Why the wealth industry needs to urgently reinvent itself

Wealth management institutions need to shift from a focus on volume and custody of third-party financial assets towards being true value providers, says Ray Soudah of MilleniumAssociates AG.

The wealth management industry is in crisis mode, according to Ray Soudah, founding chairman and chief executive officer of MilleniumAssociates AG, the Swiss and international M&A and corporate finance organisation.

Local, regional and global providers of "wealth management services" – including firms such as private independent asset managers, private banks, national banks and the like – appear desperate to increase their AUM.

Plus, they want to outsource their operating costs in order to improve their efficiency ratios and profitability.

Meanwhile, adds Soudah, clients seem resigned and destined to face the uncertainties and risks of the financial markets, despite entrusting their hard-earned monies to their service providers with the original, but now the proven and undeliverable, intention to shield against the daily onslaught of risks.

"This crisis is evidenced by majority of firms acknowledging their desire to grow by acquisition, cut costs, or even exit markets totally, a trend based on the consequence and negative impact of declining revenues and declining margins," explains Soudah.

The current focus seems to be primarily on attempts to improve or preserve the profitability of the institutions rather than the search for service improvements and client wealth protection that is supposed to be the core purpose of the industry.

"The industry has an efficiency ratio of between 75% and 95%, leaving little cushion for declining revenues," he says.

Ironically, Soudah says one of the causes of increased volatility in the markets is the continuous withdrawal by the larger service providers from market making and investment banking services in favour of the more theoretically-stable

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wealth management business. "In reality, the withdrawal of market making has indirectly increased volatility and thus earnings power in the very segments these investment-banking retrenchments were intended to protect," he explains. "It's a zero sum game."

What is future, then, for the wealth industry? More of the same in terms of growth by acquisition and cost-cutting, leaving clients' wealth preservation at the mercy of the volatile markets and thereby becoming mere operating custodians rather than managers of wealth?

Or is there a better way with primary focus on the client?

HISTORY IS NO PLAN FOR THE FUTURE

The majority of service providers are desperate to increase their profitability, at any cost.

"This is evidenced in their search for acquisitions, their desire to outsource costs and their exiting unprofitable divisions or regions," explains Soudah. "Focus is on profit preservation and growth for the service providers irrespective of the consequences."

Yet he adds that this flawed and short-sighted approach puts the service providers' profitability first rather than the concern for clients, who are essentially still financing the survival of the industry. "The client must be put first if the service providers are to retain loyalty and survive in the longer term," says Soudah. "But how?"

CHALLENGES AHEAD

Among the numerous challenges the industry faces are the perceptions of its own shareholders that it is a safe and profitable sector with low capital needs.

Nothing could be further from the truth, says Soudah. "Costs are rising despite the ongoing cost purges and profitability is likely to continue to decline in the years ahead unless drastic changes are made and the client is put at the centre."

Clients generally pay fees no matter the outcome; this is a good but short-sighted model. Plus, he adds, it is not balanced and in the end induces client distaste and search for alternatives.

"Many clients whose wealth is hardly preserved let alone grown adequately are finding that investing their resources in tangible businesses is much more rewarding compared with watching their wealth decline whilst paying for the privilege," he explains.

These challenges are hard to quantify as they occur over time and in small increments, but they accumulate and are profound in their inevitability and core reasoning.

But traditional management is failing to recognise and act upon this issue.

The biggest challenge he therefore sees, is to recognise the need to be client-centric as a fundamental objective and then work towards this long-term goal rather than remaining firm centric.

POSSIBLE SOLUTIONS AND STRATEGIES

Like the low-cost airline industry and certain segments of financial services, de-novo enterprises can shed the legacy and start again.

"One of the biggest problems for the wealth industry is its flawed belief that the recurring high salaries and bonuses are justified and necessary to preserve and grow the wealth," says Soudah.

However, there is no fresh evidence of this at all, and client performance is not linked to ongoing costs, especially personnel costs, he adds. "The industry is conflicted by nature and design."

He says that one option would be a totally new business model of a low-cost but safe service provider.

"Superior or inferior fund performances have rarely been linked to higher fees," says Soudah.

"One could consider a parallel organisation being set up to attract new and old funds under management with the scientifically hedged purpose of protecting wealth and charging nominal fees. The clients will see their wealth protected and reward their providers with a reasonable margin for positive growth."

The courage needed for such an approach must be derived from a passion for the client and the longer-term retention of the client and in turn survival of the service provider, he adds.

Other possibilities include exiting wealth management and advisory totally and becoming a true custodian.

This means giving full discretion to the clients, with them having access to all instruments and asset classes with full responsibility for the outcome.

"This sort of brokerage approach will shield the providers from high cost and criticism for lacklustre performance," says Soudah.

These options have one thing in common: putting the client – not the service provider – at the centre.

"Long live the new wealth management industry," says Soudah. "Long live client power." ■