media, and so on. It also includes the client’s experiences with the bank, starting with first impressions upon seeing the building from the street, down to details such as the colour of the carpeting; the manner in which coffee, tea, and other beverages are served; the lighting and condition of the furniture; the artworks displayed; whether meeting rooms are soundproof; and so on. Each of these touchpoints contributes to the overall perception of the brand, which we refer to here as the client experience (see Figure 8.3).

FIGURE 8.3 Main Client Touchpoints

Source: Author



In the following paragraphs, we examine each of these touchpoints and offer a few examples of how they might be improved.

Public Relations

Public relations, meaning interacting with the media and the general public, includes supporting the brand. It explains what the company does and its mission, and showcases key employees, including experts and authorities. Opportunities include speaking publicly at conferences and universities. Select media coverage offers a way to explain the company's values and philosophy. Publishing opinion leader pieces and insight on expert topics underscores the knowledge available within the company. All these channels may help to highlight the bank's awareness of key industry themes and its position on various topics and help to raise its profile overall, among clients, industry professionals, and staff.

Advertising

Professional, modern advertising gives rise to expectations that reflect brand values, image, and value proposition. It is all about positioning and finding the right balance between promises, claims, and delivery. This is the tightrope that companies must walk—raising hopes and generating positive expectations to draw clients to the brand but never promising what cannot be delivered. It is better to "over-perform" and "out-deliver," exceeding expectations to generate positive or "delightful" experiences.

Brochures, Forms, and Statements

All printed materials need to conform to the corporate design (CD) guidelines governing visual and typographical design standards. Corporate wording (CW) is a relatively new addition to this field. It includes a glossary and writing style to ensure consistency in written communications.

To create a superior client experience, it is important to look beyond the basics defined in a typical CD manual. Every single form or printout must be reviewed to ensure clarity and added value—for example, how user friendly is the bank statement? Is the design dictated by the bank's internal operations, or is it designed to support clients' need for clarity, convenience, and added-value information?

Events

Sponsoring engagements serve the broader purpose of brand building and informational gatherings directly linked to the bank's communications objective. Sponsoring engagements is discussed in detail in Chapter 7, "Why Brand Matters." With regard to informational programmes, these can be press conferences or educational gatherings targeting future recruits, prospects, or clients. Events are significant because they allow an element of surprise, which is essential to achieving a truly satisfying client experience. The nature of sporting events or arts-sponsoring opportunities provides ample elements of surprise. Programmes designed to educate and raise clients' awareness of key topics and themes can be held in unconventional locations. Lights, sound, and staging all may be employed to reinforce brand values, create the desired delightful effect, and communicate information.

Julius Baer hosts investment conferences in Zurich, where by-invitation-only attendees including clients can spend a day with world leaders in a relevant field. One such conference held in January 2011 included top experts in the field of sustainability. Apart from live panels and top speakers, the event was held in one of Zurich's most prestigious hotels, where those invited could mingle during breaks with the "A-list" panellists, who included professionals known worldwide for their leading opinions and direct involvement in topics such as investing in sustainable energy and eco-efficient vehicles.

Online: Website and e-Banking

The same principles applied to other touchpoints also can be used for the Internet and e-banking, albeit with a separate set of recommendations for online communications. In general, the Internet demands a more concise approach. It requires fewer words to express information than printed texts and is slightly less formal. You don't need to add "please" and "thank you" with every invitation to "click here."

An online presence needs to be personalised to create a superior client experience. The website should adapt to regular users' preferences while respecting the needs of clients from different generations. Although the Internet may be infrequently used by the majority of current wealth management clients, mobile communication is making major inroads into many areas of banking. Such technology is becoming highly important for some client groups, especially younger ones.

Premises

The physical presence of a private bank is a vital touchpoint. To deliver a superior client experience, traditional standards must be improved and should try to exceed the existing standards set by banks. Inspiration can be drawn from cutting-edge architects and designers. Examples include Bruno Moinard, a Frenchman known for his unpretentious yet elegant style, whose clients range from museums to upscale retailers such as Cartier. Even in the details, private banks can offer touches that enhance client experience, an example being fresh flowers, even covering a whole wall, that engage the senses. Not just the sight but the aroma of flowers tells clients that they have entered a very special world.

Staff: Direct Contacts

Employees are one of the most important client touchpoints. From the receptionist to the RM, the driver to the cashier, they all represent the brand and contribute to the client experience. To ensure that employees' behaviour provides the right client experience and that they represent the brand values, training should be mandatory and ongoing. Training should address the "extra mile" approach that makes a brand more than just a logo. For example, Singapore International Airlines, consistently ranked as the industry's most admired airline,(10) puts its cabin crew through rigorous training that goes well beyond what is needed to accomplish the job. The airline educates its staff not only in practical matters, such as learning to conquer fear in water landings. It also includes training in wine and gourmet food, as well as in the art of conversation. Employees are given the authority to make any decision up to the competence level of their immediate superior without consultation to allow them to react to unforeseen situations where consultation might result in unnecessary delays.

Banks may recruit graduates from hotel management schools where the focus is on offering a high level of service aimed at putting clients at ease. Some banks may even go so far as to engage colour and style consultants to coach employees on harmonising their style of dress with their physical persona and offer training in social etiquette. The German "bible" for social etiquette, Knigge, even offers a special edition for the banking industry,* and a large Swiss bank made headlines after reports it was testing a 43-page dress code for its staff, a story picked up by international media.**

Staff: Telephone

Apart from direct contact with staff, the telephone probably serves as the most important touchpoint for clients. In fact, clients and prospects have very high expectations regarding telephone service, availability, and responsiveness. What does a superior client experience on the telephone entail? Obviously, it is important for the client to reach the right person. Are calls taken within three rings? What is the policy regarding voicemail or messaging? Once management has established its vision of a superior client experience on the telephone, client-facing staff must be coached to adopt and support the system.

What IT systems are needed to put necessary information at your employees' fingertips when they are speaking on the telephone? What about the use of speakerphones and earpieces? Is the sound quality of telephone calls suffering because employees need to have both hands free to type during calls?

The Client Corridor

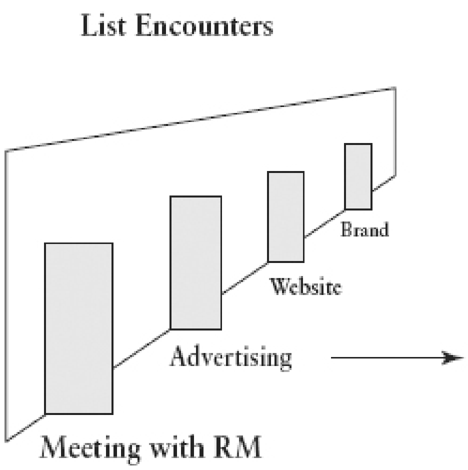
Once we have identified all the touchpoints and considered the gap between expectations and experience, how do we decide where best to invest energy and resources? The client corridor is an advanced model that allows client experience to be visualised and quantified.

The client corridor allows touchpoint interactions to be ordered and examined chronologically. The most frequent and more recent interactions are assigned a higher weighting, reflecting their predominant position within the client's range of perceptions. This allows for a very effective assignment of priorities when considering gaps between expectations and experience, because it offers insight into the interactions between the various touchpoints. Positive experiences make clients more tolerant of later negative experiences, but only for a limited period of time. The power of the client corridor approach lies in its weighting of every touchpoint interaction. As a result, it is possible to determine which of the 20 percent of these touchpoints drive 80 percent of the experience.

Because the client corridor might not be familiar to all readers, the steps illustrated in the initial stages of the process depicted in Figure 8.4 are described as follows:

FIGURE 8.4 The Client Corridor Analysis

Source: Author



Evaluate the Gaps

Weight*	Encounter	Expectation	Experience	Gap	Weighted gap
25%	Brand	3	4	1	0.3
10%	Website	3	1	−2	−0.2
10%	Advertising	2	2	0	0.0
20%	Meeting with RM	3	3	0	0.0
10%	Lunch with RM	4	5	1	0.1
5%	Foyer	2	5	3	0.2
5%	Facilities	2	5	3	0.2
3%	Brochure	2	4	2	0.1
...	...	...	...	...	...
...	...	...	...	...	...
			Overall experience		0.5

* Assigned weights are only for illustration purpose and should be defined according to specific context

- List every interaction between a client and the bank.
- Assign a weighting to each interaction.
- Don't forget indirect interactions, such as seeing an advertisement or speaking on the telephone:
- Rate the bank's delivery at each interaction.
- Calculate the gap between expectation and delivery.

Further steps include:

- Multiply the gap by the weighting to identify the touchpoints that most urgently need to be addressed.
- Assign a higher weighting for more recent events. But note that the very first impression should be more heavily weighted than subsequent impressions.

This type of simple exercise can reveal a wealth of detail that a large-scale survey might miss. Private banking is a personal business. It is an art rather than a science. Quite often, observations at the individual level are wasted not because of their seeming insignificance but because we fail to integrate them into the bigger picture. The client corridor is a tool that can be used to gain a better overview of all encounters that might occur between clients and the bank. The client corridor also can be used as the basis for creating internal or external SERVQUAL surveys (see Chapter 9, "Understanding Service Excellence").

Client Experience Is a Board Commitment

The touchpoints analysis and the client corridor should help to identify areas that require small improvements or even radical changes. The individual priorities in terms of relative importance to client experience should now be clear. Once these have been established, it is possible to create a strategic action plan.

The bank's board as a whole needs to understand the urgency of client experience and to offer its support. Therefore, a member of the board needs to take ownership in terms of being responsible for the client experience mandate. The client experience team or task force also must develop the strategic action plan to define the practical, organisational, and communications changes required to improve client experience. Budgets should be laid out and approved for each element of the client experience strategy, including everything from rebranding to remodelling interiors to addressing employees' dress and telephone etiquette.

CONCLUSION

Client experience is a priority for any organisation that wants to hold its own in the increasingly competitive global environment. Technological, social, and market trends have led to rising expectations with regard to quality and personalisation of products and quality. To succeed in this tough market, organisations have to deliver a superior experience that provides clients not just with satisfaction but with true delight. To manage client experience, a touchpoint analysis and a client corridor model can be used to determine the areas where interventions are apt to generate the most value. As client experience consistently must be applied across all touchpoints, there will inevitably be areas where significant investment is necessary. This requires a board member to take the role of "client experience champion."

NOTES

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2. Meyer, C. and Schwager, A. 2007. "Understanding Customer Experience." Harvard Business Review (Feb).

3. Peppers, D. and Rogers, M. 2005. "Return on Customer Creating Maximum Value From your Scarcest Resource", Kindle Edition. Crown Business.

4. Rae, J. 2006 Businessweek, "The Importance of Great Customer Experiences" (Nov 27).

5. Discussion with Anthony Lassman: September 5, 2008.

6. 2005. IBM Business Consulting Services and OgilvyOne Worldwide. 20:20 Customer Experience. Forget CRM—Long Live the Customer!

7. Gysi von Wartburg, R. 2010. Finanz und Wirtschaft, Private Banking Wird Virtuell. 5. May. Page 21.

8. Reichheld, F.F. and Sasser, Jr., W.E. 1990., "Zero Defections: Quality Comes to Services." Harvard Business Review 68(5).

9. Berman, B. 2005 "How to Delight Your Customer." California Management Review, 48(1), Fall 2005.

10. Fortune rankings 2010. CNNMoney.com, Fortune.

*The term "customer experience" is a general one used in academic literature to refer to anyone who might use a particular service or product, regardless of the industry involved. In this chapter, "client experience" is the term used to refer to the people who seek the services of professionals at a private bank.

*Beetz, M. 2009. Der Knigge für das Bankgeschäft.

**Jacobs, E. 2010. The Financial Times, "Dress Codes that Suit the Office."

Chapter 10

Winning the War for Talent

The "people dimension" is the most difficult element to achieve in any service organisation, and private banking is no exception. People in this business require both hard competencies and soft skills. While financial expertise can be learned, soft skills are hard to teach; qualities such as being a good listener as well as being creative and innovative can be developed over time, but they require effort and a high level of curiosity, patience, and human insight. A good balance of hard and soft skills is required in private banking. Beyond finding the right individuals, it is management's responsibility to leverage on this by assigning the people to the right function. The key question addressed in this chapter is how to attract, develop, and retain talent. While compensation plays an important role in a people business, there are several other factors that contribute to job satisfaction.

WHY THE WAR RAGES ON

Private banking is a people business. People create and deliver the investment opportunities and the client experience it offers. Given the premium positioning of private banking, it is absolutely essential to recruit the best employees and create an environment in which they can excel. This chapter discusses how to attract, develop, and retain the brightest, most talented, and most capable individuals in an industry where dedication and discretion count more than "star" qualities.

Wealth management is a great business. In an unpredictable world where activity is often frenetic and people's focus tends to be on the here and now, wealth management traditionally has been focused on the long term, projecting values such as stability and calm. Its clients, thanks to having substantial means, enjoy the luxury of thinking more than just a few quarters ahead. They very often think in terms of generations. It is also a highly profitable business when managed properly. Therefore, it attracts a great many competitors vying not only for clients but for the best staff.

In most service industries, employees make all the difference. The expression "war for talent" has been around for several years, gaining traction when in the late 1990s the dotcom boom exploded across Silicon Valley. Established consulting firms suddenly noticed that they were losing some of their brightest young minds to Internet start-ups. The realisation that talent was mobile has in the meantime become entrenched, along with the notion that it is no longer solely the job of human resources to keep valuable employees from leaving. Today, it is the responsibility of the group's most senior executives to see that retention is implemented systematically and managed effectively to avoid losing top people.

This is true in nearly all industries. With regard to private banking, a rapid expansion in this industry at the start of the new millennium played a major role in bringing the war for talent to private banking business. The growth ambitions of many private banks have led to a need for experienced relationship managers (RMs) beyond what could be supplied quickly from within their own ranks. Thus, the tendency in recent years has been to poach individuals and whole teams from competitors. As might be expected, this practice has led personnel costs to spiral upwards. The war for talent has become a competition for market share and growth and has created a major part of the industry's cost base.

But even if banks were willing to pay ever-increasing salaries, there is a limit to how often a relationship manager can change employers. Clients want continuity. Furthermore, while the recent boom in the wealth management industry helped to compensate for significant costs associated with hiring, the financial crisis of 2008 and the slowdown in economic growth in most countries has forced private banks to retrench and return to one of the industry's fundamental strengths: a focus on the long term. Instead of searching for quick solutions to attract talent, the industry must now place even more emphasis on developing and retaining top-notch employees, avoiding a trend that would lead only to higher personnel costs while offering no added value. This chapter looks at the reasons behind the war for talent and how a private bank can prepare for it—in other words, how private banks can attract, develop, and retain the best employees.

In private banking, all business area functions are influenced by an aggressive competition for talent. This is especially the case for highly specialised functions such as product specialists and people filling senior managerial functions. Where the competition is most pronounced, however, is in the hunt for relationship managers. In every growth strategy, the relationship manager is the non-scalable, limiting factor. Therefore, much of this chapter focuses on acquiring and retaining relationship managers.

WHY TALENT IS IN DEMAND

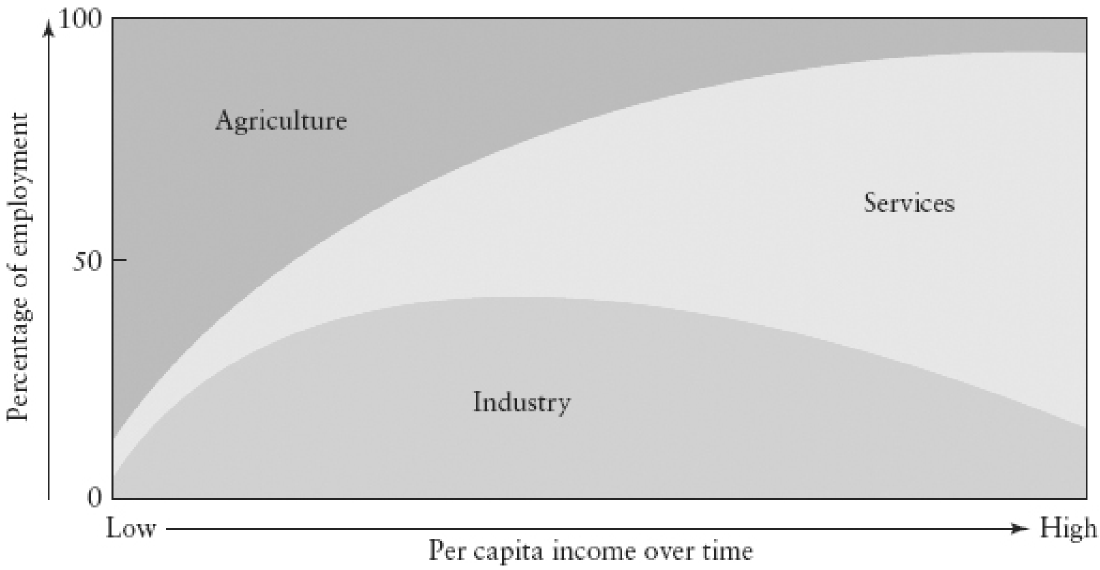
The war for talent rages on in view of numerous factors that are driving the need for relationship managers. Demand for competent and skilled individuals is on the rise in all industries. Demographic factors are shrinking the pool of available managers in established markets as an older generation of relationship managers starts to reach retirement age. Not only is the number of wealthy and affluent clients on the rise; growth in the financial services industry in many cases is outpacing the rate of economic growth, putting private banks into direct competition with each other for candidates to fill new positions. To be effective, meanwhile, a relationship manager can serve only a limited number of clients, given that these clients demand exclusivity and superior service.

Macro-Factors Include Demographics and Trends in Services

There are various trends putting pressure on the private banking industry in terms of hiring and retention. One is demographics, due to an aging population, and the other is the rapidly expanding demand in many countries for educated staff to fill jobs in the service sector. This latter situation is very much the case in developing countries that are transitioning from industrial to more service-related economies, as Figure 10.1 illustrates. As this occurs, the general level of education in a county rises, expanding the pool of potential recruits for these jobs. But at the same time, as a country's wealth increases, there also are a greater number of attractive jobs being created in all service-related areas, increasing competition for people to fill these positions. As countries continue to make the shift toward predominantly service economies, the competition across all sectors for the most talented workers will grow. This trend affects all employers, including private banks.

FIGURE 10.1 Changing Structure of Employment during Economic Development

Source: Soubbotina T. P., Sheram K.A. 2000. Beyond Economic Growth: Meeting the Challenges of Global Development. Chapter 9IX, Growth of the Service Sector. © World Bank. http://www.worldbank.org/depweb/beyond/beyondco/beg_00.pdf License: Creative Commons Attribution CC BY 3.0 Unported license



Fewer RMs to Meet a Rising Demand for Wealth Managers

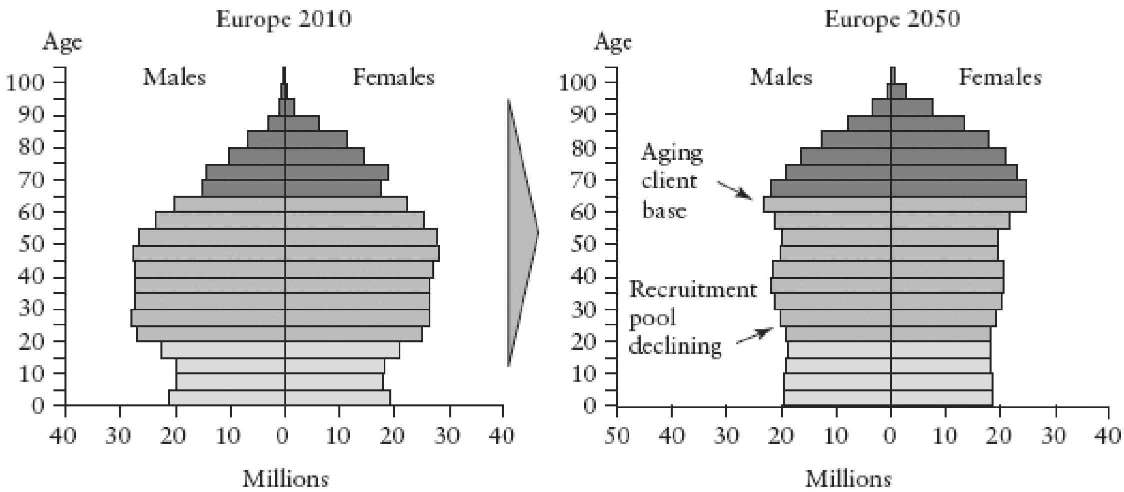
As a function of wealth being created, the need for private money managers has grown at a faster rate than that of many underlying economies. In addition, more people are needed in the financial services sector as wealth levels in many countries rise. This puts employers into direct competition not only with firms in other industries, but increasingly with each other as they seek to hire people with the right skills to be relationship managers.

At the same time, the pool of available relationship managers is actually shrinking due to the fact that the entire workforce is aging. The baby boomers born between 1945 and 1965 created a bulge in the 44- to 64-year age bracket. One study in the United States estimated in 2010 that the average age of a financial advisor was just under 49, while less than 25 percent of all financial advisors are under 40.(1) Who will fill their shoes when they retire, something that already is starting to happen?

Not only are relationship managers as a group growing older. Consider Figure 10.2; the number of those in the next working generation is also expected to decline over the coming decades. This age group will form the prime recruitment pool for new managerial talent and RMs in the coming years. Added to this is the fact that the number of potential wealth management clients is rising as the population in the age group over 60 begins to expand over the next decades. Many of the wealthy people in this age group are entrepreneurs who have spent much of their lives building a business. The number of people who have experienced this type of "slow wealth creation"* is growing faster than those who have inherited wealth or acquired their wealth very suddenly. Simply put, the industry faces a situation where the supply of relationship managers is expected to decline just as demand for their services increases.

