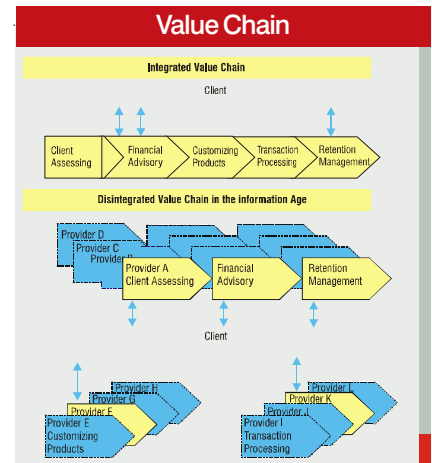


Swiss Private Banking

Redefining Business Models



With products and transaction settlements becoming a commodity, providers of private banking services need to redefine their strategic positioning.

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Providers of private banking services act as information intermediaries. In the information age, their previous information advantage is eroding with important business areas such as products and transaction settlements becoming a commodity. Therefore, providers face the pressure to redefine their strategic positioning at the beginning of the 21st century. Swiss private banking still has a highly fragmented market structure. As the sector is very important to Switzerland, the transformation potential of the leading-edge business models in the information age is being intensively discussed today. The strategic tool is the 'Business Model'—a concept which consists of the analysis of the value chain, the core com-

petencies and the network positioning. Overall, the industrialization of private banking will continue in the years to come. This will offer opportunities for countries with qualified personnel and an attractive salary level (e.g., for India and other countries in the region) to attract parts of the value chain of Swiss private banking providers.

Business models: Focusing on the core competencies within the value chain

The value chain in private banking is being disaggregated step-by-step into the areas of 'customer advice', 'product offering' and 'transaction settlement'.

Transaction settlement is a scalable business. Here, a higher rate of re-

turn becomes possible if more transactions are being processed. As transaction settlement becomes a commodity, margins have already faced erosion over the past years. Therefore, different players aim to enlarge the volume through insourcing of other banks (e.g., the UBS AG with a project called 'Bank for Banks' or smaller providers such as Märki Baumann as well as actual transaction banks such as the 'Xchanging European Transaction Bank'). Many providers consider outsourcing very attractive in this area. As IT is a crucial factor in this field, outsourcing corporations with providers in the Asian region can offer very attractive conditions and high quality solutions.

In the product offering area, clients also understand more about the banking products and demand an open architecture. Therefore, margins are also under pressure. Classical funds products equally face the demand of cost transparency these days. For the moment, structured products and hedge funds still allow interesting margins, but specialized providers of best-in-class products in the near future might well pro-

duce standardized products. So far, a lot of providers try to sell their own products and will continue to do so as long as the margins are interesting, but one has to bear in mind that more and more financial products are becoming commodities. Some providers of structured products and hedge funds have been able to build up a core competence, structuring sophisticated financial products and are, therefore, able to increase or at least maintain the product margins.

The most important component for the success of each business model is customer behavior. Some years ago, results of the industrial innovation research suggested a radical behavior change in the private banking industry. The argument was based on the recognition that the customers could reduce their informational disadvantage significantly due to the information available on the Internet and would, therefore, force margins to come down. However, this development did not occur radically. Several initiatives of new business models of online banks in Switzerland did not succeed as they did not attract enough customers. So far, adaptive strategies on the basis of existing business models have proved to be successful. The Swiss Banking Institute of the University of Zurich conducts periodical analysis of the behavior of Swiss investors and can, therefore, gauge the variation quickly. It was found that customer behavior is adapting step-by-step over time. The number of investors in the Swiss private banking customer segment which use the Internet both to gather information and to trade on the stock exchanges climbed from 13% in the year 2000 to 41% in the year 2004. This share is significantly larger than in the segment of the affluent or retail banking. The theory that the classic private banking customers do not belong to the typical online investors seems not to be confirmed here.

Therefore, in the area of customer advice, it is important to note that due to the improved information access, customers will only be willing to pay for integrated solutions. Due to the very limited scalability of the relationship man-

agers (after a 10-hour-day, a relationship manager can no longer meet clients, so for business expansion, new personnel will have to be recruited), the market is open for niche positioning. Success will depend on the capacity to offer advice, which is perceived as value adding from the customer. A possibility for customer-focused small-scale providers is to achieve the know-how on the advising processes thoroughly by third-party providers. In Switzerland, for example, Bank Wegelin and Bank Linth recently announced such cooperation. Bank Linth focuses on regional customer interface, whereas all other advice-process-components are outsourced to Bank Wegelin.

This development will force private banking providers to add more value-added services for the customer who will be less and less willing to pay high margins for pure information delivery. One can assume that private banking clients will not become uniformly online traders. But nevertheless the question is whether the clients would be willing to pay a margin which includes a remuneration for the relationship manager as well as for the brand of the financial institution or will they, over a period of time, look for providers who offer first-class advice for less margin such as independent financial consultant who then structure the whole value chain more cost-efficient for the clients. In the US, providers like 'Focused Financial Planning Inc.' have been offering this business model successfully since a long time. But there also exist about 6,000 independent financial consultants in Switzerland and in the information age this business model could be the threat of the future for existing institutions. The main challenge is, therefore, to adjust to the gradually changing customer behavior. More competition for customer relations, higher customer knowledge and the resulting increased customer expectations require an increased differentiated service offering, tailored solutions to the different customer needs and segments. The improvement of knowledge of the relationship managers is, therefore, absolutely necessary as it can be expected that margins will

come down over time and customers will only be willing to pay for integrated problem solutions.

