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The Battle for Wealth Management Hots Up

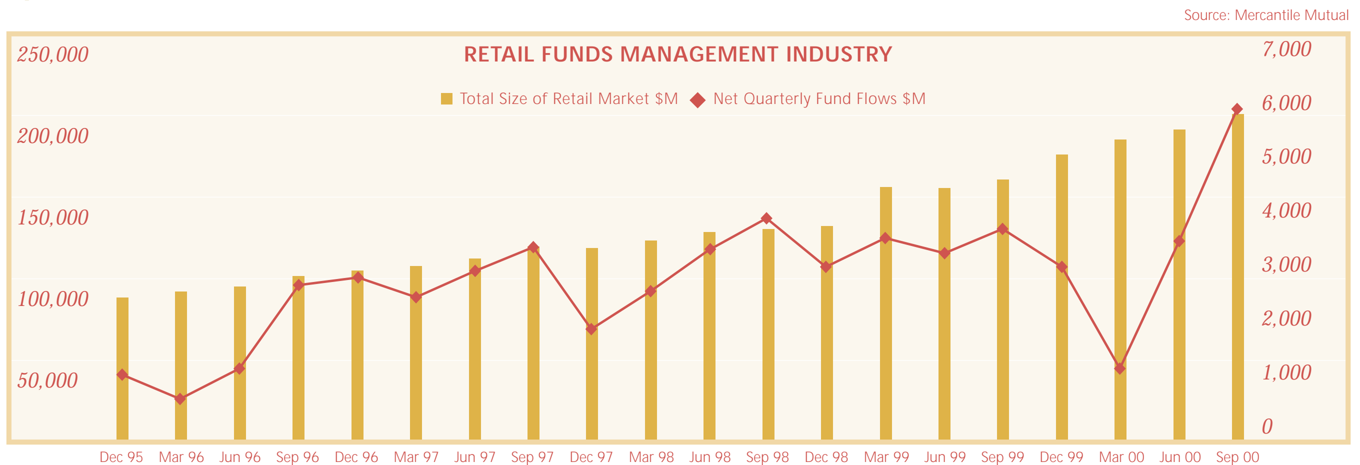
The concept of wealth management is evolving as a highly contested area for banks, insurance companies and other specialised providers as they fiercely compete in the managed funds industry.

The boom in the industry both locally and globally has been spurred by a number of factors, the most important of which has been compulsory superannuation and people's recognition that governments are not going to be able to provide for their future.

Banks and other specialised financial institutions have moved swiftly to capitalise on this business and are pushing an image as managers and creators of wealth, through both specialised products and advisory services.

They are using a range of strategies and are increasingly relying on technology to support their drive. But the industry faces a number of difficult and complex issues as the players battle for market share.

Spectacular Growth



The Australian funds management industry has grown by over 50 per cent in the last three years. According to Australian Bureau of Statistics figures, the industry accounted for more than $590 billion of Australian savings at the end of June 2000, up from $393 billion in June 1997.

This figure is consistent with global trends. The number of US households owning managed funds has risen 1000 per cent since 1980, according to the the Investment Company Institute in the US. Globally, the Australian market is overwhelmed by overseas markets. Deutsche Bank, the world's seventh biggest funds manager, alone manages almost twice the amount of funds as the whole Australian market!

What is Wealth Management?

According to National Australia Bank executive general manager Peter Scott, wealth management can be regarded as moving from a transactional relationship to a life cycle event relationship for a customer. This is related to not only creating assets for the customer, but also protecting them through appropriate investment solutions or insurance options. Income protection, for instance, is part of a wealth management solution.

Scott says that wealth management is a solution that evolves through detailed planning as the individual goes through new stages of the life cycle. He says the dynamic relationship results in transactions, but these should not be seen as the nub of the relationship.

"It is all about looking after how people's investment philosophy should be managed, establishing appropriate savings patterns at a young age, making sure that they have appropriate superannuation and making sure that their superannuation is invested in the appropriate asset allocation for their period of life," he says.