FIGURE 10.2 Demographic Development of the Population in Europe

Source: United Nations, Department of Economic and Social Affairs, Population Division. World Population Prospects: The 2010 Revision. Available at: http://esa.un.org/wpp/population-pyramids/population-pyramids_absolute.htm Accessed 2012 April 26



The fast pace of growth in the private banking industry, especially in newer markets outside of developed countries, is further increasing the demand for talent. The number of millionaires (calculated in US dollars) in all countries rose by 8.3 percent to 10.9 million individuals in 2010 from 2009, according to the CapGemini Merrill Lynch World Wealth Report. Assets of wealthy individuals grew even faster than the population, increasing by 9.7 percent to $42.7 trillion.(2) The increase in the number of high-net-worth individuals (HNWIs), meaning people with at least US$1 million in investable assets, has been strongest in Asia, including China. But economic expansion in many developing nations, including the other so-called BRIC Countries—Brazil, Russia, India, China—is expected to create new wealth.

To sum up, the need for relationship managers is being driven both by rising demand for skilled employees and by a shrinking population of experienced wealth advisors as the population ages. Compounding the effect, an aging population has a greater need to manage wealth that has been accumulated over the years.

Trusted Advisors Still the Foundation of Relationships

As discussed in Chapter 5, "Putting Clients at the Centre," wealthy clients' sophistication has increased, and it is common for them to have multiple banking and advisory relationships. Nonetheless, a long-term relationship with a trusted financial advisor still forms the cornerstone of most clients' wealth management strategies. While some may take a more hands-on approach,* they still look for an advisor to help them monitor the bigger picture, navigate complex topics, make strategic plans, or guide them through periods of change or transition. What might be thought of as "plain vanilla" investment advice (asset allocation, general tax information, and market coverage) is declining in terms of its significance. Meanwhile, banks are providing more expertise in complex issues of international taxation, asset and income protection, asset/liability management, estate management, or managing the wealth of an entire family (family offices). As the nature of the advisory role changes, an RM must meet client demands that have grown increasingly complex.

Relationship Managers Are Both the Driving and the Limiting Factor

Private banks can try to grow by increasing the "share of wallet" (the client's assets) held by each relationship manager. Due to the aging population of relationship managers, a new influx of these specialists is required to underpin future growth. The availability of new relationship managers will be the critical factor in determining whether private banks can maintain and grow their market share. The reasons behind this are numerous.

As noted, relationship managers are critical to private banking, given that the essence of what private banking offers is a customised individual relationship. There is a limit to the number of clients an individual relationship manager can support effectively. In private banking, banks need to offer more than just personalised investment advice; they also must be proactive in offering new ideas and solutions for growth or preservation of wealth. This service tailored to the individual is what separates private banks from retail banking and generates the lion's share of operating costs while also generating the greatest amount of profit. It is difficult for a relationship manager to manage, generally speaking, more than about 100 to 150 clients. If the clients' needs are very complex, the number might be as small as 50. Given the boom in wealth that began around the time of the new millennium, the number of potential clients has been growing faster than new relationship managers can be recruited and trained; the job requires knowledge of financial markets along with hard-to-acquire "soft" skills and experience.

Therefore, besides market expertise and know-how, relationship managers must possess poise and social competence, communication skills, and a talent for problem solving. A relationship manager needs to have natural sensitivity and the ability to make clients feel at ease. A relationship manager must be able to adopt the right approach, understanding and empathising with clients, bonding with heirs of long-established families and nobility as well as with those who acquired wealth within the space of just a few years or with entrepreneurs well-versed in business and investing. Relationship managers need to be independent, proactive, and focused on finding solutions. Technical and market skills have become increasingly important. At the same time, while functional and technical skills will always be valued and necessary and each relationship manager needs these skills, it is increasingly important to know how to act as an intermediary, bringing together various experts to provide specialised in-house knowledge to the client.

Relationship managers thus do not just need to have their own knowledge but must know where to go or whom to contact to ensure that the client receives the best information and guidance. Relationship managers also need to be able to network to meet new clients and must constantly be pursuing fresh leads. They need to be talented in managing time and able to coordinate and cooperate with a team of experts while possessing confident presentation skills. This type of knowledge is acquired through years of experience in the business.

WEAPONS TO WIN THE WAR FOR TALENT

The previous section examined reasons why there is a war for talent. Due to shifting demographics and continued growth of HNWI wealth, including in emerging markets, the war for talent will continue, if not intensify. The following section looks at "weapons" that can be used to win that war.

Going into battle is never cheap. In private banking, whether one develops in-house talent or aims to attract specialists from other players, those engaged in this battle must be prepared to invest for the long haul and in sizeable amounts. But this is just the start. To really win the war for talent, it also is necessary to think about developing, retaining, and, on occasion, terminating employees. One way to look at all the elements of human resources strategy is through the "employee needs proposition."

Attracting Talent

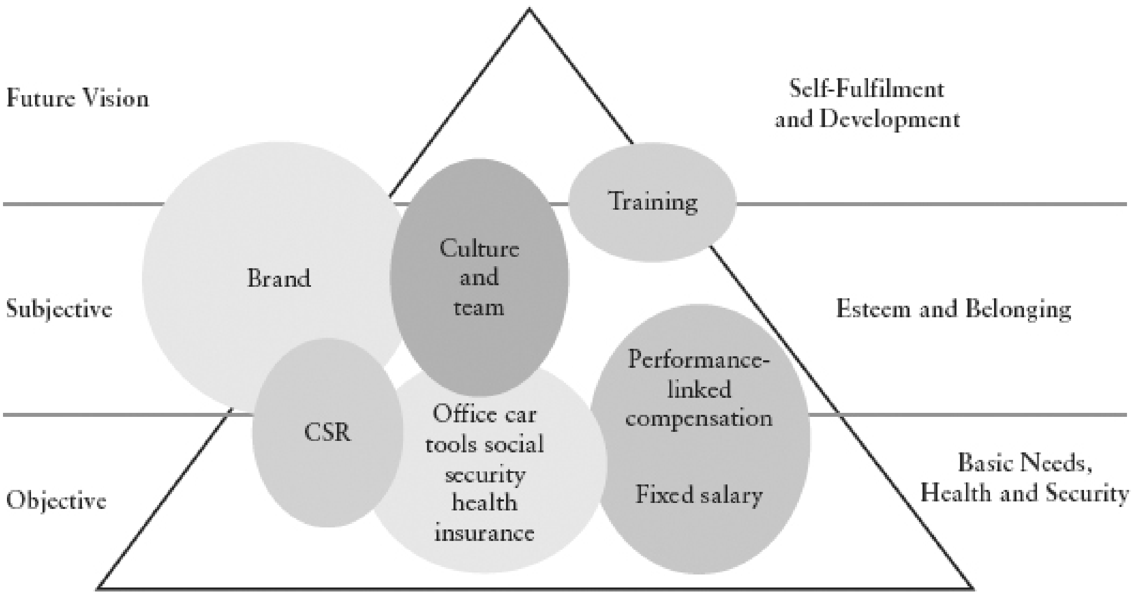
Chapter 8, "Delivering a Superior Client Experience," discusses how clients interact with the brand via so-called touchpoints and how these can be analysed using a "client corridor." We can apply the same principles to the process of attracting new talent. The employee needs proposition is a useful tool that brings together all the factors that contribute to this aim. Every encounter between a potential candidate and the bank is a touchpoint, which should be systematically analysed using an approach that evaluates gaps between expectations and actual experience. Consider the impression the bank makes on potential candidates with its branding, public relations, or marketing. Recall the atmosphere of the interviews conducted during candidate evaluations. Do the interviews truly embody the brand values and really inspire candidates to desire to join the bank?

Businesses have grown accustomed to the concept of the customer value proposition as a way of keeping customers loyal. In a similar way, the employee needs proposition blends objective and subjective criteria applied to employees' needs and aspirations.

The pyramid in Figure 10.3 is similar to one depicted in Chapter 7, "Why Brand Matters," and is based on US psychologist Abraham Maslow's hierarchy of human needs. The same structure can be used to organise the elements of what is commonly referred to as the employee value proposition*—here represented as the employee needs proposition. On the right is the hierarchy of human needs as determined by Maslow. On the left are "perceptual" categories: objective, subjective, and future vision.

FIGURE 10.3 The Employee Needs Proposition

Source: Author



Incentives are positioned according to the needs they meet. Some corporate elements, such as "brand," extend outside the pyramid because these are much bigger than what could be encompassed in a single employee contract. Similarly, some employee incentives also extend outside the pyramid, as employees can pursue training not only on the job but also independently, though an employer may offer in-house modules or provide support individuals who pursue a doctorate or a master's degree in business, for example.

The pay package must take into consideration basic needs, reflecting the right balance between risk and reward. Incentives and performance management should be appropriate for all functions. While a fixed salary covers an employee's basic needs, performance-related compensation can be viewed as a way to satisfy esteem and self-affirmation. In addition there are the higher needs including self-fulfilment and corporate responsibility, along with social responsibility at the top of the pyramid. These cannot be satisfied with more money, but serve as an example of how an employer also may provide avenues to achieve these goals.

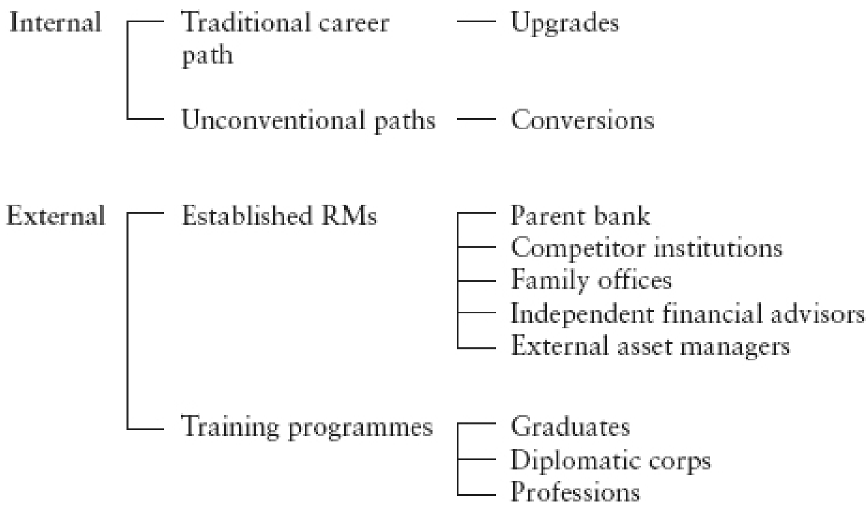
Having established the employee needs proposition framework as the basis for attracting and retaining employees, it is important to consider the steps involved in the employee life cycle—sourcing, recruiting, supporting/developing, and retaining, along with eventual retirement or, if necessary, termination.

Sourcing Talent

A private bank needs to have many types of employees: senior management and relationship managers; product specialists; and technical, operational, and support staff. While those in the latter categories can be recruited and chosen as would be the case for any position in financial services, it is different in the case of senior management and relationship managers. These people rarely apply to a bank; instead, they are usually approached. The potential sources of talent come from two main pools: internal and external, as shown in Figure 10.4.

FIGURE 10.4 Overview of Recruiting Channels

Source: Julius Baer



Internal recruits may have traditional career paths, meaning the conventional route to become a relationship manager taken by graduates who enter banking. Less conventional is the path of employees in other professions within the bank, such as lawyers or economists, who switch during their career and become relationship managers. External candidates can be recruited via a formal training programme such as graduate recruitment, or they can be established relationship managers working elsewhere.

Within these pools of talent, how does one start looking? One important source is networking. Switzerland's wealth management industry is a close-knit community. Within the country, it is possible to know everyone considered to be "someone" in the industry. The key is to identify potential candidates based on their current profiles or performance and their experience in a particular field or region. Once a detailed database of contacts is established, it is possible to fill a large number of positions without ever having to resort to a head-hunter or a job advertised through public media. Recall the theory that it is possible to connect with any person on the planet through only six intermediary steps.* Put that principle into practice, and you can usually approach a candidate fairly effectively through existing contacts. But it also makes sense to look for potential relationship managers internally before becoming involved in a costly external recruiting process. The main motivations to externally source relationship managers are experience, networks, and client portfolios. When a relationship manager retires, that also is an opportunity to promote new talent from within the bank; lawyers, product designers, assistants, and project team leaders, for example, can become successful and profitable relationship managers given that they have the right personality and receive the appropriate training and mentoring. The advantage of cultivating internal candidates is that they are already very familiar with the bank's culture, processes, and procedures, while generally being more loyal than those brought in from the outside, hence reducing future acquisition costs.

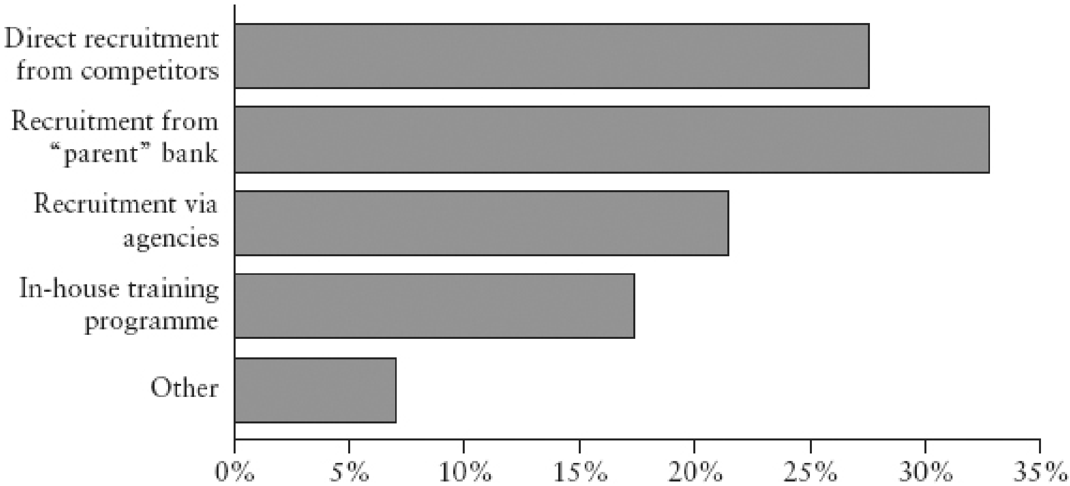
Recruitment Practices

The industry's long-term growth depends on developing new talent, including through internal channels. But the immediate growth needs can often be met only via external recruitment. Private banks, according to one survey by Oliver Wyman, may meet over 80 percent of the need for new relationship managers through "outside" hires, including from the parent organisation.(3) Based on data represented in Figure 10.5, about one-third of relationship managers are recruited through the parent bank, and more than one-quarter directly from competitors. Fewer come from in-house training. Other sources might include agencies, noncompeting financial institutions, the professions, other industries, and even diplomatic circles.

FIGURE 10.5 Recruiting Client Relationship Managers

Source: Oliver Wyman Financial Services, "Wealth Management Strategies for Success." 2006

Where do you get relationship managers from (approximate %)?



When recruiting from competitors, private banks may hire individuals or whole teams. For the hiring bank, teams are in many respects a much better proposition. Teams, unlike individuals, usually take a higher proportion of their clients with them when they move. By contrast, if a relationship manager leaves on his or her own, other team members can intervene to reduce migration losses, because the team usually has long-standing arrangements to cover absences and holidays, in effect allowing all members to develop relationships with clients. On the other hand, when a whole team is recruited, this can pose a greater integration challenge to the bank doing the hiring.

Where back-office and support staff are concerned, there are fewer ground rules. In the past, anyone with solid retail or universal bank experience would do just as well as someone with specific private banking experience. Nowadays, however, due to the importance of brand positioning, these jobs also require a high degree of loyalty and a service-minded approach. One can draw inspiration from the recruitment approaches taken by companies known to be premium providers in their industry, including those outside of banking. Whatever function is involved, a private bank needs to hire the best possible candidates, not only in terms of qualifications and talent but also through seeking people with above-average motivation, strong identification with the brand, and the ability to be flexible.

EXAMPLE: OUTSIDE-THE-BOX RECRUITMENT PRACTICES AT JULIUS BAER
The late Alex Widmer, former chief executive officer of Bank Julius Baer, believed that private banks could benefit from hiring people outside industries normally associated with wealth management, as long as the individuals had the necessary background in finance. The emphasis on client experience at Julius Baer led to the realisation that prior banking experience might not be as critical as was previously assumed. It was discovered that some of the attitudes and mindsets that the bank desired in its staff were harder to teach than the purely operational aspects. That was why the bank began to hire graduates from hotel management schools. The bank's management realised that such candidates possess a natural flair for client experience—that is what drew them to the hotel industry in the first place. Beyond possessing knowledge of the type usually acquired in top business schools, they had received more focused education in fields such as communications, service quality management, or cultural behaviour, which cultivate the soft skills. They proved able to empathise with and relate to a varietyofpeople, including wealthy clients.
Having these kinds of employees also made others in the bank more conscious of client experience and service excellence. Taking this idea to its logical conclusion, the bank hired Alain Zimmermann, an executive from the luxury goods industry to manage the brand. (Compare Chapter 7 footnote, p. 136.)

Supporting and Developing Talent

Supporting and developing talent is important. The following section discusses why future growth and a desire to be cost-effective require every institution in the industry to take responsibility for training individuals, rather than simply hiring "ready-made" talent. Once employees' basic needs have been met, the focus is on development. This is particularly important with regard to candidates for relationship manager or managerial positions. A bank needs to include development and growth opportunities as part of its goal of satisfying employees' needs, including the more abstract ones outlined by the employee needs proposition.

One way to start is with an assessment of an employee's long-term goals. If he or she starts a career in the product department, what would the person have to do to develop the skills needed to become a relationship manager? If someone is an assistant relationship manager, how long will it take until he or she is promoted? These questions can be answered through a career path "framework." By communicating the career path framework explicitly, the bank can express its commitment to an individual's development and reduce career-motivated departures.

Conferences, seminars, and intensive workshops are vital in order to induct an employee into the bank's culture, especially during the first 100 days. These platforms remain important throughout an employee's career. Larger banks such as UBS are able to maintain dedicated training and development programmes, such as those held at its Wolfsberg centre. (See box.) But it need not be a physical facility. Some banks offer online training as well as a virtual classroom and specific courses and events to achieve the same purpose without the fixed costs of maintaining an elaborate centre.

What about "stars"? In fact, in private banking teamwork is perhaps the most important element in supporting talent, as opposed to cultivating an individual star culture. In 2001, Stanford University business professor Jeffrey Pfeffer published a study entitled "Fighting the War for Talent Is Hazardous to Your Organization's Health."(4) In it, Pfeffer argues against allocating too many resources toward attracting and retaining star performers, because rewarding individual stars tends to diminish teamwork. Instead, it can lead to destructive internal competition and downplay skills of insiders while glorifying the talent of outsiders. This reduces motivation and ultimately leads to an elitist, arrogant attitude. Pfeffer writes that the particular emphasis on the individual at the expense of the team is "almost an inevitable outcome of a war for talent mindset," while companies overlook the fact that "it is often the case that effective teams outperform even more talented collections of individuals." In private banking, it is the management practices and culture of the company as a whole, as opposed to the flair and star qualities of a single individual, that will determine whether a relationship manager's efforts translate into lasting added value for all stakeholders. If the attitude driving the war for talent includes the assumption that a company's performance is nothing but the aggregate of individual performances, and an adult's learning potential is limited, one can agree. But if one believes strongly in attracting the best talent and building on strengths rather than trying to eradicate weaknesses, a valid argument can still be made for talented people to be cultivated in an organisation while ensuring that these people also work well within a team.

UBS WOLFSBERG—A DEDICATED TRAINING CENTRE
UBS conducts training and holds conferences at the Wolfsberg complex, which includes more than 125 guest rooms, modern meeting facilities, and an historic castle on the grounds. Located in northeastern Switzerland in an idyllic country setting, the centre provides top-quality catering and guest accommodations. UBS brings together management employees from around the world to the centre for conferences, so that they can exchange ideas on management, strategy, and leadership.(5)

CREDIT SUISSE BUSINESS SCHOOL—A GLOBAL CORPORATE UNIVERSITY
Credit Suisse set out to encourage ongoing learning throughout the bank by creating its "corporate university" in 2004. The Credit Suisse Business School trains internal staff, but in 2010 it offered its services to over 200 external corporate and private banking clients, especially in the Asia Pacific region. Special training is provided for private banking staff with direct contact to clients. Other programmes include leadership training that includes 46 mentoring programmes worldwide.(6)

Retaining Talents

Retention is more critical in wealth management than in many other industries, because a departing senior relationship manager can take a portion of the portfolio (meaning clients) when he or she leaves. Should this happen, in addition to losing clients, potential future referrals, assets, and revenue, the bank must face fresh acquisition and development costs. So how does one avoid losing employees to a competitor if a competitor makes them a better offer?

First, it is necessary to understand what is meant by a "better offer." Usually this refers to more lucrative compensation or increased responsibility. However, many other factors are likely to be involved; human resources specialists often say that an employee joins a company but leaves a boss. In other words, the company's image and the employee needs proposition can attract talent, but the human chemistry and the atmosphere at work will strongly influence whether or not a person stays.

Therefore, good teamwork is critical to retention. Managers must be close to their staff, listening, supporting, and developing skills and talent. In private banking, many banks are now trying to put the emphasis on being a trusted firm, focusing on teamwork rather than seeking to attract and retain clients solely on the basis of single advisors. Relying on the skills of a number of individuals within a team also provides a higher quality of advice on specific issues, all the more important in an increasingly complex world where no individual can possibly be an expert in all fields. Rather than simply encouraging the client and relationship manager to bond, involving an entire team, both the client and the relationship manager bond with the bank.

