Revenues at Risk – Why Wealth Managers Must Rethink the Revenue Mix

Dr Silvio Struebi, Partner at Simon-Kucher & Partners, gave a fascinating presentation at the Asian Wealth Management Forum in Hong Kong, advising the audience that wealth management businesses in Asia should take an in-depth and impassionate look at their revenues to decide where their future lies. The 'big picture' tasks are to tailor pricing to client segments and their actual activity, while also striving to enhance recurring revenue streams.

THE DELICATE ART OF PRICING AND SALES PSYCHOLOGY in the world of private banking and wealth management is coming into greater focus due to increasing regulation, which is forcing these providers to find ways to ensure compliance in every aspect of their client interface and to shift from ad hoc, transactional revenues towards more predictable income streams.

The premise of Struebi's presentation was that the existing approach to pricing, monetisation, and discounts in the wealth management sector in Asia needs addressing more professionally, for sustainable growth and superior service.

However, the transition to advisory revenues is not an easy one. The struggle around pricing in the wealth management sector in Asia results from the continuing focus on transactional revenue as opposed to recurring revenue, which is proving more elusive than many had expected.

Transparency in the Asia region will be even more essential in the future, due in part to the demands of regulatory reform and inspections. The wealth management industry has remained too opaque for too long, but with increasing disclosure required for clients and due to compliance, it is gradually becoming an internal priority for all the players in this industry that they focus on and willingly embrace transparency.

Competition will also intensify, and accordingly the drive towards monetisation and value pricing will become more

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crucial, with innovations and smart pricing strategies proving central to protecting and predicting margins.

Struebi explained that his firm is a mid-sized consultancy with 1,300 people across the globe and one of its core business practices is helping banks with their pricing, monetisation, and sales challenges. "We are recognised as the world leader in pricing," he stated, "and today we will talk a bit about how to shift revenues from the heavy transactional business to mandates and other products and services."

Changing behaviour patterns

He observed that revenue margins have been declining over time in the region. "What is actually happening is that customer behaviour is changing," he reported. "Competition has intensified; there is huge regulatory pressure on fees and fee disclosure. Costs of salaries and IT infrastructure are rising, and the current financial market environment is not helpful either."

Accordingly, Struebi said that banks should think about pricing when times are good - when returns are high, revenues are stable, and pricing flexibility is greater - rather than waiting until transaction revenues decline, as it may be harder to increase prices.

Understanding what you have

In terms of the revenue mix for the private banks in Asia, he noted three key points. First, loans, deposits, and transaction fees account for the majority of revenues, followed by trailer fees and some recurring fees, such as mandates, custody, wealth planning, and so on.

Second, the revenues from the core value creation of the investment element are not enough to cover the costs. And thirdly, transaction fees or trailer fees are under pressure. It is very tough to raise fees on the discretionary side, so the banks will inevitably face a revenue gap in the future.

Future-focusing

"The interesting part in all this is how we can react," Struebi explained. "There are actually five key measures, but today we will only focus on a few of these."

The first is discount management, which Struebi remarked is a major problem for banks, as they do not handle this in a structured, professional manner. Second is cost allocation, in other words, working out objectively which clients are particularly expensive to service and how much they actually produce in revenue.

The third vital measure to consider is cross-selling, rather than growing the client base. "That will be a vital future area," he noted, "because you have to work with your existing assets, just going for new growth won't pay off. Why? Because 80 percent of the assets you have are already in your book." And the fourth priority is to transform the revenue mix.

Sizing up your clients

Taking the first of these, discount management, Struebi highlighted how there is generally no clear structure between client size and transaction size. The RMs very often decide how much discount they offer but it is not necessarily correlated to activity levels.

"We must, therefore, have transparency to know what kind of fees the bank is currently charging - many banks are often unaware," he reported. "So, what we suggest these banks come up with is a segmented approach to their clients, whereby they understand that they have different clients with different needs, and the behavioural aspect should also be factored in order to arrive at the recommended pricing."

An associated topic, Struebi elaborated, is what he calls pricing governance and monitoring. "You need policies and monitoring in place, as well as reporting and pricing software to arrive at full transparency regarding your clients and what kind of products they are using."

This approach, of course, helps RMs have more meaningful sales conversations, and with the vital element of front office support for price negotiations, the RM can become a far better price negotiator than he or she has traditionally been. "Banks," Struebi advised, "should invest more and really help and train the RMs to achieve a good client conversation about pricing."

Struebi turned to transparency on cost allocation. "This can help you identify the loss-making clients," he observed. "We typically find out that 70 percent of the clients are profitable, or more or less breakeven; some 20 percent of the client base account for almost 70 percent of the revenues - the old 80-20 rule - but the biggest challenge is that we find roughly one third of the clients are not generating enough revenue."

This third of the client base then becomes a priority, as they are the clients the bank must focus on, either to upsell them or cross-sell, or move them to a different service offering and at the same time to bring down the cost of serving them.

"You would be advised to have a software solution that supports you in this," he said, "as transparency via data and analytics are the future in the wealth management industry. Cost allocation has become a core factor in most of the industries, but unfortunately not yet in banking."

Transforming the product mix is also essential. Struebi recommended that banks empower client-facing bankers with greater knowledge.

"You need to follow the examples of other industries and analyse the customer segments, their needs, and their usage patterns and ultimately support the front line, so that the RM can really recommend the right products and achieve a better product mix," he advised. "Maybe you can also push out recommendations to clients, so that they see what types of services other clients have liked and that perhaps match their portfolio. This is closer to the style of approach we will see in wealth management in the coming years."

To grow the client base, the banks, therefore, need to price their clients based on the total relationship, the value they are giving back to the bank. "At this time," Struebi observed, "everything is pretty much product-based, but client-relationship-based pricing is the way forward."

Finally, Struebi highlighted that the value proposition and delivery methodology need addressing. "In the future, we think there will be a hybrid solution between technology and traditional personalised advice," he commented. "Clients sometimes want to talk to the RMs, but not always. They need choice, so we have to fill the gaps with entry-level mandates, so that clients get used to recurring services but also to recurring fees and so that they understand the value proposition."

Struebi closed his talk by mentioning a survey his firm conducted. "We found that the banks lack the 'wow factor'," he said. "For instance, when Apple innovates, it always highlights a new feature that drives customers' willingness to pay." The mission, he concluded, is to achieve better communication and marketing of the tangible value the banks are genuinely providing.