"If you are 18 and have just joined the workforce, you should be heavily invested in growth assets. But at age 64 the risk profile is going to be more conservative and hence the type of investments will reflect this."

Another way to view wealth management is to look at both the meaning of wealth and management. According to Michael Aaron Managing Consultant of IBM, wealth can be regarded as the opposite of cash flow.

"Wealth is where you earn money based on assets, as opposed from the cash flow from employment," he says. "Wealth means that you have asset based income and cash flow is used to kick off wealth".

Aaron says once wealth is acquired, it must be preserved and grown and this is where technology can offer new mechanisms and capabilities to assist in wealth creation.

Drivers of Wealth Management

Wealth management has become extremely topical simply because Australians are acquiring wealth on an unprecedented scale. Drivers include the share market boom of the last decade, which has attracted investors through floats such as the Commonwealth Bank, Telstra, AMP and NRMA.

Other factors are an ageing population (baby boomers moving into retirement), an increasing proportion of "double income no kids" and an increasing number of independent/affluent women in the workforce.

But perhaps the biggest force is the Federal Government's compulsory superannuation regime. The NAB's Scott says part of Canberra's approach has been to scare the community and create a sense of urgency that people need to provide for their own pension entitlements, instead of relying on the government pension.

There is a realisation that many western governments simply cannot continue to provide old age pensions because of the number of retiring baby boomers.

While acknowledging that the push into superannuation and privatisation of share ownership have been major drivers, Ross Bowden General Manager of Mercantile Mutual says that education has played a major role in the growth of the industry.

He emphasises the plethora of information that is available to consumers and other issues. "People are being educated about money issues, there are TV shows on it and fund managers themselves are using the education issue as a way of promoting to clients–universities are doing courses on it," he says.

"There are simply just so many educational drivers that exist today compared to 10 to 15 years ago."

Given the obvious consumer demand, the banks have realised that wealth management is one of the major revenue growth areas. The issue is not only highlighted by the growth figures shown above, but future projections. KPMG, for instance, expects funds under management to grow at more than 10 per cent per annum compared to about 5 per cent growth in bank deposits.

It is clear that banks and other financial institutions want to compete in the wealth management arena. One of the reasons is that there are big revenues and profits involved. Pricing is based on value and people will pay for good advice and convenience, according to Michael Aaron of IBM.

Overseas experience shows that wealth management is particularly attractive because unlike lending, it does not place substantial amounts of bank capital at risk and it generates a higher return on equity.

In Canada, the Royal Bank of Canada derives a 48 per cent return on equity from wealth management, compared with 19.5 per cent overall. Not surprisingly, the bank intends to derive 25 per cent of its earnings from this segment by 2002.

Australian banks have been in a frenzy of activity to build their wealth management services, either through internal growth, alliances or acquisitions. As examples of the latter, St George Bank acquired Sealcorp, the Commonwealth Bank bought Colonial (mainly for its successful managed fund operation) and the NAB acquired MLC.

While banks and large mutual funds in North America have dominated the funds management industry, in Australia, banks have historically taken a secondary position to insurance companies and more specialised fund management organisations holding the very top positions in terms of funds under management. This is all changing due to acquisition and other expansion activity by banks.

Banks through their organic growth and acquisitions have enormous potential to fight back in the industry, mainly because they have larger customer bases than insurance companies. They also have a better understanding of doing transactions through direct channels, while insurance companies are limited to indirect channels and do not do many transactions.

Ross Bowden of Mercantile Mutual says that because banks have not had a history of being involved in funds management, some of them found it a challenge to get into the industry but have moved to build scale quickly through acquisitions.