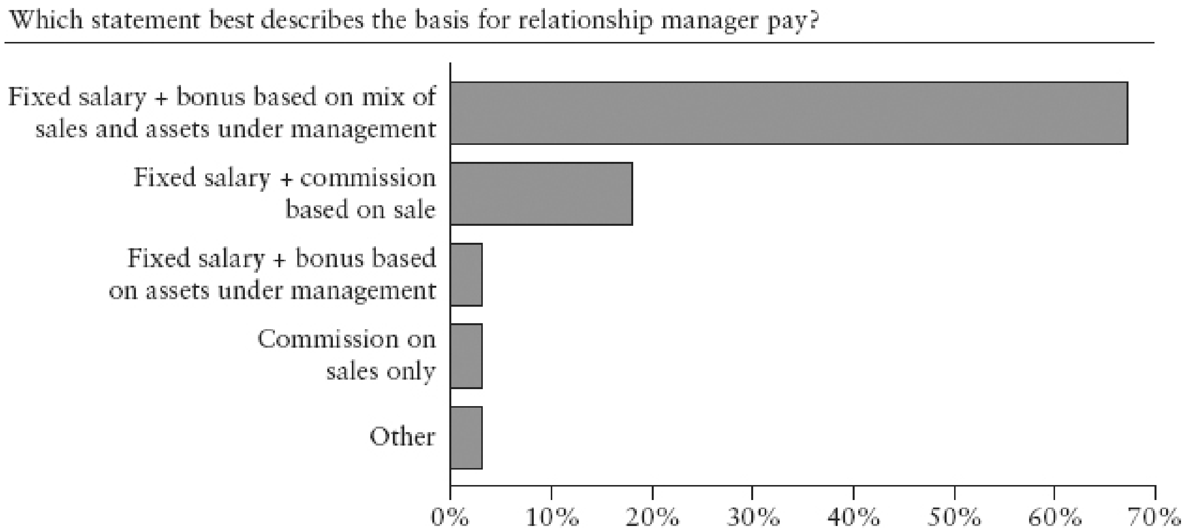
The quality of support offered to relationship managers contributes to retention and to client satisfaction. Support for relationship managers could include, for example, dedicated groups that operate in-house to help them meet clients' needs. Ideally the all-round support given to a relationship manager should enable him or her to deliver a superior client experience and level of advice that would be difficult to replicate at another company. Even so, for many clients the relationship manager is still more important than the institution. A survey conducted by the VIP Forum published in 2004 found that only 30 percent of HNWI clients saw the institution as more important than the advisor.(7) However, these findings also indicate that there is ample scope for private banks to enhance the ties between clients and banks.

In terms of compensation, various approaches may be used. Non–client-facing staff usually receive compensation based on a discretionary model tied to objective principles. Relationship managers traditionally receive a base salary and bonus. Increasingly, the bonus has been based on profit contribution models (the profit earned by the individual, his or her unit, and the bank as a whole).

Figure 10.6, based on a study by Oliver Wyman (2006 study), shows that nearly 70 percent of relationship managers received compensation consisting of a fixed salary and bonus based on a combination of sales and assets under management.(8) This represents a good compromise between the interests of the bank and its clients; other alternatives might be less satisfactory. For example, arrangements paying relationship managers a fixed salary and commissions could tempt relationship managers to "oversell" transactions. On the other hand, the smaller percentage of relationship managers who earn a bonus related solely to assets under management might in turn be tempted to focus on increasing deposits at the expense of performance.

FIGURE 10.6 Remuneration of Client Relationship Managers in Europe

Source: Oliver Wyman Financial Services, "Wealth Management Strategies for Success." 2006



The crisis in financial markets in 2008 heightened public awareness of the bonus culture in banks. Although payment of very large bonuses is a practice more common at investment banks than in private banking, a debate continues on how to best align incentives with risk, including at private banks. In addition to the basic salary and bonus elements, some banks may also offer stock and stock options as additional incentives. However, wealth management firms most often use longer vesting periods than other financial firms to increase retention. Many firms are considering adopting longer vesting periods to encourage employee loyalty and add an incentive for staff to act in their clients' best long-term interests, hence in the bank's own interests as well. At the same time, employees usually prefer shorter vesting periods. So both sides of the equation must be carefully evaluated. Multi-year bonuses are becoming increasingly common, meaning the bonuses are tied to performance over several years. One should note that relationship managers who spend their careers seeking to accumulate wealth for clients might be expected to look after their own interests. At the level of the individual relationship manager, it is therefore wise to balance incentives and use a granular approach to profit-and-loss accounting. This can be achieved by taking into consideration full costs per relationship manager, not just revenues after direct costs. Furthermore, any formula-based compensation model needs to be thoroughly tested in different market performance scenarios before being rolled out.

When deciding which benefits to offer, human resource executives at private banks should look beyond the traditional offerings and consider what can be done to heighten the sense of community, increase pride in the brand, encourage good corporate citizenship and teamwork, and enhance employee loyalty. When an employee's basic salary is sufficient to cover the bottom layer of needs on Maslow's pyramid, other considerations come to the fore, such as reputation, professional titles, education, and career development plans. These incentives are more significant than earning a little more or paying slightly less tax. The employee needs proposition introduced earlier in this chapter offers some insights into how the different needs might be grouped and aligned with company's aims.

Termination and Retirement

Some companies, particularly in North America, apply a "pruning" strategy to their staff and fire the lowest-performing 5 percent of their relationship managers each year. In Europe, this practice is not widespread. It is common to terminate employees who do not perform or meet targets but not on the basis of any numerical quotas. One should always measure an individual's performance against that person's personal business plan and within the context of the market.

That said, a private bank needs to have some kind of termination policy to avoid spending a disproportionate amount of energy helping a struggling minority rather than strengthening the competent majority. Although reviews typically take place on a quarterly basis, it is difficult to judge an individual relationship manager's performance over a span of less than 12 months. So it is unwise to make rash judgements regarding what simply might be a temporary period of subpar performance or bad luck.

Many private banks are keen to retain the skills and resources of good relationship managers beyond retirement. This trend will become even more pronounced in the future due to the demographic developments described earlier in this chapter. There are a number of solutions and models for compensation. One solution would be to simply delay the inevitable—in other words, to put off retirement. A wiser strategy, however, is to successively transition these employees; an older relationship manager can hand over his or her portfolio in stages to a younger colleague, while mentoring and supporting more junior relationship managers, thus remaining available to clients and the company as a consultant until entering formal retirement.

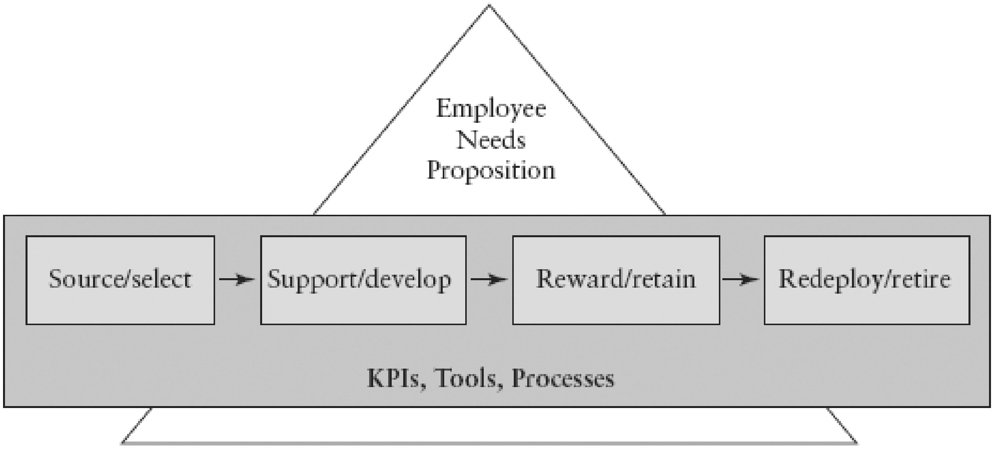
MEASURING YOUR SUCCESS: THE HR TOOLKIT

The employee needs proposition is the key to developing an effective strategy for human resources. This section deals with the practical aspects by examining the processes, tools, and key performance indicators (KPIs)—quantifiable measurements used to evaluate the success of a particular activity—employed to win the war for talent.

As in every area of the bank, human resources needs to be led by so-called management by objectives (MBO) principles, which means setting goals with the individual employee that reflect the bank's overall goals. These goals shall then guide all of the employee's actions and decision making at work and serve as the benchmark during performance appraisals. Figure 10.7 shows the four stages of the employee life cycle: source and select, support and develop, reward and retain, and finally, redeploy or retire. Notice the employee needs proposition in the background, which affects all these stages. Let us now look at the approaches, tools, processes, and key performance indicators needed to implement the strategy and to set and monitor objectives.

FIGURE 10.7 The Human Resources Life Cycle: How the Employee Needs Proposition Applies to the Initial Phase and Subsequent Three Main Phases

Source: Julius Baer



Source and Select

Sourcing and selecting requires structured processes and a number of key performance indicators. These are described in detail in the following section.

Sourcing Candidates

This chapter already has touched on the advantages of using a networking approach to sourcing candidates.

What are the practical steps to adopt to build on this approach? One way is to create the central database mentioned earlier, a "Who's Who" of relationship managers. Human resources should note previous positions, current employer, track record, and areas of expertise of all the professionals with whom the bank's employees regularly come into contact. It is amazing how much information can be collected over time after a suitable repository has been created and an orderly work flow process established.

Once such a database is set up, the bank can identify possible candidates. There might be two forces at work denoted as "push" and "pull." Push refers to cases in which a relationship manager initiates contact or shows a strong readiness to change his or her employer. This is very uncommon, however, unless the institution where the relationship manager is currently employed is facing difficulties. The more usual scenario is a pull situation whereby the initiative comes entirely from the bank seeking to hire.

A recruiting bank should analyse all factors affecting a relationship manager's push and pull situations carefully. A relationship manager can switch banks only a few times during a career, due to the undesirable impression of instability that this creates for clients. So he or she must carefully consider any new position and time job moves very carefully. In a pull situation, the bank needs to offer the candidate a strong employee needs proposition.

Selecting Candidates

The first requirement for tools used by human resources departments is that they must provide a structured approach for writing job descriptions. This means getting the relevant information from line managers regarding the specific demands of the job and then formulating and updating the description. This document serves as the basis for the recruitment advertisement and the interview and job performance evaluation; the better the job description, the easier it will be to do the rest. It is a good idea to create a checklist to ensure that all relevant managers and staff have contributed to writing the job description and to engage the help of an expert to make it into a polished advertisement.

The next step is to appoint an interview guide to cover all the essential areas, including job knowledge, personal and career background, situational issues, or current circumstances, and finally, to conduct personality profiling and check the candidate's character references.

The interview guide must communicate clearly with no ambiguities so that the interviewer understands exactly what information is needed to assess whether the candidate is suitable for the position. In order to match the level of the interview to the level of the position, human resources should work with the line manager to determine the questions to be asked about a candidate's knowledge as it bears on the job. It is also recommended that interviewers be clear on the importance of having a personal set of standard questions to ask each candidate so as to involve the interviewer more directly in the process. In order to make it easier to rate candidates, a bank can draw up a list of plausible answers for each question and then assign a score to candidates' answers. Obviously all these tools will bring consistent results only if the interviewers are trained in using them.

When discussing recruitment, it is common to think of it in terms of finding the right person for the job. But in fact, the process would be better served if it were viewed as posing two potential dangers: not hiring the right person or hiring the wrong person. These can be expressed as Type I and Type II errors. While it soon becomes apparent when the wrong person is hired, it is nearly impossible to know when the right candidate has fallen through the net. In the former case, one can try to track the false positives when candidates turn out to be unsuitable and then analyse the interview process to see what signals were missed. This type of tacit knowledge, skill, or experience, however, is difficult to document or quantify.

For this reason, human resources specialists should be involved in the interviews to support the line manager. But this requires clear feedback from the line manager about the candidate, both during the selection process and after it is completed. This feedback is also crucial for refining the hiring process. In senior-level positions, where it is extremely important to ensure that there will be no clashes in terms of corporate culture, the head of the bank should be able to interview and veto any appointments. Even though human resources and line managers are trusted in matters of competence, the CEO needs to ensure that the candidate will be able to embrace the organisation's culture and bond with the management team.

Key Performance Indicators in Recruitment

Here are some useful measures that might be applied as key performance indicators, which should be regularly reviewed and analysed:

- Recruitment cost per employee. This is the sum of the fees required to advertise jobs, executive search agency fees, employee and referral finders' fees, travel expenses, relocation expenses, payments to internal recruiters, and sign-on bonuses. These should be established for RMs and for other types of employees separately. It is important to monitor the relative weighting of the various cost elements in this process.
- Time to fill. This refers to the time needed to fill the position. If you use this as a part of a management by objectives' compensation model for human resources, it also is essential to consider the "time to start." It does little good if your human resources department finds a suitable hire quickly, only to have this person be unable to start work for a long time due to notice periods and "gardening leave."*
- Recruitment pipeline. There are a number of ways to evaluate the recruitment pipeline. These include tracking the number of open positions, the number of employees screened, and the job acceptance rate. Together, these indicate how competitive the bank's offers are and gauge the recruitment procedure's efficiency. Note that a low acceptance rate does not always mean the package was unattractive. Sometimes candidates have no real interest in the job. They simply want a benchmark or assessment of their current market value to use when negotiating compensation vis-à-vis their current employer.
- Number of early departures (for example, after one year of hire). A high number may indicate that something went wrong during the recruitment process; either new hires were not right for the positions (Type I error) or the positions did not match the new hires' expectations (a communication gap during hiring).

Support and Develop Employees

A structured approach is needed for the first months after a new employee joins the company. He or she must be immersed in the corporate culture to become fully acquainted with company's values and how the bank puts them into practice in daily business. Sufficient guidance should be provided for training, administrative issues, and where to go for information. It is also important to get feedback from new employees after the first 100 days in the job to learn how the "indoctrination" process went. This information can be used to improve the process for future new employees.

But the process doesn't stop after the first three months. The bank needs to deliver on the promises spelled out in the employee needs proposition made during recruitment and throughout the tenure. This is best done by defining and implementing an explicit development strategy for employees, based on the following tools and processes:

- Specific, explicit career path frameworks. These give employees an overview of steps required to take control of their careers while giving them a clear time horizon.*
- Structured learning or training, targeting clear and distinct groups. When creating an employee development strategy it is important to evaluate internal and external training options, deciding what to offer in-house and what to outsource.

- Management involvement and management development. Managers need to be responsible for the members of their team but also need to encourage employees to become managers by offering opportunities to develop the 360-degree perspective and interpersonal skills that a management position requires.
- Management by objectives. Set clear objectives at the beginning of the year and then evaluate whether employees have achieved the goals when performance appraisals are done at the end of the year. Use a rating for each objective and link it to compensation and training opportunities.
- Succession planning. The CEO needs to manage a leadership pipeline that will create the next generation of leaders and executive board members.

Key Performance Indicators in Development

- Performance differential. One way to calculated this is to compare the new employee's performance and the performance of an established employee taken as a benchmark.
- Time to portfolio. This reflects the time it takes for a new relationship manager to build a portfolio that begins to cover the investment made by the bank in hiring that particular relationship manager. This is one of the critical cost issues involved when hiring relationship managers. On the basis of estimates and personal experience, it takes a relationship manager about one year to build a portfolio that will cover direct costs because of the time needed to acquire clients and transfer existing client portfolios.
- Training and development costs per employee. This includes all costs related to internal and external education of an employee that were covered by the employer over a specific period. An average training and development cost per employee can then be calculated across the entire bank in order to compare it to previous years or external benchmarks. Alternatively an average can also be calculated per department in the bank in order to benchmark departments against each other departments.
- Training quota. This refers to the percentage of employees receiving training.
- Turnover due to career development issues. This might include employees who decide to change jobs because they could not satisfy their ambitions in their current job.

Reward and Retention

Further tools and processes should be implemented to develop the reward and retention stage of the human resources strategy include:

- Specific competency profiles and job-function benchmarks. These provide an easier way to make objective decisions regarding recruiting and terminating.
- Compensation benchmarking. This allows for comparisons to be made with competitors and should be done on a regular basis.
- Formula-based compensation. This approach is being revolutionised by regulations introduced in the wake of the financial crisis. Besides linking net new money and revenues to the direct costs arising from individuals, banks also need to consider risks and withhold compensation until a relationship manager's activities show they have created lasting value.
- Benchmarks linked to geographical regions. Such benchmarks can be used to build compensation models, which should help to prevent any bias favouring rapidly expanding markets. It may be easier for relationship managers to attract new money in such regions, but banks shoulder more cost and risk in these markets.
- Diversity management. Diversity means more than being simply "politically correct." A mix of gender, nationality, and age in the workforce can create a more creative environment where new ideas flourish and the bank is more open to change. Such a workforce is certainly easier to lead when a bank wishes to go in new directions or access new markets.

Key Performance Indicators in Reward and Retention

- Average tenure. Under normal circumstances, average tenure is a good measure of retention success. However, any changes to the rate of recruitment will distort this indicator. For example, at Bank Julius Baer there was a period when average tenure was dropping radically every quarter; rather than being caused by defections, it was due to a steady recruitment process. At one point during this period, almost one-quarter of the employees at the bank had been with the company for less than one month. That was an extreme challenge for training and cultural integration. The figure then dropped from 23 percent to 20 percent in the following 12 months as the expansion phase tapered off.
- Average absences and the holiday balance. These are more finely grained indicators of employee well-being than length of tenure. They also give indications of individual and departmental workloads and motivation levels. In private banking, the balance of unused holiday entitlements are generally higher than in other

industries and doctor-approved absences are below average. These are indicators of a motivated staff working in a fast-paced, high pressure environment.
- Turnover arising from compensation and benefit issues. This may indicate that compensation is not competitive relative to the market.

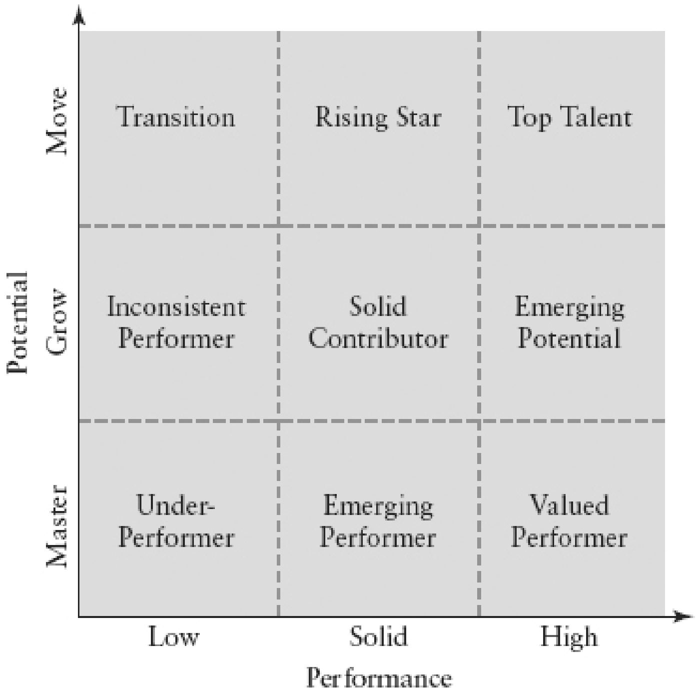
Redeploy, Retire, or Terminate

No human resources strategy is complete without a policy for redeployment, retirement, and termination. Using the information gathered in the course of the activities described, it is possible to establish a "human capital portfolio"—an overview of each employee's career.

Even though human resources is a "people" business, a matrix as represented in Figure 10.8 based on each employee's current performance (X-axis) and development potential (Y-axis) helps to provide an objective overview of that employee's positioning in terms of career performance and goals. This makes it easier when determining which employees should be promoted, which ones need time to grow, and which ones should be let go. A bank can also map the positions of whole departments or teams in this way.

FIGURE 10.8 How Employees Figure on a Matrix

Source: Julius Baer



With that in mind, one can consider the best key performance indicators to use when evaluating performance.

Key Performance Indicators in Employee Turnover

- Turnover rates. Zero turnover is not necessarily a good sign. New people bring fresh impulse and ideas and encourage increased efficiency. A better measure may be to compare turnover rates with those of peers.
- Termination versus resignation. In regard to resignations, these two conditions must be differentiated. There are staff whose departure is regretted and those where a departure was viewed as best for the employee and/or the employer.
- Track nonperformers. With regard to relationship managers, it is best to keep track record of performance metrics such as net new money, return on assets, and assets under management. In terms of a bell curve, compare the individual metrics with the distribution of those across the entire bank. Is the individual's curve a normal bell with a solid middle and an even spread of top and poor performers? Or are extremely good or bad performances skewing the picture?
- Record keeping. It may also be useful to keep a record of why people leave the firm and track the frequency of various factors influencing the decisions—for example, if many employees move to the same competitor, or if a number of them cite the same reason for departure (salary, "bad chemistry" with a superior, or other factors). Companies should keep a record of where people tend to move and consider whether or not to adopt or emulate these companies' hiring or compensation practices.

CONCLUSION

The war for talent is a fact—an inevitable consequence of major changes affecting an industry in which individual companies must increasingly compete for employees. Demographics and economic developments are contributing to this trend. Despite the financial market crisis in 2008 and the ensuing recession in many countries, the fundamental dynamics of the war for talent have not changed. Wealthy people will still seek the services of trusted firms and advisors who take a long-term view toward managing assets. Bank collapses and redundancies have led to what banks might consider more "reasonable" compensation demands. But companies also have used downsizing as an opportunity to shed weaker performers, leading to a further concentration of highly qualified individuals to fill positions. The war for talent continues, albeit sometimes with different tactics.