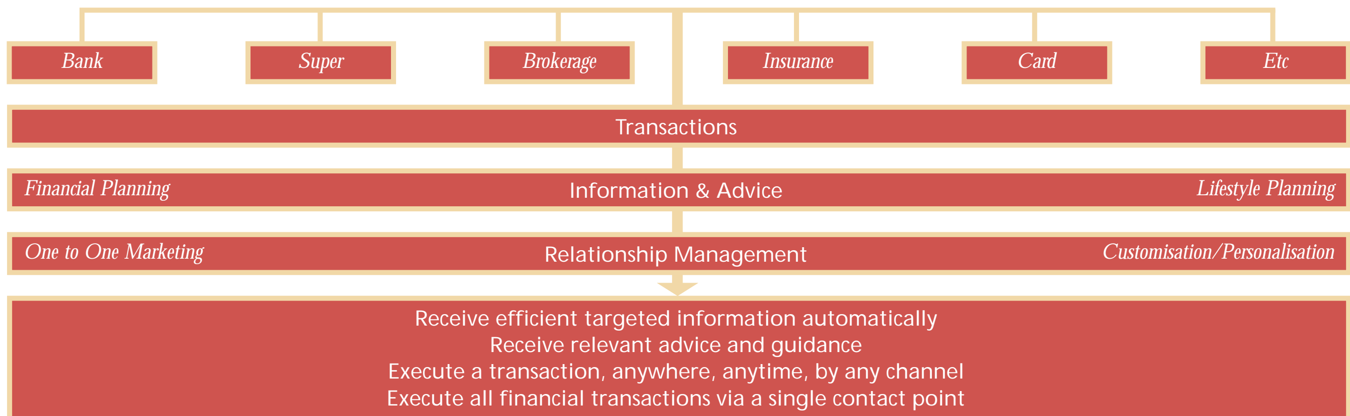
Scale in the industry is a major issue and as Bowden points out, the Dutch-based ING group, which controls Mercantile Mutual, is bigger than the Big Four Australian majors combined. This gives ING enormous scale capability.

Retail Funds Under Management: Top 10 Managers

Top Ten (previous quarter)	Manager	Size$M	Market Share %
1(1)	National / MLC	29,272.66	14.56
2(2)	AMP	24,738.08	12.3
3(4)	Commonwealth Bank	18,826.03	9.36
4(3)	BT Financial Group	18,179.58	9.04
5(5)	Colonial (incl Colonial First State)	14,940.61	7.43
6(6)	Westpac Banking Corporation	13,075.13	6.5
7(7)	ANZ	10,155.91	5.05
8(9)	Mercantile Mutual	10,029.81	4.99
9(8)	Macquarie Investment Management Ltd	9,857.29	4.9
10(10)	Perpetual Investments	5,158.90	2.57
Top 10 Total		154,233.99	76.71
Industry Total		201,061.26	100

Source: Mercantile Mutual

Wealth Management and the Customer



Source: IBM

Ross Bowden of Mercantile Mutual identifies three types of investor.

The first is the classic do it yourself (DIY) investor who wants to make his or her own decisions. This investor does not want any independent advice and does all the research and associated transactions through his or her own resources. He or she may use a small software programme like Quicken or others to assist in portfolio management.

The second type of investor is at the opposite end of the scale of the first. He or she is loosely called the delegator and wants to delegate all investment decisions and seeks out advice.

The third is called the validator. These people feel empowered to seek information on the internet or obtain a range of printed material. They will form an opinion but want someone to validate that opinion and help them out with the recommendation. Bowden says this is the fastest growing sector, but says US research suggests the DIY and delegator types can become validators.

Bowden also points out that consumers can be in different categories according to the type of product. Some people will be completely DIY for straightforward commoditised products, but join another category for more complex products.

Channel Choice – Conflict for Consumers and Providers

All consumers are faced with a choice over what channels they will use for their wealth creation. Steve Bond Banking Industry Manager of IBM says there are a number of delivery means, including the DIY investor using the internet and other self-service research facilities, licensed financial advisers, or direct advice from an institution.

Bond from IBM says the decision for consumers centres around what value proposition they really want to buy and whether the financial institution can effectively deliver it.

There are numerous decision issues that need to be considered with a financial adviser. Can they be trusted and do they really know the investment issues that need to be considered? If they go direct, can the product providers deliver the service and can banks be as good at being advisers as they are at delivering transactions?

As well, there are some very serious conflict of interest issues for the banks. Can they provide wealth management services on a truly objective basis when they have their own products on offer alongside those of other institutions? Without independent and objective guidelines, obvious problems arise.