A private bank needs to hire the best possible candidates in terms of qualifications and expertise—people with above-average motivation, brand identification, and flexibility. This does not contradict the importance of teamwork or suggest that adults have limited potential to learn new skills. Hiring the best candidates is simply akin to securing the pole position in the starting grid, meaning even with other factors being equal, the company is placed in an advantageous position.

Given wealth managers' oft-repeated claim that theirs is a long-term business, market downturns offer them an advantage to attract potential talent at fair prices while investing in support and development. This will pay dividends over time, benefiting not just a single bank but the industry as a whole.

In periods when resources are less freely available, a bank can still fight the war for talent by paying extra attention to higher-level needs and by offering subjective incentives. These include strengthening the brand and ensuring that employees receive the esteem and affirmation they need, while providing career development opportunities. It is also essential that management communicates a strong vision for the future, while remaining close to individual employees.

NOTES

1. Cerulli Associates, The Cerulli Edge Advisor Edition – "Hire Train or Else." Q3 2010. Quoted in: Jeff Schlegel, "Opening the Doors," Financial Advisor Magazine, December 2010.

2. Capgemini Merrill Lynch Wealth Management. 2011. World Wealth Report 2010.

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5. Stäheli, C. Wolfsberg. 2008. "The Platform for Executive & Business Development." Schloss Wolfsberg bei Ermatingen. Die Schweizerischen Kunstführer GSK.

6. Business School Jahresbericht. 2010. Credit Suisse

7. VIP Forum. 2004. "Organizing for Sales Effectiveness."

8. Oliver Wyman. (See note 3.)

*See Chapter 5, "Putting Clients at the Centre," for a discussion of wealth creation.

*See Chapter 3, "Finding the Right Organisation and Operational Strategy," for further information about why clients have become more active in managing their assets.

*The pyramid in Figure 10.3 resembles the needs hierarchy developed by Abraham Maslow, as applied to branding. The same structure can be adapted to show elements of the employee value proposition (EVP) included in the book War for Talent published in 2001, based on a landmark 1997 McKinsey study. When these concepts are combined, the result is the employee needs proposition (ENP), a concept developed by this book's author.

*The idea that all humans on the planet are separated by a constant number of "degrees of separation" is a theme that has been discussed and investigated by various studies. The result of an experiment by Stanley Milgram and

Jeffrey Travers conducted in 1969 in the United States involved sending letters to people, who were then requested to pass along a letter to a certain stockbroker in Boston. If they did not know the person, they were asked to pass the message instead to someone they knew, who, they believed, might have a better chance of being acquainted with the broker. On average, six people served as intermediaries until the broker got the message. A more recent separate study by Microsoft that analysed billions of emails calculated the separation at closer to 6.6 degrees. Original Source: Travers, Jeffrey and Stanley Milgram. 1969, "An Experimental Study of the Small World Problem." Sociometry, 32(4), pp. 425–443. The information about Microsoft came from media including a report published by the BBC News (2008 Aug. 3 "Study Revives Six Degrees Theory").

*"Gardening leave" describes a situation in which an employee gives notice and vacates a position but after leaving the old employer is barred from starting the new job for a set number of months. This practice is designed to prevent the new employer from gaining an unfair advantage through information or contacts obtained from recent hires.

*For example, determining which interim positions might be required and what training must be completed for an employee to become a candidate for the position of Head of Treasury.

Chapter 11

Defining and Growing Leadership and Culture

In private banking, it is important to demonstrate that the institution can challenge the accepted wisdom and provide new and creative solutions. A leader may be defined by some particular event that requires the ability to deal with something where the perimeters are different, difficult, or not clearly defined, such as opening a new business. It is in fact much simpler and perhaps more exciting to build up something from scratch in a growth market. In an established business, the task of leading change is no less difficult. Taking time to communicate is always a high priority, to people both inside the firm and on the outside. Establishing a sense of purpose is also important in any company. Beyond that, it is necessary to give people tasks whose demands exceed what they personally believe they can accomplish. My biggest satisfaction is hearing someone say, "I never thought it was going to be possible, but we made it." If you really want something, you can make it happen. During my career, I have seen people rise to the occasion. How the concept of leadership has evolved and what makes a good leader are the main topics addressed in this chapter.

WHAT MAKES A LEADER?

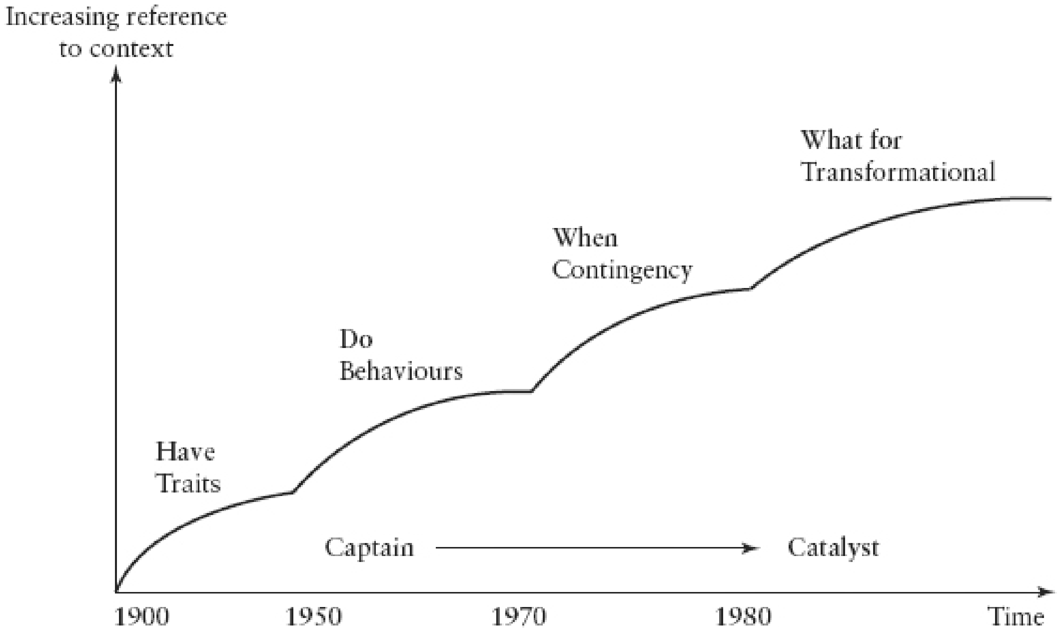
Leadership is the focus of countless books, seminars, and conferences.* As often as it is discussed, however, what precisely "leadership" is, let alone how to encourage its development, is subject to much debate. Ideas about what makes a good leader can change. When people are young, their earliest leadership models are often remote figures, such as sports stars or fictional heroes. As they get older, they begin to question what qualities really make a good leader. Leaders who seemed remarkable a generation or two ago might be viewed through the lens of history as somewhat less impressive. In business, some leaders lauded by their contemporaries may appear to us today as simply opportunists who acted out of self-interest and with disregard for the rights of others. Even the best leaders who fail to secure the support of followers are apt to struggle to maintain their mandates.

Leaders need integrity to stand the test of time. People who believe they know what attributes a leader must possess (persistence, self-confidence, tolerance, task knowledge, etc.) cannot guarantee that someone possessing all these qualities will succeed, any more than they can predict that someone who apparently lacks them will fail as a leader. Crises can bring out leadership qualities that individuals did not know they possessed. The idea that everyone potentially has the qualities of leadership makes the subject relevant and worth discussing. Being able to spot the leadership qualities in others and encouraging these can also define a true "leader."

In terms of business leaders, a great deal has changed over the years, including how leadership is perceived and studied. As shown in Figure 11.1, over the past 80 years or so there have been four principal leadership theories.(1) Early studies focused on traits of leaders. Once research began into what makes a leader, at first it seemed obvious to analyse certain traits considered necessary to lead. Such theories postulate that leaders possess certain outstanding qualities that others lack. Heroic leaders are men and women, so the thinking went, who had characteristics that set them apart from others.

FIGURE 11.1 The Evolution of Leadership Research Models

Source: Author



One danger with this theory is that leaders who believe they possess these qualities may infer that they are "destined" to lead, perhaps even assuming that they are infallible. After all, someone who has leadership traits must have superior knowledge. Eventually studies came to look instead at behaviours and whether a leader was task-oriented, people-oriented, directive (a decision maker), or participative. Where certain behaviours are concerned, the problem might lie partly in which sort of behaviour to employ. What happens when business leaders must serve two opposing aims, such as a desire to meet output goals while at the same time ensuring staff well-being?

As the study of leadership evolved, contingency theories became increasingly popular. These asserted that a good leader would need to have more than one style, adapting to fit each situation, so that a combination of behaviours is ultimately more important than any single trait. Those studying leadership behaviour also looked at the degree to which leaders involve followers in decision making. During the past 30 years, focus has shifted to making a distinction between transforming and transactional leaders. It has been frequently suggested that a true leader has to take his or her eyes off the bottom line from time to time, to scan the horizon for developments likely to pose challenges as well as the long-term trends that the organisation faces. A transformational leader should be able to do this and encourage others in the organisation.

As to "vision," this is often seen as a desirable trait in leaders. A leader lacking vision can hardly lead others. Of course, it could be argued as well that visionaries are just risk takers who happen to get lucky, and for every visionary, there are likely to be innumerable failures. So perhaps an element of risk taking should be included. The transformational leader needs to be a communicator as well, or at least to have people who can communicate ideas to reinforce the vision. There is often a need for at least one dedicated soul in the background serving the vision with perseverance and skill to make it a reality.

Anyone who has worked in a corporation has had both good and bad bosses. Generally a good boss or leader is someone who can guide people to discover their own capabilities. As the corporate hierarchy flattens in an increasingly networked environment, promoting more autonomy is becoming a key skill needed for good leadership. A good leader motivates. A bad leader de-motivates.

To sum up, a key element of leadership may be to share with people a vision, motivating them to achieve it and giving them the means to do so, encouraging them along the way. Along with motivation, leadership involves delegating responsibility.

Why Leadership Is Relevant

Most organisations operate within the confines of command-and-control reporting structures. Nonetheless, whether or not you are currently in a leadership position, you have leadership potential within you. Unlocking your leadership potential begins with the recognition that your unique background gives you perceptions and insights that no one else has. Your contribution matters; the days when leadership depended on having too many male hormones and an overdose of driving ambition, running roughshod over subordinates, are past. The world has entered the post-heroic era of leadership, where the known and unknown challenges of the future demand new approaches and insights.

As long as there have been people grouped together, there have been hierarchies, and with these hierarchies comes leadership. As practiced by government officials, a type of hierarchical management existed already in ancient Imperial China. Russian literature of the 19th century is full of civil servants obsessed with their position in the bureaucratic pecking order.* The modern concept of the corporate manager is a fairly new development, however. During the past century, as corporations grew in size and complexity, businesses found they needed far more managers than leaders. Management skills are probably easier to teach than the qualities that make a good leader. As businesses become successful, they see no need to change. And therein lies one of the problems for businesses and one of the most important tasks for a leader: recognising the need for change and managing it well.

What Do Leaders Really Do?

One definition of the differences between leaders and managers has been proposed by Kristina G. Ricketts, a leadership development specialist. She defines leadership as “a process whereby an individual influences a group of individuals to achieve a common goal,” while management means “to exercise executive, administrative, and supervisory direction of a group or organisation.” According to Ricketts, an individual can be a great leader, a great manager, or both.(2)

It was only in the 1970s that academics bothered even to distinguish between managers and leaders. A study published in 1977 by Harvard professor Abraham Zaleznik entitled “Managers and Leaders: Are They Different?” ignited widespread debate in business schools when it suggested that scientific management methods failed to encourage the qualities necessary to drive individuals to succeed in a corporate environment as leaders.(3) Instead, corporations tended to churn out bureaucrats focused on impersonal goals that preserved the status quo and stifled leadership. With their “conservatism and inertia, organisations provide succession to power through the development of managers rather than individual leaders,” Zaleznik wrote.

Rather than framing the debate as “leader versus manager,” in 1990, another Harvard professor, John Kotter, introduced the idea that leadership and management in fact complement each other. While management is about coping with complexity, organizing, and staffing, leadership looks to “align” people by motivating and inspiring them. It is not a mystical process. In fact, effective business visions “have an almost mundane quality to them.” It is not the originality of the vision that counts, but rather how well it suits the purpose at hand. Rather than downplaying management, he noted that strong leadership with weak management is worse than the opposite.(4)

Companies need a vision. Those that lack a vision, or at least a direction, typically make up for this by substituting long-term planning for direction. In such situations, “even short-term planning can become a black hole” swallowing “an infinite amount of time and energy,” according to Kotter. Another danger is that without a genuine direction to inspire them, managers become cynical and the planning process degenerates into a political game.

One example of the positive power of leadership that Kotter mentions is American Express. Founded in 1850, by the late 1970s the company was facing growing competition from other credit card providers. Lou Gerstner, a management consultant, was named president of the company’s travel-related services. He focused on strategy, choosing to position the company to appeal to affluent customers. He also challenged the notion at the time that discouraged product growth and innovation. A more entrepreneurial culture was introduced. At the same time, the company broadened its market reach, vastly expanding its business overseas. Other innovations included 90-day insurance on purchases made with the card, a platinum card, and a cost-saving and more convenient billing method. The company also introduced a revolving credit card, Optima. As a result of these changes, the division was able to increase its net income by “a phenomenal 500 percent between 1978 and 1987.” Gerstner later went on to head a major restructuring at RJR Nabisco, Inc., before moving to IBM and leading the company through a successful turnaround.

Leading Change

Following from the idea that one of the most important goals of leadership is to allow and facilitate change, companies seeking to implement change often rush to pronounce prematurely that a result has been satisfactorily implemented. They then discover that a declaration of victory, made by managers accustomed to thinking in terms of cycles of “hours, days or weeks, not years,” was contrary to fact—victory had not been achieved, according to Kotter.(5) A lack of leadership, along with what is described as “arrogance, insularity, and bureaucracy” in large and well-established firms can impede transformation. But the solution usually doesn’t arrive in the form of a single, heroic individual capable of swaying thousands of employees to follow his or her lead. Rather, the process requires many people to get on board and participate in the task of leading change. Competent management is also important. Without it, the transformation process can veer out of control.

Leading Successful Change

Leaders who want to manage change must be aware of certain aspects, according to Kotter. To achieve effective transformation requires many aspects. A leader must:

Create a sense of urgency.
Instead of allowing complacency, it is important to communicate that the changes envisioned are necessary and any delays in efforts to adopt them can have negative consequences. One CEO told the division managers that he would sell or close any divisions that did not achieve top or at least second position in a manager's industry within a certain time period. But unless reaching such a goal has been thoroughly planned and communicated clearly, the effort might fail to achieve anything and could make the situation worse. Companies also must not generate a false sense of urgency that would only promote anger and frustration rather than a desire to succeed.
Make the message vivid to create urgency.
People change for emotional reasons. While spreadsheets and slides may offer sound factual reasons for why change is necessary, it is far better to provide examples. It is more effective to use, for example, pictures and tangible examples that appeal to emotions. A leader must communicate directly and in a personal way. If examples are available, use them. Kotter and Dan S. Cohen in one study cite the case of a programme to adopt a central purchasing plan, which gained traction after a manager demonstrated that the company's factories used 424 kinds of gloves, with prices ranging from $5 to $15. The company went on to adopt a company-wide purchasing system.(6)
Form a guiding coalition and sideline those who resist change.
To implement true change, it is necessary to have support at the top of the corporation and equally important to have on board those in the company involved in the nuts and bolts of change management. Otherwise, the effort will stall and ultimately fail, bogged down in numerous small political struggles within the company that bring the process to a halt. Those who might oppose the process could be people in the company who are happy with the way things are. This corrosive faction will undermine reform efforts unless they are provided with distractions or are isolated from the main group.
Clearly communicate the vision.
Change can be threatening and force managers and employees to sacrifice time and energy to achieve something that will be realized only in the future. Communication makes the process much easier to bear. The "vision" a leader has needs to be communicated often, clearly, and in a personal way. Keeping a central focus helps to reduce distractions. The message needs to be simple, and it must be communicated often. A leader has to behave in line with the message. An initiative to cut costs, for example, must involve all levels. If senior managers don't cut their spending as well, it means little. Be honest. Honest communication might be painful but this creates trust. Don't rely on propaganda that isn't backed by facts or followed up with real action.
Persevere to make changes for the long haul.
One problem with companies where much of the focus is on the short term is to declare victory too early in the process. It helps to have short-term goals to achieve some "wins" early on. Even so, it is hard to maintain the energy necessary to drive change over the long haul. One trap to be avoided is to hire consultants to assist for a limited period of time and when they are finished, to see the business revert to its former state. One way to prevent this is to promote people within the organisation who are instrumental in driving change.
Empower employees to overcome obstacles.
A good leader knows that it is impossible for one person to overcome all obstacles standing in the way of change. Leaders must actively confront managers who seek to block progress. Beware of managers who offer resistance because they say changes have been tried in the past and failed to work. But don't give up on them. If these sceptics can be converted, they can become strong allies. Rewards must be aligned so that innovation is worth the risk involved. In addition, reinforce the desired new behaviour; it may help to provide role models.

Leadership as a Brand

Whether a company is making pizzas or jet engines, manufacturing or providing services, successful companies often have an easily described set of traits associated with the brand. According to a study published in 2007, written by consultants Dave Ulrich and Norm Smallwood, the "leadership brand" should last longer than any single leader or CEO.(7) The executive at the top is considered credible only as long as he or she personifies the brand. The brand's vital traits, according to these authors, are the qualities that customers truly care about. The company might even draw up a "leadership brand statement" making it plain what makes its leaders special, while outlining primary leadership standards and supporting the company's brand in the marketplace. It should be sufficiently flexible to allow companies to change as needed.

Leaders who exemplify the brand should be predisposed to it already and should have the knowledge, expertise, and skills necessary to do well in the organization. Ulrich and Smallwood even formulate a ratio that they believe will produce a company's future leaders of "50–20–30": 50 percent on-the-job experience, 20 percent working with mentors and role models, and 30 percent formal training. Training should focus on content rather than on processes: the competence should be useful to both customers and investors.

Transformational Leadership

A further distinction can be made—namely, differentiating leaders who can usher in true transformation from those who merely reach bargains with employees to get things accomplished. A transactional leader approach might involve exchanging rewards and promises for effort. The transformational leader can motivate by driving those involved in the process to go beyond their own interests to think in terms of the greater good. A true leader can expand the range of wants and needs among those individuals in an organisation. The transformational leader raises the level of awareness, while the transactional approach offers compensation based on merit.

Engaged employees are those who are actively involved in their company's business. Leaders and managers have an active role in increasing the percentage of employees who are engaged. Not only do high levels of engagement among staff make for a more productive, happier work environment; engagement plays a major role in determining how successful a company is. Based on one such study published in 2003 by Gallup, business units that are considered to be in the top half in terms of engagement levels achieve more than 0.4 standard deviation units' higher composite performance than those in the bottom half.(8)

How leaders achieve employee engagement is considered to be key in their success. The way they approach their role can have a major difference on whether or not they succeed in this task.

Transformational leaders seek to instil a vision and influence followers to act selflessly for the common good. Martin Luther King, Mahatma Gandhi, and Nelson Mandela are examples of leaders who changed nations with transcendent visions.

A study by David Rooke and William Torbert identified seven types of leaders, based on how these might relate to and interpret their surroundings and respond to situations that might pose a threat to their power or safety.(9) Opportunists, as the name suggests, seek to win at any price and alienate those around them. Diplomats are keen to avoid any conflict, which hampers their effectiveness. Experts spend much time gaining expertise and are the most typical of the professionals in the study. They are helped by their desire to continuously improve but can treat those around them lacking their knowledge with disdain. Achievers might clash with experts because they focus on goals, including market demands. Achievers often delegate more and bring in higher revenues than experts. Individualists look for creative solutions and can be highly successful, but they create conflicts if they ignore key processes. Strategists are rare and are most effective as transformational leaders. Alchemists are the most rare types and are highly effective in achieving where others may fail. They can achieve reconciliation between warring factions and usually have high moral standards. They can simultaneously be involved in many different organizations at one time.

A leader can evolve. One of the most common types of transformation involves people classed as "experts" becoming "achievers." This might be the result of a promotion into a management role, according to Rooke and Torbert. A person who is an expert in a particular area must learn to pay more attention to deadlines in a leadership situation, while managing priorities and performance. They will be confronted not only with finding technical solutions, which they are good at, but with addressing customers' demands and delivering solutions on schedule. Another type of transformation might involve leaders who evolve into "strategists" or "alchemists." Their focus might shift from self-fulfillment to looking beyond day-to-day business to find fulfillment through social responsibility.

Both individuals and teams can make similar changes. Most teams at the senior management level operate as achievers, preferring clear targets and deadlines and doing well when situations are adverse and deadlines tight. These teams may never bother to reflect on or take the time to question goals and assumptions. In large corporations, where senior management teams operate as experts, the situation may be worse. Here, there is little "teamwork" involved as such. Like individuals, however, teams can evolve as well. One example would be a financial services firm that emerged from an environment of severe cost-cutting into one calling for vision and innovation. To make the transition, the team had to find new managers willing to experiment. The company began to be seen by outsiders as being innovative, allowing it to attract top talent. Results, too, were better than those of industry competitors.