At the NAB, Scott says, the bank seeks to overcome the conflict problems by asking a number of questions about how the individual customer should structure their affairs. For instance, have they got enough money going into super, savings plans in a non super environment, income protection plan etc.

"The value proposition is sourcing for the customer the best fund manager that is available to manage that proposition, not (telling the customer) that we have a fund manager that you should use," Scott says.

"This is called the managers of managers approach at the National."

The other conflict for a bank is the temptation to steer the customer towards a traditional bank product such as a property loan or term deposit. This helps the bank balance the books in terms of assets and liabilities, but is not a good diversification investment strategy.

According to Scott, a managed fund could be the best solution for the customer. But this could create tension between two parts of a bank: the one dealing with the promotion of traditional banking investments and the other in wealth management/managed funds.

Ultimately, banks will need to manage this problem by maintaining standards of independent quality advice and have the customer referred to those areas whenever an issue of investment advice relating to wealth management structures or general financial planning arises.

Impact of Technology and the internet

We know that technology is having a major impact on the financial services industry and that the internet is creating revolutionary change.

But what is the impact when it comes to wealth management?

Ross Bowden of Mercantile Mutual says technology is giving people information choices they did not have before. It has increased the speed at which this can occur and allows solutions to be customised for customers, particularly from a large company's viewpoint.

Many large organisations do not know their customers intimately, so technology enables them to keep much more information and to channel specific solutions for customers. Bowden also says other significant technology benefits include one-to-one marketing and a choice of delivery channels.

Each category of customer as detailed above will use technology to varying degrees. Bowden uses the term "click, call and face". This means some people want to click for the information, others want to call while others want face-to-face contact, especially when seeking value-add services. This then involves making all the channels available at the convenience of the customer.

According to Peter Scott, technology and the internet have radically changed the entry threshold for new suppliers. This has meant an increase in people's preparedness to get involved in wealth management and their ability to have more knowledge and confidence in dealing with financial institutions.

There has been a significant power shift from one of "it is a privilege of doing business with the financial institution", to "I am the purchaser and I will buy from whomever I want and whenever I want".

IBM's Michael Aaron contends that technology enables institutions to offer wealth management services to lower income and wealth customer segments than in the past. The best service levels are in the banks' private banking divisions – available only to a small minority of customers – but this is changing fast.

Aaron says technology will assist a financial institution to service a customer with $100,000, rather than $1 million, to invest. Small business customers and professionals would be key target markets.

While personal bankers cannot be cost effectively used, technology-driven solutions include "wrap" accounts. These are integrated statements which enable the institution to get a single view of the customer's assets and liabilities.

IBM also contends that financial institutions can understand the customer better; and with the use of profiling and personalisation technology can make offers that they are likely to accept and want, with a better conversion rate than the 5 per cent or so from direct marketing strategies.

The other area in which technology helps is in the use of intelligent agents to manage a customer's affairs better, including when to pay bills, manage tax payments and what assets to liquidate in order to make required payments.

A final point on technology is the development of wealth management software services which greatly simplify the management task. They give customers and advisors easy access to all required data and expertise and time consuming tasks such as tax returns which can be prepared almost automatically.

In the US, broking house PaineWebber recently joined forces with IBM to bring individualised online financial advisory services to PaineWebber clients, by providing more than 8,600 PaineWebber financial advisors the ability to individualise online client profiles.

The NAB's Scott notes that wealth management has become focused on information, which is where technology plays a huge role. The banks may be financial service providers, but Scott says their real role is to "assemble and manipulate" information about tax structures and so on.

From that perspective, the information business is all-pervasive in terms of wealth management services. Customers expect their financial institution to have the technology not only to provide information readily, but to present it in an easily understood way.

Summary

Wealth management has become a hotly contested issue for banks and other financial institutions. We are likely to see many more institutions wanting to grow their wealth management presence and will increasingly rely on technology to achieve this.

However the industry is not without its complexities and conflicts, all of which must be considered. ◘

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