Good management seeks to promote good leadership. But while the world abounds with examples of bad managers, perhaps what should be even more worrisome are the "bad leaders." As a study by Barbara Kellerman, a research director at Harvard University and author of the book Bad Leadership has pointed out, the world is actually full of examples of bad leaders. We need to face this situation to fully understand effective leadership.(10)

Kellerman identified seven types or traits of bad leaders: the incompetent, rigid, intemperate, callous, corrupt, insular, and evil. Her examples show that bad leaders can be found in nearly all walks of life. There can be no bad leadership without compliant followers. “Leaders and followers are often locked in a complicated dance,” according to Kellerman, who adds that it is important to understand the dynamics that drive them. The risk of becoming a bad leader is very real. Strategies to avoid this include limiting tenure, power sharing, staying grounded and balanced, keeping focused on the main tasks, and making certain that they are able to draw on a network of people who give them honest feedback.

The Leadership Pipeline

Although it might seem obvious that a company needs to produce leadership in-house, it is not a given that companies offer adequate programmes to replenish the ranks of leaders. Assuming that companies can develop future leaders through planning and execution, and there is generally a shortage of leaders, it makes sense to take a hard look at how a corporation grows these individuals. Perhaps shareholders should be wary of companies where this is not a priority, particularly as, according to authors Ram Charan, Stephen Drotter, and James Noel, the “greatest benefit of a leadership pipeline comes when organisations need to build or re-configure.”(11) The authors believe that with the right training nearly anyone can develop leadership potential. To keep the leadership pipeline flowing, companies should clearly delineate roles and create performance standards for each level. The authors describe the six “passages” in the evolution of leaders in the following transition stages:

- Managing self to managing others: This might be the most difficult transition. The biggest problems are created by new managers who fail to let go of their old jobs. The key tasks include figuring out what needs to be done and assigning work, providing feedback to direct reports including monitoring and coaching, and establishing relationships to build networks to improve dialogue and trust. Regular feedback and coaching at this stage can be very helpful.
- Managing others to managing managers: At this level, it is important to realise that it is not the same to manage others as it is to manage managers. First-line managers must be empowered. Learning to delegate is important, as is learning to share authority. More time is spent training other managers. Groups of individuals must be brought together into effective teams. It is important to avoid hiring “clones” or cronies for jobs. The function also requires someone willing to tear down boundaries that impede work and information flow.
- Managing managers to managing a function: A broader focus is required at this level. Thinking in terms of long-term results and from different perspectives is important. There should be a shift to understanding that the function exists to serve the entire business. The transition to this role demands an understanding of the whole functional unit, not simply those parts of which they possess previous knowledge. To succeed, functional managers must love to learn about what they don’t know. A leader recognises that he or she need not be the expert in every area. This stage is marked by a shift from talking to listening. Classroom training works, but on-the-job experience is especially invaluable.
- Functional manager to business manager: The emphasis shifts to thinking more in terms of cost and revenue. In this position, the focus goes from valuing one’s own function to valuing all functions in an appropriate way. It sometimes requires stepping back to see the bigger picture. Rather than simply fixing a problem, it is crucial to understand what the overriding goal should be. This role also thrusts managers into what might be an uncomfortable spotlight. Success can be measured in terms of providing effective communication, assembling a strong team, understanding how the business can make money, effective time management, and awareness of “soft” issues (culture, feedback, organisational beliefs).
- Business manager to group manager: A key skill at this level is to learn to allocate what might sometimes be scarce resources to promote growth in one business, possibly at the expense of others. It requires prioritising an entire portfolio of strategies and measuring managers based on more than just financial results. The CEO is ultimately responsible for ensuring that his or her business units obey laws, uphold company policy, and enhance the brand, while pursuing a profit. The job requires looking beyond the “what” to the “how”—what lies behind the profit, not simply how much profit is generated. At this level, managers must “become comfortable thinking and strategising about what’s invisible,” which requires being able to envision what lies ahead for the company in terms of markets and potential competition. A key tool to develop leadership at this level is to rely on a set of measurements that includes not just financial metrics but success in developing managers, strategic thinking, “corporate citizenship,” and planning.
- Group manager to leading an entire enterprise: Skills for CEOs go beyond mastering strategic ability and leadership. A CEO must be able to fill key positions with the right people. The job requires being able to deliver “predictable” results, setting a strategic direction by knowing where he or she wants to take the enterprise, enabling two-way communication throughout the entire group, and being able to get things done.

Becoming more sensitive and attuned to groups and interests outside the company is important—not just to shareholders but to the media and the general public, regulators, activist groups, and others. But if the CEO is spending far more time polishing his or her image externally, there is liable to be something wrong. The most successful CEOs are be those who have succeeded in the important stages preceding this one.

The Nuances of Training Leaders

It is not enough to have a training programme. Companies must realise that not all competencies are right for each level of development. Specific stages in career development call for different responses, and this must be reflected in training modules. The idea that "leaders are leaders" or that "good people can handle anything" espoused by some companies overlooks the fact that successful leaders' behaviours and styles must evolve as their careers progress, according to a study published in the Harvard Business Review in 2006. The authors, four consultants and management experts—Kenneth Brousseau, Michael Driver, Gary Hourihan, and Rikard Larsson—argued that decision-making skills that work for senior executives can wreck the career of middle managers. Senior managers can also make the mistake of reaching decisions just as they did as a first-line supervisor.(12) As managers progress up the hierarchy, the style of decision making changes. Most important here is that while lower-level managers assign, explain, and communicate, senior-level managers do more listening than telling. At this level there should be a greater emphasis on understanding than directing. Successful managers learn to adapt their decision making. Others may notice that something is amiss as they progress through the ranks but are unsure what. They try a little of everything, which doesn't work. "The bottom 20 percent of managers get stuck in this uncertainty zone, where they often remain for the rest of their careers," according to the authors. "The primary lesson for managers is that failing to evolve in how you make decisions can be fatal to your career." Good leadership programmes acknowledge that there are differences between the skills for line managers, mid- and upper-level executives, and senior executives. Managers also must learn to adapt their styles to the circumstances. Those who can do so have a better chance of succeeding.

In the book What Got You Here Won't Get You There, the authors Marshall Goldsmith and Mark Reiter provide a clear rundown of what might be called "bad habits of otherwise highly effective people."(13) They chronicle their experiences as consultants to leaders, including those in industry and even in the armed services. One message is that leaders must identify traits that are holding them back, even when intuitively they may believe these were the very traits that made them successful. An example is a "brilliant, dedicated" executive, who was extremely creative. His flaw was being a poor listener. In fact, he attributed his success partly to the fact he was a poor listener because this helped him to tune out "bad ideas." Conceding at last that this was a problem, he grew defensive, saying starting to listen too much could endanger his creativity. Finally he came around to agreeing that it was more productive to give people their say than it was to "justify his own dysfunctional behaviour."

Another problem is that of the executive who must supply "value added," even when it is not desired. For example, two top executives were discussing a new venture. When one would volunteer an idea, the other would respond, time and again, by saying that "it was a good idea, but would be better if . . ." In fact the urge to always embellish what others come up with may improve the content of my idea "by 5 percent, but you've reduced commitment to executing it by 50 percent," Goldsmith and Reiter write. Instead, the ownership of the idea has been co-opted, leaving the person who thought it up with less enthusiasm. One way to effectively counteract this is to pause before speaking and ask whether or not the comments are really worth making. The same could be said of another CEO discussed in the book, whose endless debating about ideas left his employees feeling that he had stifled discussion. During talks with employees, leaders must remember that there is usually an inequality in such debates; as in most firms, what the CEO says is the final word.

Another fallacy is believing that employees listen to everything, all the time. A CEO who sent a memo was puzzled because the message didn't get through. The author calls this behaviour "checking the box"—in other words, assuming that doing something will automatically lead to the desired result. In fact, the CEO had no idea who had read the memo let alone understood it, and even more crucial, who believed it. This means that follow-up is key. If it involves a message, it may take several tries until people "get" it.

Being a leader is not about having a title or holding a position. No matter what character traits one possesses, no one is born a leader. Everyone has the potential to develop leadership, and those in leadership need to keep in close contact with those around them. This includes taking a genuine interest in issues beyond work. Leadership potential is unlocked by delegating responsibilities and offering guidance and training.

Leadership needs to be experienced at all levels of an organisation. Clear communication is key. If others don't know what is required of them, how can they perform as expected?

CONCLUSION

In today's environment, a good leader is generally considered less of a commander than a catalyst. Both types of leaders are still needed. In the aftermath of the financial crisis, as in the wake of any crisis, the qualities competent leaders bring to the table are greatly needed.

Many people associate leadership qualities with accomplishments. For others, success might be awards, recognition by peers, or professional accolades. But for some, facing their toughest challenge, even one that is not publicly acknowledged, might be their most satisfying moment. It could involve building a business from the ground up. This can offer major personal satisfaction. It is something every leader should experience, at least once. Everyone's experiences can offer lessons in leadership. I conclude with some of my personal thoughts on this.

KEY INSIGHTS BASED ON THE AUTHOR'S EXPERIENCE

Lessons from Singapore

In January 2000 my employer at the time, Credit Suisse, was thinking of expanding its business in Asia. Singapore was to become an alternative booking centre. My boss at the time, Alex Widmer, had presented a plan to the executive board to set up this new hub. Throughout the spring of that year the bank searched for a candidate but could not find anyone willing to head the project. However, as the bank already had committed itself to this project in the end, I was asked if I would take the job. I packed within two days and was on my way to Asia.

Nobody said it would be easy. What was supposed to become the office was little more than a storeroom with a computer set up in one corner. At 23, I was facing the challenge of building an entire team of people, made an even more difficult task because the new bank had little to offer new employees apart from the tiny office. In the end, however, the plan was a success. And today that centre is still one of Credit Suisse's most successful outside of Switzerland.

Philosophy

The lesson? Singapore taught me that there is no project that is too big. And after arriving somewhere that is different from the culture with which you are familiar, you also must learn to motivate people in different cultures. You learn quickly to understand modesty. Everyone plays a role. There is no one better than anyone else. Everyone in a new operation is there for a reason and has a skill set. As a manager, your job is to make sure that you know what that skill set is and how the different people work together. Another important thing I learned: nothing is impossible. That is a part of my philosophy that I've taken from those times in Singapore. You cannot be a leader if your energy level is low. You need to be there with a presence and make people feel that their problem is the most important. You need to have a high level of curiosity. The only way you can learn is by asking a large number of questions. I try not to take myself too seriously. It helps people to relax and breaks down barriers. I am a risk taker. But no matter how complex a situation is, I always try to reduce it to something manageable.

Motivating People

Being optimistic also plays an important role, as does determination. Even when all the odds are against you, goodwill and motivation and having the right interest at heart usually will prevail. Over time you eventually get to where you want to go. If you are genuinely motivated, this also is communicated and gets picked up by those around you. That creates an energy that resistance cannot stop. People become persistent and really want to accomplish the task. That creates a momentum, an energy where people never give up. And eventually it does work.

On Being CEO of Julius Baer

A leader also gets defined by the moments that the person goes through. Sometimes you need to be put in the situation to develop your skills. Stepping into the job of being CEO at Julius Baer in May 2009 at the age of 35, I was helped by the fact that I already had served as COO and was thus quite familiar with the whole bank. It was important to understand right from the start the things that should be preserved, which revenues ought to be protected, which ones could be grown, and where revenues were that were more variable or more fixed. It is easier and more thrilling to build up something from scratch when you have a great mandate in a growth market. When you start with an established system and restructure something, in some cases the people might not even necessarily understand why the business (along with their jobs) is being restructured. When you need to change something, you need to explain to people why you're going to make changes.

Clients

The job of CEO of Julius Baer also posed a new challenge, that of moving from an internal role to one that included establishing the trust of clients. For the past two years, I've met on average one client per day. I think that is a very good discipline. Client demographics are changing, and this has also influenced clients' expectations. They are better informed and often more closely involved with the markets. Even though they may still delegate decisions, they very often have an opinion, and they will listen to different opinions. They will compare, and they will challenge you.

Culture

A leader defines the culture of the organisation. We have an open culture; we care about each other. I try to talk directly to the organisation, to show myself, to be there where I can to talk to people. I listen. In our organisation we are trying to have a relatively flat hierarchy. To create a high-performance company, you need to create transparency about the information that defines the company. I think that is absolutely key, especially when we have to manage people who generally are very highly educated and quite smart. You don't convince them by authority. You convince them because they like to work for you and you respect them.

Excellence

We speak a good deal about excellence. I think excellence is achieved when you deliver a service or a product or an experience that meets a certain standard or a certain expectation level. To be excellent, in the majority of cases, means you can replicate an experience, service, or quality at the level that always meets or exceeds the expectation of the counterparty. For that, you need to have processes and systems. But above all you need the right people. In the financial services industry, it is not just the product and services per se but the tangible experience, which, at the end of the day, is provided by people.

Challenging Others to Excel

A leader must challenge people with new ideas. One such example was a decision to use Swiss ski jumper and Olympic gold medallist Simon Ammann in advertisements in Switzerland, a departure from our advertising that usually was not based on a single person. But it has proved successful and also demonstrated that the bank can challenge accepted ideas to produce creative initiatives. Such ideas, however, must be consistent with the brand and the image and fit with the overall approach.

Employees also need to be challenged. One way to do this is to assign to people more than they believe, personally, they can accomplish. The biggest satisfaction I get is when someone comes back to me and says, "I never thought it was going to be possible, but we made it." That's for me, always, the biggest satisfaction, because my favourite line is to say, "You see, I told you so. If you really want something, you can make it happen."

NOTES

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*In the programme for the World Economic Forum held in Davos, Switzerland in 2011, the word "leader" was used 44 times. The word "leadership" appeared 26 times, including in the following contexts: leadership under pressure, extreme leadership (mountaineering, polar exploration), the leadership voice (singing), how to inspire leadership (orchestral), how to promote dignity-based leadership, and "mindful leadership."

*In Anton Chekhov's story "The Death of a Civil Servant," a government clerk worries himself literally to death after sneezing on a higher-ranking official.

Chapter 11

Defining and Growing Leadership and Culture

In private banking, it is important to demonstrate that the institution can challenge the accepted wisdom and provide new and creative solutions. A leader may be defined by some particular event that requires the ability to deal with something where the perimeters are different, difficult, or not clearly defined, such as opening a new business. It is in fact much simpler and perhaps more exciting to build up something from scratch in a growth market. In an established business, the task of leading change is no less difficult. Taking time to communicate is always a high priority, to people both inside the firm and on the outside. Establishing a sense of purpose is also important in any company. Beyond that, it is necessary to give people tasks whose demands exceed what they personally believe they can accomplish. My biggest satisfaction is hearing someone say, "I never thought it was going to be possible, but we made it." If you really want something, you can make it happen. During my career, I have seen people rise to the occasion. How the concept of leadership has evolved and what makes a good leader are the main topics addressed in this chapter.

WHAT MAKES A LEADER?

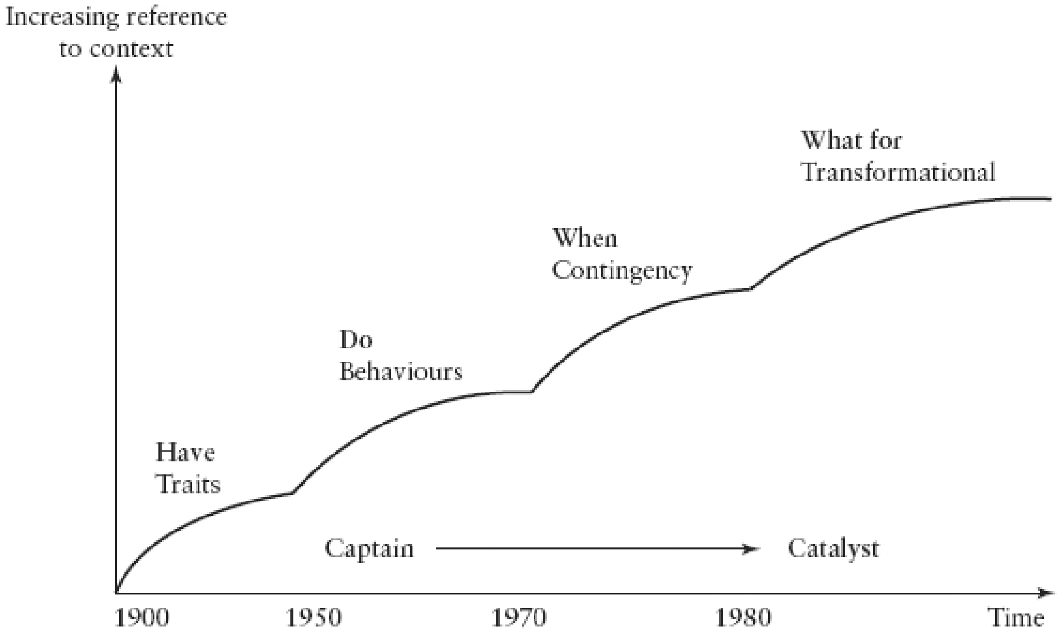
Leadership is the focus of countless books, seminars, and conferences.* As often as it is discussed, however, what precisely "leadership" is, let alone how to encourage its development, is subject to much debate. Ideas about what makes a good leader can change. When people are young, their earliest leadership models are often remote figures, such as sports stars or fictional heroes. As they get older, they begin to question what qualities really make a good leader. Leaders who seemed remarkable a generation or two ago might be viewed through the lens of history as somewhat less impressive. In business, some leaders lauded by their contemporaries may appear to us today as simply opportunists who acted out of self-interest and with disregard for the rights of others. Even the best leaders who fail to secure the support of followers are apt to struggle to maintain their mandates.

Leaders need integrity to stand the test of time. People who believe they know what attributes a leader must possess (persistence, self-confidence, tolerance, task knowledge, etc.) cannot guarantee that someone possessing all these qualities will succeed, any more than they can predict that someone who apparently lacks them will fail as a leader. Crises can bring out leadership qualities that individuals did not know they possessed. The idea that everyone potentially has the qualities of leadership makes the subject relevant and worth discussing. Being able to spot the leadership qualities in others and encouraging these can also define a true "leader."

In terms of business leaders, a great deal has changed over the years, including how leadership is perceived and studied. As shown in Figure 11.1, over the past 80 years or so there have been four principal leadership theories.(1) Early studies focused on traits of leaders. Once research began into what makes a leader, at first it seemed obvious to analyse certain traits considered necessary to lead. Such theories postulate that leaders possess certain outstanding qualities that others lack. Heroic leaders are men and women, so the thinking went, who had characteristics that set them apart from others.

FIGURE 11.1 The Evolution of Leadership Research Models

Source: Author



One danger with this theory is that leaders who believe they possess these qualities may infer that they are "destined" to lead, perhaps even assuming that they are infallible. After all, someone who has leadership traits must have superior knowledge. Eventually studies came to look instead at behaviours and whether a leader was task-oriented, people-oriented, directive (a decision maker), or participative. Where certain behaviours are concerned, the problem might lie partly in which sort of behaviour to employ. What happens when business leaders must serve two opposing aims, such as a desire to meet output goals while at the same time ensuring staff well-being?

As the study of leadership evolved, contingency theories became increasingly popular. These asserted that a good leader would need to have more than one style, adapting to fit each situation, so that a combination of behaviours is ultimately more important than any single trait. Those studying leadership behaviour also looked at the degree to which leaders involve followers in decision making. During the past 30 years, focus has shifted to making a distinction between transforming and transactional leaders. It has been frequently suggested that a true leader has to take his or her eyes off the bottom line from time to time, to scan the horizon for developments likely to pose challenges as well as the long-term trends that the organisation faces. A transformational leader should be able to do this and encourage others in the organisation.

As to "vision," this is often seen as a desirable trait in leaders. A leader lacking vision can hardly lead others. Of course, it could be argued as well that visionaries are just risk takers who happen to get lucky, and for every visionary, there are likely to be innumerable failures. So perhaps an element of risk taking should be included. The transformational leader needs to be a communicator as well, or at least to have people who can communicate ideas to reinforce the vision. There is often a need for at least one dedicated soul in the background serving the vision with perseverance and skill to make it a reality.

Anyone who has worked in a corporation has had both good and bad bosses. Generally a good boss or leader is someone who can guide people to discover their own capabilities. As the corporate hierarchy flattens in an increasingly networked environment, promoting more autonomy is becoming a key skill needed for good leadership. A good leader motivates. A bad leader de-motivates.

To sum up, a key element of leadership may be to share with people a vision, motivating them to achieve it and giving them the means to do so, encouraging them along the way. Along with motivation, leadership involves delegating responsibility.

Why Leadership Is Relevant

Most organisations operate within the confines of command-and-control reporting structures. Nonetheless, whether or not you are currently in a leadership position, you have leadership potential within you. Unlocking your leadership potential begins with the recognition that your unique background gives you perceptions and insights that no one else has. Your contribution matters; the days when leadership depended on having too many male hormones and an overdose of driving ambition, running roughshod over subordinates, are past. The world has entered the post-heroic era of leadership, where the known and unknown challenges of the future demand new approaches and insights.

As long as there have been people grouped together, there have been hierarchies, and with these hierarchies comes leadership. As practiced by government officials, a type of hierarchical management existed already in ancient Imperial China. Russian literature of the 19th century is full of civil servants obsessed with their position in the bureaucratic pecking order.* The modern concept of the corporate manager is a fairly new development, however. During the past century, as corporations grew in size and complexity, businesses found they needed far more managers than leaders. Management skills are probably easier to teach than the qualities that make a good leader. As businesses become successful, they see no need to change. And therein lies one of the problems for businesses and one of the most important tasks for a leader: recognising the need for change and managing it well.

What Do Leaders Really Do?

One definition of the differences between leaders and managers has been proposed by Kristina G. Ricketts, a leadership development specialist. She defines leadership as "a process whereby an individual influences a group of individuals to achieve a common goal," while management means "to exercise executive, administrative, and supervisory direction of a group or organisation." According to Ricketts, an individual can be a great leader, a great manager, or both.(2)

It was only in the 1970s that academics bothered even to distinguish between managers and leaders. A study published in 1977 by Harvard professor Abraham Zaleznik entitled "Managers and Leaders: Are They Different?" ignited widespread debate in business schools when it suggested that scientific management methods failed to encourage the qualities necessary to drive individuals to succeed in a corporate environment as leaders.(3) Instead, corporations tended to churn out bureaucrats focused on impersonal goals that preserved the status quo and stifled leadership. With their "conservatism and inertia, organisations provide succession to power through the development of managers rather than individual leaders," Zaleznik wrote.

Rather than framing the debate as "leader versus manager," in 1990, another Harvard professor, John Kotter, introduced the idea that leadership and management in fact complement each other. While management is about coping with complexity, organizing, and staffing, leadership looks to "align" people by motivating and inspiring them. It is not a mystical process. In fact, effective business visions "have an almost mundane quality to them." It is not the originality of the vision that counts, but rather how well it suits the purpose at hand. Rather than downplaying management, he noted that strong leadership with weak management is worse than the opposite.(4)

Companies need a vision. Those that lack a vision, or at least a direction, typically make up for this by substituting long-term planning for direction. In such situations, "even short-term planning can become a black hole" swallowing "an infinite amount of time and energy," according to Kotter. Another danger is that without a genuine direction to inspire them, managers become cynical and the planning process degenerates into a political game.

One example of the positive power of leadership that Kotter mentions is American Express. Founded in 1850, by the late 1970s the company was facing growing competition from other credit card providers. Lou Gerstner, a management consultant, was named president of the company's travel-related services. He focused on strategy, choosing to position the company to appeal to affluent customers. He also challenged the notion at the time that discouraged product growth and innovation. A more entrepreneurial culture was introduced. At the same time, the company broadened its market reach, vastly expanding its business overseas. Other innovations included 90-day insurance on purchases made with the card, a platinum card, and a cost-saving and more convenient billing method. The company also introduced a revolving credit card, Optima. As a result of these changes, the division was able to increase its net income by "a phenomenal 500 percent between 1978 and 1987." Gerstner later went on to head a major restructuring at RJR Nabisco, Inc., before moving to IBM and leading the company through a successful turnaround.

Leading Change

Following from the idea that one of the most important goals of leadership is to allow and facilitate change, companies seeking to implement change often rush to pronounce prematurely that a result has been satisfactorily implemented. They then discover that a declaration of victory, made by managers accustomed to thinking in terms of cycles of "hours, days or weeks, not years," was contrary to fact—victory had not been achieved, according to Kotter.(5) A lack of leadership, along with what is described as "arrogance, insularity, and bureaucracy" in large and well-established firms can impede transformation. But the solution usually doesn't arrive in the form of a single, heroic individual capable of swaying thousands of employees to follow his or her lead. Rather, the process requires many people to get on board and participate in the task of leading change. Competent management is also important. Without it, the transformation process can veer out of control.

Leading Successful Change

Leaders who want to manage change must be aware of certain aspects, according to Kotter. To achieve effective transformation requires many aspects. A leader must:

Create a sense of urgency.
Instead of allowing complacency, it is important to communicate that the changes envisioned are necessary and any delays in efforts to adopt them can have negative consequences. One CEO told the division managers that he would sell or close any divisions that did not achieve top or at least second position in a manager's industry within a certain time period. But unless reaching such a goal has been thoroughly planned and communicated clearly, the effort might fail to achieve anything and could make the situation worse. Companies also must not generate a false sense of urgency that would only promote anger and frustration rather than a desire to succeed.
Make the message vivid to create urgency.
People change for emotional reasons. While spreadsheets and slides may offer sound factual reasons for why change is necessary, it is far better to provide examples. It is more effective to use, for example, pictures and tangible examples that appeal to emotions. A leader must communicate directly and in a personal way. If examples are available, use them. Kotter and Dan S. Cohen in one study cite the case of a programme to adopt a central purchasing plan, which gained traction after a manager demonstrated that the company's factories used 424 kinds of gloves, with prices ranging from €4.21 to €12.63. The company went on to adopt a company-wide purchasing system.(6)
Form a guiding coalition and sideline those who resist change.
To implement true change, it is necessary to have support at the top of the corporation and equally important to have on board those in the company involved in the nuts and bolts of change management. Otherwise, the effort will stall and ultimately fail, bogged down in numerous small political struggles within the company that bring the process to a halt. Those who might oppose the process could be people in the company who are happy with the way things are. This corrosive faction will undermine reform efforts unless they are provided with distractions or are isolated from the main group.
Clearly communicate the vision.
Change can be threatening and force managers and employees to sacrifice time and energy to achieve something that will be realized only in the future. Communication makes the process much easier to bear. The "vision" a leader has needs to be communicated often, clearly, and in a personal way. Keeping a central focus helps to reduce distractions. The message needs to be simple, and it must be communicated often. A leader has to behave in line with the message. An initiative to cut costs, for example, must involve all levels. If senior managers don't cut their spending as well, it means little. Be honest. Honest communication might be painful but this creates trust. Don't rely on propaganda that isn't backed by facts or followed up with real action.
Persevere to make changes for the long haul.
One problem with companies where much of the focus is on the short term is to declare victory too early in the process. It helps to have short-term goals to achieve some "wins" early on. Even so, it is hard to maintain the energy necessary to drive change over the long haul. One trap to be avoided is to hire consultants to assist for a limited period of time and when they are finished, to see the business revert to its former state. One way to prevent this is to promote people within the organisation who are instrumental in driving change.
Empower employees to overcome obstacles.
A good leader knows that it is impossible for one person to overcome all obstacles standing in the way of change. Leaders must actively confront managers who seek to block progress. Beware of managers who offer resistance because they say changes have been tried in the past and failed to work. But don't give up on them. If these sceptics can be converted, they can become strong allies. Rewards must be aligned so that innovation is worth the risk involved. In addition, reinforce the desired new behaviour; it may help to provide role models.

Leadership as a Brand

Whether a company is making pizzas or jet engines, manufacturing or providing services, successful companies often have an easily described set of traits associated with the brand. According to a study published in 2007, written by consultants Dave Ulrich and Norm Smallwood, the "leadership brand" should last longer than any single leader or CEO.(7) The executive at the top is considered credible only as long as he or she personifies the brand. The brand's vital traits, according to these authors, are the qualities that customers truly care about. The company might even draw up a "leadership brand statement" making it plain what makes its leaders special, while outlining primary leadership standards and supporting the company's brand in the marketplace. It should be sufficiently flexible to allow companies to change as needed.

Leaders who exemplify the brand should be predisposed to it already and should have the knowledge, expertise, and skills necessary to do well in the organization. Ulrich and Smallwood even formulate a ratio that they believe will produce a company's future leaders of "50–20–30": 50 percent on-the-job experience, 20 percent working with mentors and role models, and 30 percent formal training. Training should focus on content rather than on processes: the competence should be useful to both customers and investors.

Transformational Leadership

A further distinction can be made—namely, differentiating leaders who can usher in true transformation from those who merely reach bargains with employees to get things accomplished. A transactional leader approach might involve exchanging rewards and promises for effort. The transformational leader can motivate by driving those involved in the process to go beyond their own interests to think in terms of the greater good. A true leader can expand the range of wants and needs among those individuals in an organisation. The transformational leader raises the level of awareness, while the transactional approach offers compensation based on merit.

Engaged employees are those who are actively involved in their company's business. Leaders and managers have an active role in increasing the percentage of employees who are engaged. Not only do high levels of engagement among staff make for a more productive, happier work environment; engagement plays a major role in determining how successful a company is. Based on one such study published in 2003 by Gallup, business units that are considered to be in the top half in terms of engagement levels achieve more than 0.4 standard deviation units' higher composite performance than those in the bottom half.(8)

How leaders achieve employee engagement is considered to be key in their success. The way they approach their role can have a major difference on whether or not they succeed in this task.

Transformational leaders seek to instil a vision and influence followers to act selflessly for the common good. Martin Luther King, Mahatma Gandhi, and Nelson Mandela are examples of leaders who changed nations with transcendent visions.

A study by David Rooke and William Torbert identified seven types of leaders, based on how these might relate to and interpret their surroundings and respond to situations that might pose a threat to their power or safety.(9) Opportunists, as the name suggests, seek to win at any price and alienate those around them. Diplomats are keen to avoid any conflict, which hampers their effectiveness. Experts spend much time gaining expertise and are the most typical of the professionals in the study. They are helped by their desire to continuously improve but can treat those around them lacking their knowledge with disdain. Achievers might clash with experts because they focus on goals, including market demands. Achievers often delegate more and bring in higher revenues than experts. Individualists look for creative solutions and can be highly successful, but they create conflicts if they ignore key processes. Strategists are rare and are most effective as transformational leaders. Alchemists are the most rare types and are highly effective in achieving where others may fail. They can achieve reconciliation between warring factions and usually have high moral standards. They can simultaneously be involved in many different organizations at one time.

A leader can evolve. One of the most common types of transformation involves people classed as "experts" becoming "achievers." This might be the result of a promotion into a management role, according to Rooke and Torbert. A person who is an expert in a particular area must learn to pay more attention to deadlines in a leadership situation, while managing priorities and performance. They will be confronted not only with finding technical solutions, which they are good at, but with addressing customers' demands and delivering solutions on schedule. Another type of transformation might involve leaders who evolve into "strategists" or "alchemists." Their focus might shift from self-fulfillment to looking beyond day-to-day business to find fulfillment through social responsibility.

Both individuals and teams can make similar changes. Most teams at the senior management level operate as achievers, preferring clear targets and deadlines and doing well when situations are adverse and deadlines tight. These teams may never bother to reflect on or take the time to question goals and assumptions. In large corporations, where senior management teams operate as experts, the situation may be worse. Here, there is little "teamwork" involved as such. Like individuals, however, teams can evolve as well. One example would be a financial services firm that emerged from an environment of severe cost-cutting into one calling for vision and innovation. To make the transition, the team had to find new managers willing to experiment. The company began to be seen by outsiders as being innovative, allowing it to attract top talent. Results, too, were better than those of industry competitors.

Good management seeks to promote good leadership. But while the world abounds with examples of bad managers, perhaps what should be even more worrisome are the "bad leaders." As a study by Barbara Kellerman, a research director at Harvard University and author of the book Bad Leadership has pointed out, the world is actually full of examples of bad leaders. We need to face this situation to fully understand effective leadership.(10)

Kellerman identified seven types or traits of bad leaders: the incompetent, rigid, intemperate, callous, corrupt, insular, and evil. Her examples show that bad leaders can be found in nearly all walks of life. There can be no bad leadership without compliant followers. "Leaders and followers are often locked in a complicated dance," according to Kellerman, who adds that it is important to understand the dynamics that drive them. The risk of becoming a bad leader is very real. Strategies to avoid this include limiting tenure, power sharing, staying grounded and balanced, keeping focused on the main tasks, and making certain that they are able to draw on a network of people who give them honest feedback.

The Leadership Pipeline

Although it might seem obvious that a company needs to produce leadership in-house, it is not a given that companies offer adequate programmes to replenish the ranks of leaders. Assuming that companies can develop future leaders through planning and execution, and there is generally a shortage of leaders, it makes sense to take a hard look at how a corporation grows these individuals. Perhaps shareholders should be wary of companies where this is not a priority, particularly as, according to authors Ram Charan, Stephen Drotter, and James Noel, the "greatest benefit of a leadership pipeline comes when organisations need to build or re-configure."(11) The authors believe that with the right training nearly anyone can develop leadership potential. To keep the leadership pipeline flowing, companies should clearly delineate roles and create performance standards for each level. The authors describe the six "passages" in the evolution of leaders in the following transition stages:

- Managing self to managing others: This might be the most difficult transition. The biggest problems are created by new managers who fail to let go of their old jobs. The key tasks include figuring out what needs to be done and assigning work, providing feedback to direct reports including monitoring and coaching, and establishing relationships to build networks to improve dialogue and trust. Regular feedback and coaching at this stage can be very helpful.
- Managing others to managing managers: At this level, it is important to realise that it is not the same to manage others as it is to manage managers. First-line managers must be empowered. Learning to delegate is important, as is learning to share authority. More time is spent training other managers. Groups of individuals must be brought together into effective teams. It is important to avoid hiring "clones" or cronies for jobs. The function also requires someone willing to tear down boundaries that impede work and information flow.
- Managing managers to managing a function: A broader focus is required at this level. Thinking in terms of long-term results and from different perspectives is important. There should be a shift to understanding that the function exists to serve the entire business. The transition to this role demands an understanding of the whole functional unit, not simply those parts of which they possess previous knowledge. To succeed, functional managers must love to learn about what they don't know. A leader recognises that he or she need not be the expert in every area. This stage is marked by a shift from talking to listening. Classroom training works, but on-the-job experience is especially invaluable.
- Functional manager to business manager: The emphasis shifts to thinking more in terms of cost and revenue. In this position, the focus goes from valuing one's own function to valuing all functions in an appropriate way. It sometimes requires stepping back to see the bigger picture. Rather than simply fixing a problem, it is crucial to understand what the overriding goal should be. This role also thrusts managers into what might be an uncomfortable spotlight. Success can be measured in terms of providing effective communication, assembling a strong team, understanding how the business can make money, effective time management, and awareness of "soft" issues (culture, feedback, organisational beliefs).
- Business manager to group manager: A key skill at this level is to learn to allocate what might sometimes be scarce resources to promote growth in one business, possibly at the expense of others. It requires prioritising an entire portfolio of strategies and measuring managers based on more than just financial results. The CEO is ultimately responsible for ensuring that his or her business units obey laws, uphold company policy, and enhance the brand, while pursuing a profit. The job requires looking beyond the "what" to the "how"—what lies behind the profit, not simply how much profit is generated. At this level, managers must "become comfortable thinking and strategising about what's invisible," which requires being able to envision what lies ahead for the company in terms of markets and potential competition. A key tool to develop leadership at this level is to rely on a set of measurements that includes not just financial metrics but success in developing managers, strategic thinking, "corporate citizenship," and planning.
- Group manager to leading an entire enterprise: Skills for CEOs go beyond mastering strategic ability and leadership. A CEO must be able to fill key positions with the right people. The job requires being able to deliver "predictable" results, setting a strategic direction by knowing where he or she wants to take the enterprise, enabling two-way communication throughout the entire group, and being able to get things done. Becoming more sensitive and attuned to groups and interests outside the company is important—not just to shareholders but to the media and the general public, regulators, activist groups, and others. But if the CEO is

spending far more time polishing his or her image externally, there is liable to be something wrong. The most successful CEOs are be those who have succeeded in the important stages preceding this one.

The Nuances of Training Leaders

It is not enough to have a training programme. Companies must realise that not all competencies are right for each level of development. Specific stages in career development call for different responses, and this must be reflected in training modules. The idea that “leaders are leaders” or that “good people can handle anything” espoused by some companies overlooks the fact that successful leaders’ behaviours and styles must evolve as their careers progress, according to a study published in the Harvard Business Review in 2006. The authors, four consultants and management experts—Kenneth Brousseau, Michael Driver, Gary Hourihan, and Rikard Larsson—argued that decision-making skills that work for senior executives can wreck the career of middle managers. Senior managers can also make the mistake of reaching decisions just as they did as a first-line supervisor.(12) As managers progress up the hierarchy, the style of decision making changes. Most important here is that while lower-level managers assign, explain, and communicate, senior-level managers do more listening than telling. At this level there should be a greater emphasis on understanding than directing. Successful managers learn to adapt their decision making. Others may notice that something is amiss as they progress through the ranks but are unsure what. They try a little of everything, which doesn’t work. “The bottom 20 percent of managers get stuck in this uncertainty zone, where they often remain for the rest of their careers,” according to the authors. “The primary lesson for managers is that failing to evolve in how you make decisions can be fatal to your career.” Good leadership programmes acknowledge that there are differences between the skills for line managers, mid- and upper-level executives, and senior executives. Managers also must learn to adapt their styles to the circumstances. Those who can do so have a better chance of succeeding.

In the book What Got You Here Won’t Get You There, the authors Marshall Goldsmith and Mark Reiter provide a clear rundown of what might be called “bad habits of otherwise highly effective people.”(13) They chronicle their experiences as consultants to leaders, including those in industry and even in the armed services. One message is that leaders must identify traits that are holding them back, even when intuitively they may believe these were the very traits that made them successful. An example is a “brilliant, dedicated” executive, who was extremely creative. His flaw was being a poor listener. In fact, he attributed his success partly to the fact he was a poor listener because this helped him to tune out “bad ideas.” Conceding at last that this was a problem, he grew defensive, saying starting to listen too much could endanger his creativity. Finally he came around to agreeing that it was more productive to give people their say than it was to “justify his own dysfunctional behaviour.”

Another problem is that of the executive who must supply “value added,” even when it is not desired. For example, two top executives were discussing a new venture. When one would volunteer an idea, the other would respond, time and again, by saying that “it was a good idea, but would be better if . . .” In fact the urge to always embellish what others come up with may improve the content of my idea “by 5 percent, but you’ve reduced commitment to executing it by 50 percent,” Goldsmith and Reiter write. Instead, the ownership of the idea has been co-opted, leaving the person who thought it up with less enthusiasm. One way to effectively counteract this is to pause before speaking and ask whether or not the comments are really worth making. The same could be said of another CEO discussed in the book, whose endless debating about ideas left his employees feeling that he had stifled discussion. During talks with employees, leaders must remember that there is usually an inequality in such debates; as in most firms, what the CEO says is the final word.

Another fallacy is believing that employees listen to everything, all the time. A CEO who sent a memo was puzzled because the message didn’t get through. The author calls this behaviour “checking the box”—in other words, assuming that doing something will automatically lead to the desired result. In fact, the CEO had no idea who had read the memo let alone understood it, and even more crucial, who believed it. This means that follow-up is key. If it involves a message, it may take several tries until people “get” it.

Being a leader is not about having a title or holding a position. No matter what character traits one possesses, no one is born a leader. Everyone has the potential to develop leadership, and those in leadership need to keep in close contact with those around them. This includes taking a genuine interest in issues beyond work. Leadership potential is unlocked by delegating responsibilities and offering guidance and training.

Leadership needs to be experienced at all levels of an organisation. Clear communication is key. If others don’t know what is required of them, how can they perform as expected?

CONCLUSION

In today's environment, a good leader is generally considered less of a commander than a catalyst. Both types of leaders are still needed. In the aftermath of the financial crisis, as in the wake of any crisis, the qualities competent leaders bring to the table are greatly needed.

Many people associate leadership qualities with accomplishments. For others, success might be awards, recognition by peers, or professional accolades. But for some, facing their toughest challenge, even one that is not publicly acknowledged, might be their most satisfying moment. It could involve building a business from the ground up. This can offer major personal satisfaction. It is something every leader should experience, at least once. Everyone's experiences can offer lessons in leadership. I conclude with some of my personal thoughts on this.

KEY INSIGHTS BASED ON THE AUTHOR'S EXPERIENCE

Lessons from Singapore

In January 2000 my employer at the time, Credit Suisse, was thinking of expanding its business in Asia. Singapore was to become an alternative booking centre. My boss at the time, Alex Widmer, had presented a plan to the executive board to set up this new hub. Throughout the spring of that year the bank searched for a candidate but could not find anyone willing to head the project. However, as the bank already had committed itself to this project in the end, I was asked if I would take the job. I packed within two days and was on my way to Asia.

Nobody said it would be easy. What was supposed to become the office was little more than a storeroom with a computer set up in one corner. At 23, I was facing the challenge of building an entire team of people, made an even more difficult task because the new bank had little to offer new employees apart from the tiny office. In the end, however, the plan was a success. And today that centre is still one of Credit Suisse's most successful outside of Switzerland.

Philosophy

The lesson? Singapore taught me that there is no project that is too big. And after arriving somewhere that is different from the culture with which you are familiar, you also must learn to motivate people in different cultures. You learn quickly to understand modesty. Everyone plays a role. There is no one better than anyone else. Everyone in a new operation is there for a reason and has a skill set. As a manager, your job is to make sure that you know what that skill set is and how the different people work together. Another important thing I learned: nothing is impossible. That is a part of my philosophy that I've taken from those times in Singapore. You cannot be a leader if your energy level is low. You need to be there with a presence and make people feel that their problem is the most important. You need to have a high level of curiosity. The only way you can learn is by asking a large number of questions. I try not to take myself too seriously. It helps people to relax and breaks down barriers. I am a risk taker. But no matter how complex a situation is, I always try to reduce it to something manageable.

Motivating People

Being optimistic also plays an important role, as does determination. Even when all the odds are against you, goodwill and motivation and having the right interest at heart usually will prevail. Over time you eventually get to where you want to go. If you are genuinely motivated, this also is communicated and gets picked up by those around you. That creates an energy that resistance cannot stop. People become persistent and really want to accomplish the task. That creates a momentum, an energy where people never give up. And eventually it does work.

On Being CEO of Julius Baer

A leader also gets defined by the moments that the person goes through. Sometimes you need to be put in the situation to develop your skills. Stepping into the job of being CEO at Julius Baer in May 2009 at the age of 35, I was helped by the fact that I already had served as COO and was thus quite familiar with the whole bank. It was important to understand right from the start the things that should be preserved, which revenues ought to be protected, which ones could be grown, and where revenues were that were more variable or more fixed. It is easier and more thrilling to build up something from scratch when you have a great mandate in a growth market. When you start with an established system and restructure something, in some cases the people might not even necessarily understand why the business (along with their jobs) is being restructured. When you need to change something, you need to explain to people why you're going to make changes.

Clients

The job of CEO of Julius Baer also posed a new challenge, that of moving from an internal role to one that included establishing the trust of clients. For the past two years, I've met on average one client per day. I think that is a very good discipline. Client demographics are changing, and this has also influenced clients' expectations. They are better informed and often more closely involved with the markets. Even though they may still delegate decisions, they very often have an opinion, and they will listen to different opinions. They will compare, and they will challenge you.

Culture

A leader defines the culture of the organisation. We have an open culture; we care about each other. I try to talk directly to the organisation, to show myself, to be there where I can to talk to people. I listen. In our organisation we are trying to have a relatively flat hierarchy. To create a high-performance company, you need to create transparency about the information that defines the company. I think that is absolutely key, especially when we have to manage

people who generally are very highly educated and quite smart. You don't convince them by authority. You convince them because they like to work for you and you respect them.
Excellence
We speak a good deal about excellence. I think excellence is achieved when you deliver a service or a product or an experience that meets a certain standard or a certain expectation level. To be excellent, in the majority of cases, means you can replicate an experience, service, or quality at the level that always meets or exceeds the expectation of the counterparty. For that, you need to have processes and systems. But above all you need the right people. In the financial services industry, it is not just the product and services per se but the tangible experience, which, at the end of the day, is provided by people.
Challenging Others to Excel
A leader must challenge people with new ideas. One such example was a decision to use Swiss ski jumper and Olympic gold medallist Simon Ammann in advertisements in Switzerland, a departure from our advertising that usually was not based on a single person. But it has proved successful and also demonstrated that the bank can challenge accepted ideas to produce creative initiatives. Such ideas, however, must be consistent with the brand and the image and fit with the overall approach.
Employees also need to be challenged. One way to do this is to assign to people more than they believe, personally, they can accomplish. The biggest satisfaction I get is when someone comes back to me and says, "I never thought it was going to be possible, but we made it." That's for me, always, the biggest satisfaction, because my favourite line is to say, "You see, I told you so. If you really want something, you can make it happen."

NOTES

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*In the programme for the World Economic Forum held in Davos, Switzerland in 2011, the word "leader" was used 44 times. The word "leadership" appeared 26 times, including in the following contexts: leadership under pressure, extreme leadership (mountaineering, polar exploration), the leadership voice (singing), how to inspire leadership (orchestral), how to promote dignity-based leadership, and "mindful leadership."

*In Anton Chekhov's story "The Death of a Civil Servant," a government clerk worries himself literally to death after sneezing on a higher-ranking official.

Chapter 12

Measuring and Managing Performance

Without targets you cannot measure achievements, deviations from stated objectives, or performance. There is a need for both quantitative and qualitative targets. A performance culture is rooted in defining objectives and creating a results-oriented approach. But it involves more than just looking at financial numbers. It also has to do with the type of delivery achieved and its quality. Measuring performance requires accountability in order to obtain a result that provides information about a given quality at a certain point in time. Resources that can be invested are finite. It is necessary, therefore, to take a structured approach to make best use of these limited resources. This mentality is important to ensure that people respect and invest the resources wisely within the time constraints available and from the standpoint of the company's objectives. Once this process has been established, then and only then should performance be examined in terms of results and numbers.

UNDERSTANDING PERFORMANCE MEASUREMENT

If performance management is neglected, the best-crafted strategies and visions will be to no avail. Even when a company has a credible vision, it will not achieve it if it cannot implement the steps to fulfil its goals. As discussed in Chapter 11, "Defining and Growing Leadership and Culture," leading is about creating a credible vision. But it doesn't stop there. Equally important is the execution, which has to be right. Performance management supplies the necessary link required to translate leadership's vision into the very concrete actions involved in making it a reality.

Performance management can be applied to individual employees and entire companies. For employees, it can measure an individual's performance and be used to set pay based on how he or she achieves targets and goals. For the business as a whole, performance management measures how well goals are achieved across the entire organisation or by divisions and teams. In all cases, goals—specific targets—must be aligned with the company's priorities. If growth is targeted, this might relate to reaching specific revenue targets. If the aim is to become more competitive, it might be necessary to lower costs relative to peers and take measures to ensure a culture of innovation. If profit margins are to be expanded, this can be expressed by establishing precise targets.

Performance management can best be understood as the key to implementing strategy. Doing a good job of measuring performance is therefore at the heart of successful performance management. This chapter specifies which measurements are needed and how to assess the results. It is important to note that effective measurements need to go well beyond financial data. Relying on historical information alone is like trying to steer a car looking only in the rear view mirror. For companies, a focus on the past increases a risk that by the time some development is hurting the business to the degree that it is reflected in numbers, it is probably too late to offer a remedy. Similarly, positive developments that offer clues as to where future revenues can be obtained may be neglected unless close watch is kept on the factors truly driving performance. When only the "backward-looking" aspects are factored in, as is the case with most mainstream financial data, management's view of the company's ability to respond to future events is greatly restricted. This becomes clear especially during crises when businesses that were thought to be sound suddenly fail. It is much easier to hit targets in good markets. Performance management, therefore, is more in focus in poor markets. At such times, shortcomings may suddenly become glaringly apparent. Again, however, it will be too late to respond; that is why systems are needed to provide information about performance in a timely way, especially taking into account indicators that go beyond mainstream financial data.

In the context of performance management, information about and reporting by private banks is fairly straightforward; as a rule of thumb, assets under management provide about two-thirds of revenue, and employees generate about 70 percent of costs. The usual metrics include net new money (volume of inflows of client money minus volume of outflows), total client assets under management, costs relative to income, and profit margin (measured by net profit relative to assets under management). These metrics provide most of the information necessary to assess the growth and profitability of a private bank. But again, it is important to include those pieces of information that offer a sense of how business and trends might develop in the future. During the 2008 financial crisis, it is fair to say that if banks had been more aware of the changes that would affect their business, more questions would have been raised about their own viability. Questions also would have been asked about the type of behaviour encouraged and rewarded by performance-related compensation. For any company, but especially banks, rethinking how performance is measured and managed is required on a continual basis.

The following paragraphs examine general measures suited to evaluating performance, before taking a closer look at ways in which private banks specifically can use the information about their current business to be more proactive, rather than waiting until it is too late. In particular, the so-called balanced scorecard approach can deliver a sensible and fairly simple way to take into account major aspects of the business to deliver a bigger picture. It is also important especially for banks seeking to encourage a culture focused on “excellence,” as opposed to one where the only measures that are taken into account are financial targets.

THE EVOLUTION OF PERFORMANCE MANAGEMENT

Even when a company has the best people and its strategy is sound, it can still falter. Often it may come down to just one single factor that makes the difference—execution of strategy. Even competent and talented CEOs who fail to get things done can stumble in this regard. According to a widely cited study published in Fortune, in an estimated 70 percent of the cases where a CEO failed, it was caused by poor execution.(1) This book has covered many strategy-related concepts and themes that are important in creating a culture of excellence. But to get there, real hands-on tasks must be accomplished.

In companies with a simple organisation, especially smaller companies run by the founder, those at the top of the executive chain stay in close touch with most of the business through direct contacts with employees and customers. As an organisation grows, this type of control becomes more difficult. Many methods may be introduced in an attempt to regain the intuitive interaction that formed the basis of oversight when the company was smaller and simpler. Any business prepared to collect enough information can deliver just about every imaginable parameter in real time to the CEO or other decision makers. But as the financial crisis of 2008 proved, monitoring data is not the same as actually managing performance to achieve sustainable growth.

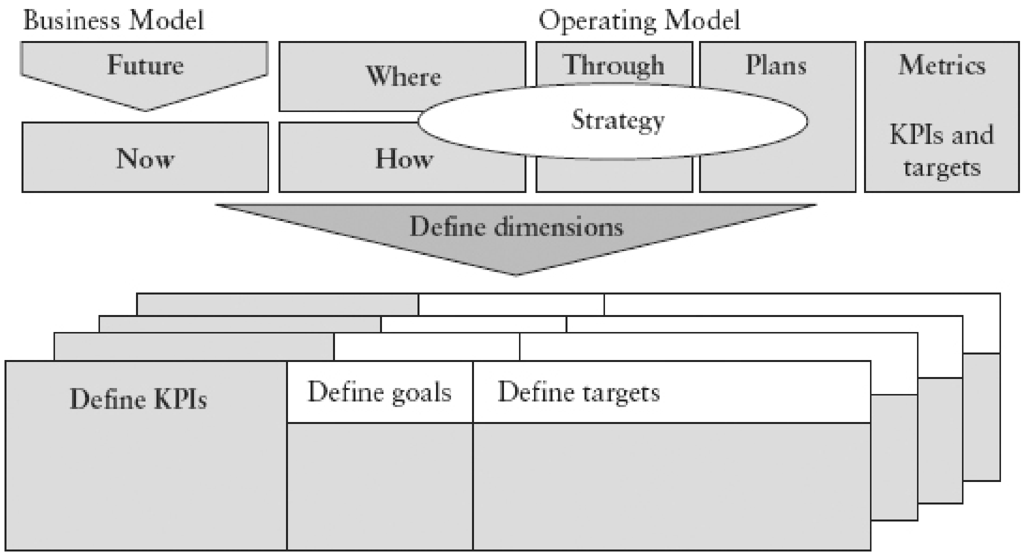
FROM MODELS TO STRATEGY TO METRICS

Performance management originated in industrial manufacturing. But as larger companies grew more prevalent, metrics have been adapted to suit service providers, including banks. For financial firms, the business model should define what a bank does to generate revenues through its client value proposition. This takes into account the products and services for which the customer pays. Success is defined by the extent to which the customer’s needs are met. According to this view, the operating model is a separate and distinct set of measures applied to functions needed to support, control, and manage delivery of products and services that comprise the customer value proposition. These measures define how the bank creates value for its stakeholders.

It will be the strategy that determines how the business operations and processes are carried out. The performance management system, however, provides the vital link between the strategy as it is envisioned and how it is implemented in the real world. The process to set up an effective system begins with defining the performance to be assessed and determining which aspects here are most relevant. For each it is then important to choose what will be measured. It is now time to close the circle and return to the first chapter of this book. The chart that follows is similar to the one presented in Chapter 1, “A Framework for Excellence in Private Banking.” This time, however, the key performance indicators, specific goals, and targets are added, as shown in Figure 12.1.

FIGURE 12.1 From Strategic Planning to Performance Management

Source: Author

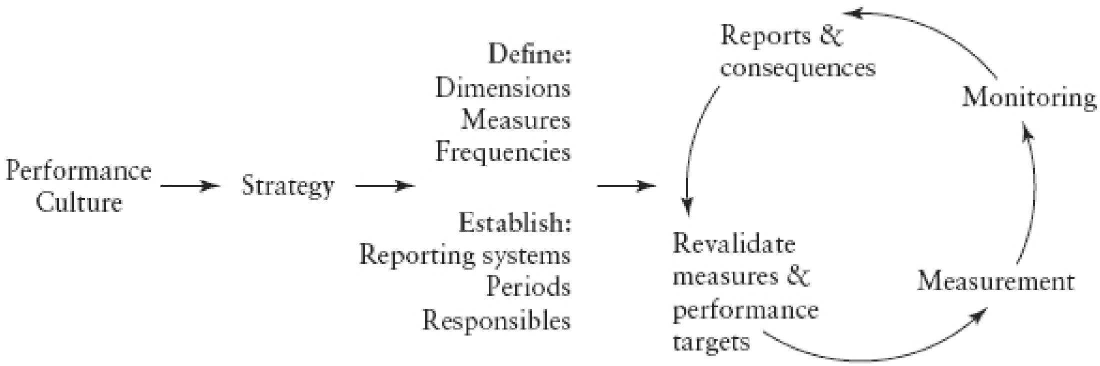


THE PERFORMANCE CYCLE

The performance cycle is a process designed to allow a company to improve the offering to the customer or client as well as its own earnings. Figure 12.2 shows a type of performance cycle. The first step is to define the main perimeters essential to the measurements, as well as the precise things to be measured. In addition, the frequency must be determined—in other words, how often are measurements to be taken? Systems to gather and report data are needed. Responsibilities must be assigned for judging different parts of the process. Once these initial steps have been completed, the cycle becomes self-perpetuating. Conclusions can be drawn and actions taken at an appropriate point. These might include readjusting the measures and performance targets or revalidating them, providing they are still appropriate. Then the necessary changes can be introduced in terms of either the people involved or the processes themselves.

FIGURE 12.2 The Performance Cycle

Source: Author



The annual budgeting process is an example of a performance cycle. It tends to be fairly ineffective as a performance management tool. Too often companies' budget processes are dominated by factors that go beyond financial figures. Furthermore, relying on a budget alone means that performance management is focused solely on financials, when in fact other dimensions are needed. In addition, the annual budget and the annual financial report take into account only past performance. Performance management, however, requires timely data that will allow a company to intervene preemptively. The best that can be achieved is gathering as much relevant information as possible about the current situation. This means choosing categories that can be monitored in real time, or at least on a weekly basis, in addition to those that should be monitored monthly or at least quarterly.

DIMENSIONS OF PERFORMANCE MANAGEMENT

The importance of assessing performance on many different levels was highlighted in a 1992 study by Harvard professor Robert Kaplan and technology consultant David Norton.(2) Their approach was based on a year-long research project involving 12 companies considered at the time to be on the leading edge of performance measurement. According to their results, information needed to make a complete assessment of a business goes beyond financial measures. It also requires those considered predictive, such as customer satisfaction. They advocated assigning equal weights to different aspects of performance measurement, thus creating the idea of a "balanced" scorecard. The approach can be compared to instruments in an airplane cockpit. Each offers a separate set of information. All readings are essential and require constant monitoring. Companies pay attention to all types of information. Kaplan and Norton advocated using four main "dimensions": customers; internal perspective; innovation; and how, on the outside, shareholders perceive the company. Financial data are just part of the picture. These can provide an historical perspective on performance, but other factors are needed.

Which diagnostic tools are needed to make a valid assessment? In 1995, American economist Peter F. Drucker published a paper entitled "The Information Executives Truly Need."(3) His study highlighted the fact that advances in technology are forcing companies to see their businesses in a new light. Drucker, who had witnessed firsthand the rise of global industry in the first half of the 20th century as well as the advances in technology in the 1980s and 1990s, challenged the idea that big companies were truly "profitable" even though, based on conventional accounting methods, they appeared to be. He advocated moving from traditional cost accounting to activity-based accounting, which includes the cost of all resources—including the cost of capital—to determine whether or not a business creates wealth. Gaining a clear understanding of profitability requires questioning not just the cost of processes but the notion that all processes are as efficient as possible. It may involve deciding whether all the processes are even necessary. This is especially key for service industries, including banking, where it is hard to separate different strands of "production." Thinking along such lines forces these companies to see that ultimately there is just one activity at the centre of costs and results—serving the customer. It is the yield per customer that determines the true profitability of the business.

Drucker further advocated managing by objectives—allowing leaders and subordinates to agree on goals and then letting subordinates figure out how best to achieve them. His management by objectives (MBO) approach is viewed as the antithesis to "management by control." To achieve it businesses need to employ a variety of indicators to gain a full picture and to set targets. This should allow them to create genuine value. The four diagnostic tools outlined by Drucker are as follows:

1. Foundation information
The tools most often used in this category are the standard figures, including cash flow and liquidity projections. For manufacturers, these may include inventories versus sales, earnings versus cost of servicing debt, receivables outstanding versus sales, and so forth. If these fall within a normal range, they can offer little new information. If they fall outside of that range, this indicates a problem that must be identified and treated.
2. Productivity information
Productivity measures traditionally were used in output where physical manufacturing was involved. But increasingly these are being applied to knowledge and services. By identifying the value added over all costs, it is possible to determine whether a product or service truly adds value. This information can identify the areas that have high productivity and usually a correspondingly high value. Another tool is benchmarking against the best in the industry. Such approaches can be used to pinpoint where action might be needed.*
3. Competence information
It is important to identify a company's core competencies. One way to do this is by recognising as early as possible both successes and failures. One aspect considered critical is innovation. Some method is needed to track innovations over a given period and to understand which opportunities were missed and why. Success shows what the market wants and will pay for. Lack of success can be viewed as a first indication that the market is changing or that the company's competencies are out of line.
4. Resource-allocation information
Managing resources, meaning capital and people, requires collecting readily available information. In terms of capital this includes figuring out, for example, return on investment. What is often overlooked, however, is the risk to the company if the proposed investment fails to produce the expected results or alternatively, if the investment is more successful than anticipated. Then the company must consider whether it has the resources to finance increased demand. In terms of people (human resources), the considerations are even more crucial.

DEFINING THE METRICS

Having defined the dimensions to be considered when evaluating performance, the next task is to select the performance measures or metrics. The challenge is to find manageable sets of measures appropriate to each task.

Measurement and Monitoring, Reports and Consequences

When designing the measuring and reporting system, it is important to define who is responsible for reporting, what form the reports should take, how often the reports are made, and the level of detail required.

Measuring and monitoring are routine steps in any performance cycle. During this process, teams or individuals receive early warning signals or get interim encouragement. This information can be presented along with an assessment of the probability of meeting specific targets.

The goal of performance management should be to direct behaviour to ensure the implementation of the strategy. Implementing strategies always involves a process of change within an organisation. Experts on change management typically agree that human behaviour is hard to alter unless consequences are involved. Based on that, risk of failure must be made clear and the right behaviour acknowledged and rewarded.

Alongside monitoring individual performance, an effective system to manage performance requires reporting at predefined intervals, accompanied by regular appraisal and discussion of necessary actions. Normally there are predetermined ranges considered acceptable for each measure.

The Role of Benchmarks

Benchmarking is the process of identifying best practices and top performers and using them as a reference for company or individual performance. Benchmarking offers a quick and easy way to assess performance and identify areas of strengths and weaknesses. It can be applied to competitors or peers.

There is a danger if a company becomes preoccupied with competition. A company fixated on rivals might fail to recognize opportunities beyond its day-to-day businesses. One way to resolve this is to make competition effectively irrelevant. In the book Blue Ocean Strategy by W. Chan Kim and Renée Mauborgne, the authors advocate looking for opportunities beyond the turbulent “red” waters where competitors, like sharks, feed on smaller prey. Instead, they advise companies to seek out “blue oceans” where competition is minimal or nonexistent.(4)

PRIVATE BANKING AND PERFORMANCE MEASUREMENT

As mentioned at the start of this chapter, it is not enough to simply look at the financial metrics of an organisation when measuring performance. By the time these pieces of information show meaningful developments it is often too late to react to trends and developments. This is true for private banks as well. Problems are likely to show up first in areas such as client satisfaction, innovation achieved, and so on before they are ever reflected in the financial figures.

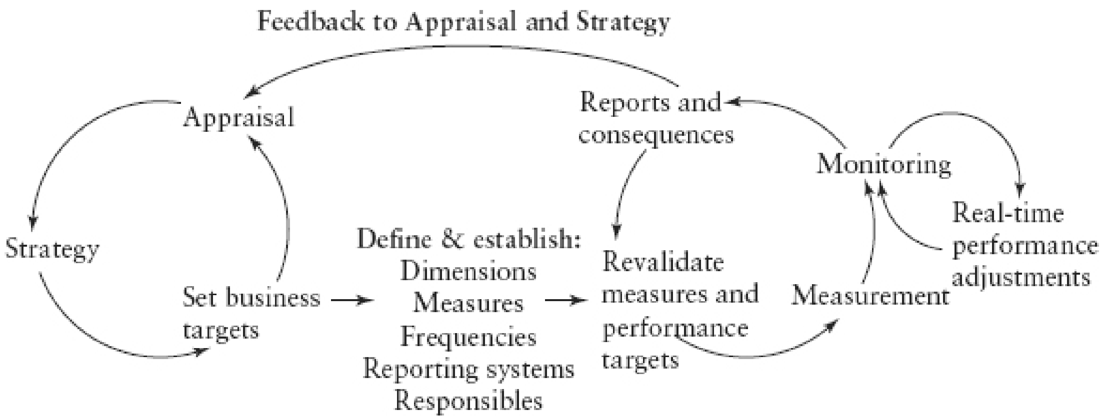
In private banking, where employee compensation constitutes 70 percent of the cost base, business performance depends largely on the performance of individuals. Managing performance can thus be viewed to a large degree as managing the performance of individuals. Improving performance takes time. During weak market phases especially, it is very hard to increase income, so much of the emphasis is placed on lowering operating expenses. Assessing individual performance also depends in part on what role the individual plays. For example, a team head needs to ensure the success of relationship managers through coaching and mentoring. Accordingly, his or her performance measures should emphasise these aspects of learning and growth or related internal processes. A relationship manager’s performance should be measured by client satisfaction, which may be a factor in increasing net new money or increasing the profitability of those assets already managed. There are two ways to measure whether targets are being met, based on discretionary or non-discretionary factors. Discretionary performance measurements are based on subjective assessments. Non-discretionary performance mostly is expressed in numbers derived from clear formulas or figures that are directly related to a business process. In private banking, this latter measure often includes net new money or assets under management.

In private banking, a key indicator used to evaluate the performance of a relationship manager is net new money, expressed as a percentage of current assets under management. The ratio of new money to existing money makes it clear whether the relationship manager is struggling with acquisitions, losing business, or bringing in new business. In terms of accounts, it is more effective for a team head to look at how many accounts have been opened and closed, or net new money, rather than looking only at assets under management in order to gain more insight regarding future trends in this area. Fluctuations in assets under management, at least in the short run, are more likely to be related to market performance than the performance of the bank. Yet even here, a single metric tells only part of the story. A holistic approach is required. Using the balanced scorecard already described in this chapter makes sense. It can be viewed as a tree; clients and financials might be compared to the foliage and fruit, which flourish only when the soil (innovation and competencies of employees), as well as the trunk and root system (processes) are healthy.

When put into practice in private banking, the feedback loop shown in Figure 12.3 must link performance of an individual relationship manager or division to the overall strategy. If a relationship manager completely fails to reach the defined targets, the organisation should consider that person's individual situation and should appraise the way the business case was evaluated and what assumptions were made about the market. Were the indicators used during the recruitment process disregarded? What specific market (i.e., geographic region and whether it is a growth market or a consolidating market), or client segment is the relationship manager targeting? Are the difficulties encountered a sign of some larger and more problematic trend ahead? These questions can provide important insights. Used actively, they might even encourage learning and growth across the entire organisation. For example, if a department is not achieving its referral targets or is not ranking high in terms of what is called in the business "market purity,"* a bank might need to reconsider the underlying assumptions about synergies rather than simply try to remedy the problem by putting pressure on the teams involved.

FIGURE 12.3 Feedback Loop Linking Performance Cycle to Strategy

Source: Author



Rewards must be included in the performance cycle. The widespread focus on compensation in the financial industry and regulatory recommendations, including those in Switzerland, could place limits on the scope of discretionary performance-related compensation allowed. But positive incentives provide a foundation for outstanding performance. Nonfinancial incentives, such as those discussed in Chapter 10, "Winning the War for Talent," may play a major role here as well. There are several ways for nonfinancial incentives to be used to drive performance. For example, relationship managers who achieve an outstanding performance can be singled out and invited to speak at events or during training to share tips and offer examples of best practice. This also caters to higher-level human needs.

With regard to the overall business of private banking, based on the categories described, the most important questions to gain a clear view of performance might be some of the following:

1. Learning and growth
Are innovation and creativity encouraged? Or is cultural inertia hindering change? Are people asking questions and developing new skills and capabilities? What is the state of the company knowledge base and document management? What kind of new talent is the company hiring?
2. Internal business processes
Where can the operating model be improved to cut costs and increase margins? Where can processes be improved to increase efficiency? Can information be made more transparent? Can paperwork be reduced? Where are efforts being duplicated because of lack of internal communication?
3. Clients
Is the brand adequately differentiated through client experience? What do clients say about the service and products? How do they feel about information and service access? Are client referrals increasing or decreasing? What is the product penetration in different client segments? What is the net promoter score of a team or individual relationship manager?*
4. Financials

This category covers all the standard financial information, along with questions about how the bank is perceived by investors and analysts. What resources will it have available for a new strategy? What products or services have been successful in the market? Is the current strategy successful? Did the relationship manager deliver the promised business case?** Did an investment in a particular market pay off? Should a product be discontinued? How are regulatory changes affecting the cost base?

Applied to internal "competitors" or peers, benchmarking can be useful in setting a bar based on the performance of the top relationship managers, using them as a standard by which to measure others in the team or division. The advantage of this approach is that comparisons can be made based on a level playing field; each relationship manager is operating in the same environment with the same products and services and support systems. The remaining variables are each individual relationship manager's target segment, personal network, and, finally, personal performance.

Another area pertains to products. Some banks fix sales targets for in-house products. Sales of such products by relationship managers are then tracked. At best, this is a questionable practice. It contradicts the core value proposition of offering clients uniquely tailored custom solutions. When sales figures tied to specific products are used as performance measures, a conflict of interest can arise between the short-term goal of selling more products and the desire to achieve long-term client satisfaction. It is in the best long-term interest of a private bank, where fully two-thirds of the revenue is derived from assets under management, to avoid angering clients. As long as assets remain stable, they can serve as a good forecaster. So the challenge is not what is to be done, but what should not be done. The first rule is thus to not annoy or disappoint the client. In that sense, performance management might be viewed in a different light. Aggressive sales tactics that in theory might momentarily bolster revenues will, in the long run, unsettle clients, especially if the product performance disappoints. This will do more harm than good.

For a private bank, it is relatively easy to identify the relevant key performance indicators and the factors driving them. Private banks face a major challenge during periods when markets suffer shocks and setbacks, leading clients to be more conservative and retreat to defensive cash positions. It is extremely important in such periods to ensure that the bank is running lean and efficient operations, especially in service and support functions. Beyond that, banks need to focus on better risk management and compliance throughout the entire business. It becomes even more important to monitor signals so as to position the business to be responsive to changes in markets, the competitive landscape, and client needs.

To summarise, it is vital for measurements to be centred around realistic goals based on a concrete strategy. It is essential to have sound information upon which to base a strategy. International businesses plans, for example, need to be based on in-depth local know-how, as opposed to the global wealth reports of consulting firms. And especially in private banking, the industry should not dogmatically adhere to a two-year break-even period. Private banks operate in an industry characterised by long-term developments. Those in the business must have the courage to be honest. That includes being able to say when an investment will likely need a longer period to break even. It is also important to realise that forward-looking indicators are very important. If only "hard" financial metrics are used, such as assets under management, by the time these detect that something is amiss in terms of net new money flows, it is already late in the game and the brand will come under pressure. It is far better to address problems before they reach this stage.

EXAMPLES OF MONITORING AT BANK JULIUS BAER

Performance self-assessment: Julius Baer uses a global management information system. Each relationship manager has a customised application that allows him or her to see the key performance indicators deemed relevant to that person's job. The information is updated at regular intervals. For example, net new money flows are updated weekly, as is transaction income. Costs, return on assets, and cost/income ratios are updated monthly. The bank can also track internal process dimensions (i.e., financial results, learning, clients, or internal processes) or productivity. It can display the number of new discretionary mandates or mandate switches (money flows from one mandate type to another). With regard to risk, it has been incorporating risk figures. Various types of risk exposure are monitored on a monthly basis.

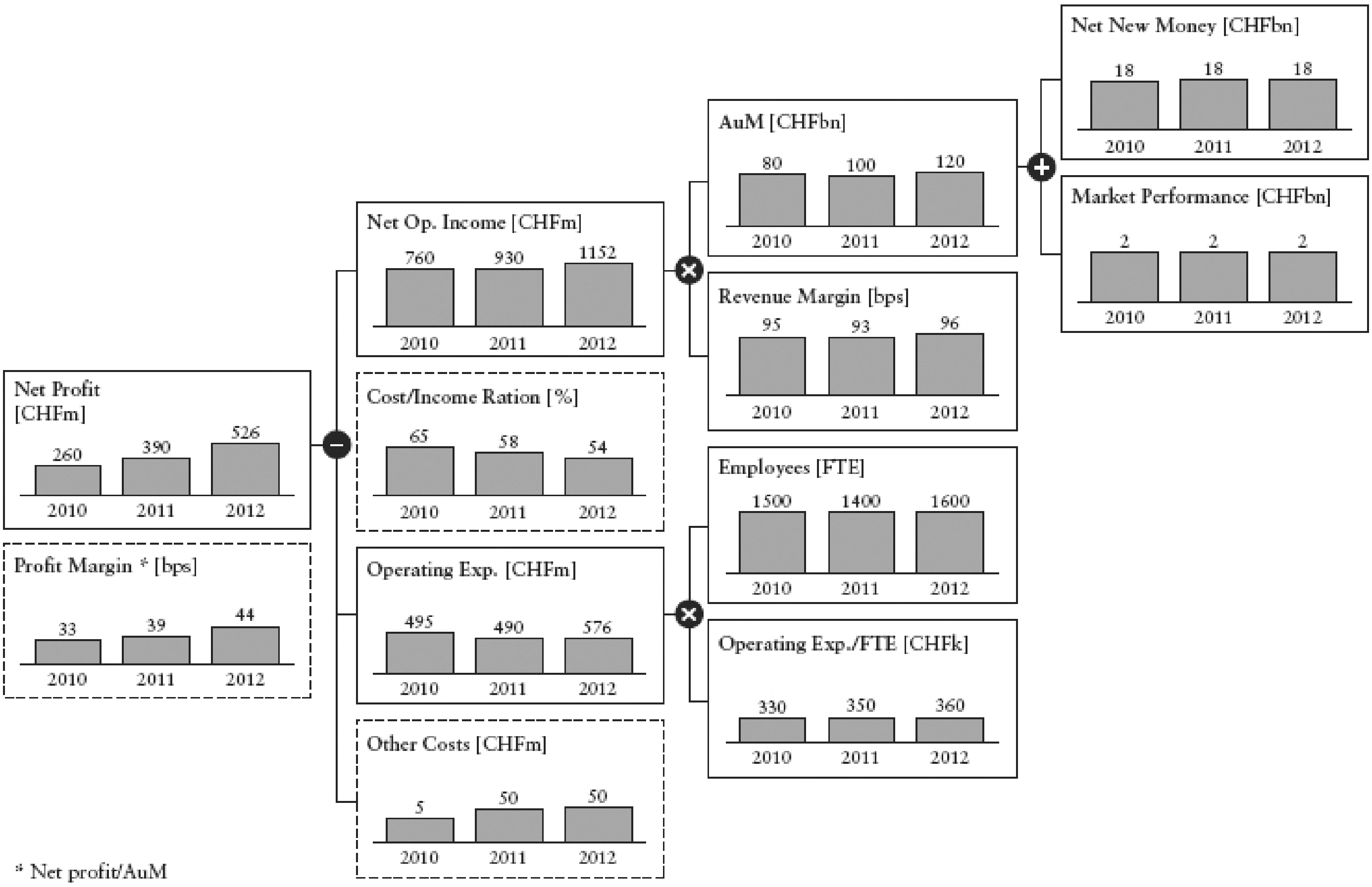
Product performance: At Bank Julius Baer, the success of internal products is tracked in the management information system in order to evaluate the sales performance of each product, but specific product sales targets are never set for divisions, teams, or relationship managers. This is done to allow for an objective focus that aims to serve clients' genuine needs.

CHOOSING WHAT TO MEASURE

In private banking, net new money, assets under management, and return on assets are the key performance measures. Figure 12.4 provides a schematic overview of the interdependencies among private banking's key measures.

FIGURE 12.4 Key Performance Measures of a Private Bank

Source: Author



Looking at net new money one can say that it satisfies the criteria of being meaningful, reliable, and distortion-resistant and reflects the quality of service. It is meaningful because it translates directly into growth in revenues. It is reliable because there is no measurement error or uncertainty. It resists distortion because inflows and outflows are both taken into account. It is responsive, meaning that when the relationship manager does a proper job of taking care of clients and their assets, net new money is likely to increase either directly through an increased share of the individual client's assets or indirectly through referrals. By contrast, poor service and bad advice will result in outflows or negative net new money.

Assets under management as a metric is a direct driver of revenue. It is less suited, however, for use as a key performance indicator. While assets under management are meaningful in the sense that revenues are linked to this measure, they are far from a reliable measure of relationship manager performance. Profitability or return on assets (RoA) is more strongly linked to the asset mix and the performance of financial markets. Depending on the asset mix, the profitability of assets under management may be more reflective of the market than the performance of an individual relationship manager. Equity funds, for example, offer significant higher margins than money market funds.

Even though margins are relatively unresponsive measures and are usually fairly static, it is important to track them in relation to net new money. One reason is that this can prevent relationship managers from seeking to gain net new money at all costs. The relationship manager can grant special conditions to attract new money. Discounts and special terms are sometimes used to tempt new clients to enter the relationship. The bank needs to be careful that this is not done at the expense of profitability.

BALANCED SCORE CARD: SOFT MEASURES IN PRIVATE BANKING

The “soft” measures applied in the balanced scorecard system outlined in this chapter depend very much on the function of the employee or division. For a relationship manager, the measures most heavily weighted would be those pertaining to financial and client “dimensions.” As long as these measures are on target, there is little need for intervention. If there are problems meeting targets, however, the team leader may look for other ways to spot potential problems or to identify possible solutions. Such information might serve as an early warning signal. For each specific area, four items can be examined in detail:

1. Learning and growth
This category might include how frequently the relationship manager makes use of technology in the form of, for example, “dashboards” or “cockpit information systems.” These provide a broad overview of critical information; whether or not the individual accepts these technologies and takes advantage of them, they can yield highly valuable information. Low use may, for example, indicate problems with the systems. It can also point to the potential in the future for possible efficiency gains if more use is made of them by individuals in the bank. There also should be an effort to ensure an adequate number of internal training modules completed or chartered financial analyst certifications to ensure a level of staff competency throughout the organisation.
2. Internal business processes
There should be both qualitative and quantitative measures for processes. In Chapter 9, “Understanding Service Excellence,” the SERVQUAL system and the gap methods are described as effective ways to measure service quality. How close does a particular service come to matching best-in-class benchmarks or ideals? Such measurement techniques also can be applied to assess division and individual performance. Here the speed and accuracy of transaction processing or account openings or the number of unsettled trades are quantitative performance measures useful for the employees involved in such processes.
3. Clients
This measure might take into account referral rates or client satisfaction in terms of an individual relationship manager or team. For example, one bank rated clients based on their satisfaction on a scale from 1 to 10. Focusing on the two extremes at the negative and positive ends of the scale, taking into account “detractors” (1–2) and “promoters” (9–10), the bank calculated a “net promoter score” derived by subtracting the number of detractors from the number of promoters. Neutral clients (3–8) were ignored, as they were felt to have less impact on referrals or brand reputation. Most relationship managers had a net promoter score of around +30. But in one case a relationship manager scored −60. The problem turned out to be a result of a sector mismatch; the relationship manager came from the food industry and was now working with steel industry clients. After being allocated to a different sector that person’s net promoter score improved to a level more in line with peers. Other measures of client-related performance would be client calls per day, client meetings or interactions per month, and the like. But these measures are mainly relevant from a coaching or training point of view and are not relevant indicators of performance per se.
4. Financial performance
Financial performance is the most visible key performance indicator. Not only management but the financial community, including analysts, journalists, and regulators, follow financial performance indicators such as assets under management (AuM), net new money (NNM), or the cost–income ratio (CIR).

For a detailed overview of the key measures that might be applied to private banking, please refer to the Appendix at the end of the chapter.

CONCLUSION

A private bank needs to be run according to targets. If there are no targets, it is impossible to measure achievements, deviations from targets, or performance as a whole. Quantitative targets as well as qualitative targets are necessary. The job of a CEO is to ensure that the company is going in the right direction. This is accomplished by continual monitoring and by keeping in close contact with staff. Once the direction is set and clearly communicated, employees need to be empowered to reach the goals and targets set. Resources are critical to delivery. Employees also require encouragement, controls need to be established and monitored, performance must be measured, and there must be compensation and rewards tied to these measures.

Assessing the right measures requires a clear focus on strategy, which needs to be simple and concise and expressed consistently to provide a meaningful basis. Companies must be honest and realistic in setting targets, avoiding traps such as failing to realise the difference between a mission statement and a strategy. The former is more general whereas the latter can be measured and evaluated in terms of achieving precise goals. It is important to base targets on realistic assessments (e.g., market share) that are truly attainable. This avoids internal wrangling when it comes to making forecasts used to set goals.

Performance management has been around for decades. It is only recently with the introduction of modern technology that it has become a highly technical discipline, allowing companies to gather information about past performance and to use this information to help predict success or failure. It has evolved into an effective tool that can spotlight problems at an early stage. Rather than serving as a dull counterpoint to the "real" business of a company, performance management has become an integral part of all phases of a business. This is true in service companies including banks, which in the past typically had a hard time measuring the true costs involved in their business.

In banking there are no items being produced on an assembly line. All areas of the company are aligned toward one goal: serving the customer. Each client will determine the yield on investment. For banks, the way forward must be to achieve the maximum sustainable profitability in this regard. Sustainability is understood, therefore, as engaging in those activities that offer the most benefit and value to each individual client.

NOTES

1. Charan, R. and Colvin, G. 1999. "Why CEOs Fail." Fortune. 21 June.

2. Kaplan, R.S. and Norton D.P. 1992. "The Balanced Scorecard." Harvard Business Review, Jan/Feb.

3. Drucker, P.F. 1995. "The Information Executives Truly Need." Harvard Business Review, Jan/Feb.

4. Kim, W.C. and Mauborgne, R. 2005. Blue Ocean Strategy, Harvard Business School Press.

*In private banking, such an approach can be used to identify current problems and future potential. A bank is interested in the productivity or profitability of individual relationship managers, as well as in teams and divisions in relation to the full costs that they incur.

*Market purity refers to the strictness of segmentation. Low market purity exists when, for example, the Latin American team is also handling many clients from Germany or when the retail division in an universal bank does not refer its HNWIs to the private banking unit.

*The 'net promoter' score is calculated by subtracting the number of satisfied clients from the dissatisfied ones.

**In private banking, a relationship manager will present a "business case"—literally, this takes into account items such as the client's assets that the manager believes that he or she can deliver within a given time period, and so forth.

APPENDIX: KEY PERFORMANCE INDICATORS

Key performance indicators in private banking are in one sense no different from those used in any other industry. The central measures are the level of client assets under management and especially flows of new client money (net new money). But a holistic approach is needed. For each of the main categories—financial/risk, learning/growth, clients, internal processes—these aspects must be included in measuring how successful the bank is in meeting targets. A balanced scorecard, as outlined by Kaplan and Norton, can thus be applied to private banking using Drucker's diagnostic tools.

Tables 12.1–12.4 offer a breakdown of the main variables to be tracked when it comes to performance, both for the business as a whole and for individual relationship managers. It is important to identify both the variables that are tracked and their frequency to assign a benchmark and add quantitative comments where needed:

TABLE 12.1 Variables to Be Used to Track Education and Growth

Source: Author

Financial				
KPI	**Monitoring Frequency**	**Benchmark**	**Target Range**	**Comments**
Foundation				
Cash flow	Weekly			
Assets under management	Monthly			
Productivity				
Net new money	Weekly			
Profit margin	Weekly			
Return on assets	Monthly			
Cost/income ratio	Monthly			
Competence				
Pipeline net new money	Monthly			
Resource Allocation				
Assets under management by mandate type	Monthly			
Assets under management by relationship manager	Monthly			
Assets under management by portfolio manager	Monthly			
Assets under management by investment advisor	Monthly			

TABLE 12.2 Variables to Be Used to Track Internal Processes

Source: Author

Learning and Growth				
KPI	**Monitoring Frequency**	**Benchmark**	**Target Range**	**Comments**
Foundational				
Number of training courses	Yearly			
Online training modules	Yearly			
Productivity				
Employee suggestions	Monthly			
Number of clients by RM	Monthly			
Number of discretionary mandates per portfolio manager	Monthly			
Number of investment advisory mandates per investment advisory	Monthly			
Number of new products launched	Yearly			
Competence				
Number of CFAs	Yearly			
Influx – number of new RMs	Yearly			
Number of articles in magazines	Yearly			
Resource Allocation				
Educational cost per employee	Yearly			
Educational cost/ total cost	Yearly			

TABLE 12.3 Variables to Be Used to Track Clients

Source: Author

Clients				
KPI	**Monitoring Frequency**	**Benchmark**	**Target Range**	**Comments**
Foundation				
Client experience	Yearly			
Client satisfaction	Yearly			
Productivity				
Number of clients	Monthly			
Pipeline clients	Monthly			
Pipeline net new money	Monthly			
Competence				
Percentage of fully completed client profiles	Monthly			
Percentage of clients with a risk profile	Monthly			
Percentage of clients with complete documentation	Monthly			
Number of client complaints	Monthly			
Resource Allocation				
Number and assets under management of self-directed clients	Monthly			
Number and assets under management of discretionary mandates	Monthly			
Number and assets under management of investment advisory mandates	Monthly			

TABLE 12.4 Variables to Be Used to Track Financial Performance

Source: Author

Internal Processes				
KPI	**Monitoring Frequency**	**Benchmark**	**Target Range**	**Comments**
Foundational				
Percentage of business units with documented processes	Yearly			
Productivity				
Number of process improvements	Yearly			
Time needed to open an account	Yearly			
Number of client accounts per back-office employee	Yearly			
Number of transactions per mid-office employee	Quarterly			
Percentage of straight through processing	Yearly			
Competence				
Number of employees with a process competence certification	Yearly			
Percentage of employees who read the process handbook	Yearly			
Resource Allocation				
Number of employees involved in key processes	Quarterly			

About the Author

Boris F.J. Collardi has been Chief Executive Officer of Bank Julius Baer & Co. Ltd. since May 1, 2009 and since October 1, 2009 also of Julius Baer Group Ltd. He joined Bank Julius Baer as Chief Operating Officer at the beginning of 2006, following Julius Baer's acquisition of three private banks and GAM at the end of 2005. Boris Collardi played a decisive role in the swift and successful integration of these banks and the subsequent positioning of Bank Julius Baer as one of the premier addresses in global wealth management. Prior to that, he gained extensive leadership experience in various functions during his 12 years at Credit Suisse, both in Europe and Asia, including the positions of Global Chief Financial Officer and Chief Operating Officer EMEA of Credit Suisse Private Banking.

Boris Collardi, who is fluent in French, English, Italian, and German, is a frequent seminar speaker, a sought after interviewee and panelist, and a regular WEF participant. Among other awards received, he's been named No. 1 CEO in the Extel 2011 Pan-European Awards (Awards for Excellence) assigned by Thomson Reuters and No. 1 "rising star" among European private bankers under the age of 40 by Wealth Bulletin in 2008. Since 2008 Mr. Collardi sits on the Advisory Board of Lee Kong Chiang School of Business at Singapore Management University.

A Swiss and Italian citizen, Boris Collardi completed schooling in Nyon, Switzerland and furthered his education by attending various programmes including an executive programme at Lausanne's prestigious IMD business school.

He is married, and lives in one of the quieter villages near Lake Zurich.

Boris Collardi strongly believes in the benefits of sharing knowledge and experience. This is his first book.

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