Zurich wealth forum as a platform to discuss the consequence of these developments – business excellence meets science excellence

Knowledge is the key to mastering the innovation process in private banking in the information age. What remains unchanged is the need to ensure that knowledge gained through research, learning and experience does not undermine the traditional core skills, which will continue to be indispensable in the future as well. Therefore, the Zurich Wealth Forum was set up as a leading platform for businesses and universities to share information and ideas on future-oriented areas of wealth management.

The Zurich Forum brings together experts from the scientific and business community with a view to help shape the future of wealth management. On top of the presentations and discussions, the forum provides an opportunity for participants to cultivate personal contacts and share information and ideas. The renowned Swiss Banking School and the foundation of the major Swiss banks provide the forum for highest-level executive education. The University of Zurich provides facilities for this purpose for the full duration of the forum. An evening social event is also organized where participants will have further opportunity to foster personal contacts.

The forum provides for plenary discussions with key speakers addressing important strategic issues on the one hand, and workshops where participants have the opportunity to examine and discuss specific topics in greater detail, on the other. In the workshops, which are run in parallel, scientists expound on recent research findings while practitioners present business solutions and concepts relating to the subjects in question. A key aim of the forum is to promote dialog between the business and scientific communities, and by so doing, lend fresh impetus to both sectors. Wishing to represent an interna-

tional perspective, the forum is conducted in English.

Competition: Network positioning

The once conservative financial sector is in a state of transition. What would have been unthinkable 20 years ago is now commonplace. Lagging slightly behind other banking segments, private banking or wealth management is now also in the throes of a radical transformation. However, the greatest challenges lie not in the immediate future but in the medium- to long-term. The restructuring of the sector is still ongoing. Forces underlying the transformation are information technology, advances in scientific research, de-regulation and re-regulation. Among the service providers this has led to heightened competition, faster innovations in products and processes, and market globalization.

Changes in the financial sector have been accompanied by changes among clients. Today's private clients have individual and heterogeneous financial needs. They are more discerning and better informed about financial matters than ever, and have an understanding of the relationship between income, risk and cost. They have the choice among an array of offerings by the asset management industry and can select from a large and diverse range of products and services. And they are aware of their power in terms of demand as a consumer.

Value chains will, therefore, disintegrate within the medium-term due to the increasing margin pressure. Multiple cooperation models can be observed in all three areas in the market already. If you follow this business logic, the expected concentration and consolidation process will not develop through large mergers of entire banking institutes, but rather toward the outsourcing or the sale of single parts of the value-added chain, with which economies of

scale are essential. All providers have to analyze their own strengths and weaknesses to position themselves. The key question will be which partner will be in the focal position to control the distribution of the margin between the network partners in the future. While larger providers preferably strive for the roll of the focal provider in a network, for smaller providers the search for their niche position and equivalent outsourcing partners appears to be the most meaningful option. Doing that, they can keep their independence also in long-term focusing on their advisor model.

Until recently, all three value disciplines—customer advice, product creation and transaction settlement—were furnished through each provider independently. It is questionable whether this business model can be maintained. Two basic alternatives to shape the future business model are open to providers:

- **Hold adherence to the integrated business model:** Established providers can try for a certain time to maintain the previous business models without opening new developments. This model is known in innovation research as 'Burst of Improvement' and often leads to a situation where the opportunity to adapt proactively to the occurring change will be missed. The consequence can be a disappearance from the market. The delegating group of customers will stay large enough for some more years. Therefore, the classical integrated private banking business model can be maintained for some years. As a consequence, profits will come down over time as less and less clients will accept this model as well as the high margins which are also a consequence of the lack of use of the potential efficiency gains of the information age.

- **Modularize the value chain:** The changes towards a modular value chain seem to be unavoidable in the long run as informed customers will begin to bring the margins down and providers, therefore, will be forced to adapt their business models and process structures. Keeping that in mind, it must be assured that the management culture remains conducive to adopt the long-term, the medium-term as well as the short-term developments of the business models. Developments and changes of customer behavior have to be observed exactly and outsourcing possibilities have to be analyzed and implemented.

The limiting factor of the technologically possible developments in private banking is the individual customer with his limited reception capacity. The precious resource 'time' is being used individually according to subjective customer preferences. Only if the perceived utility of a new business model is higher than the utility of the previous model, a change will be taken into consideration. The information-based services of private banking consist not only in providing information, but also on information processing with the use of implicit knowledge. Hence, it is the capacity to offer structured advice on complex problems that offer the best possibilities in the future. Long-term success depends especially on the readiness of the providers to offer the customer, under consideration of its limited rationality, the additional value that will be then perceived as such by the client. Ongoing education of relationship managers is a key to success as future clients will only be willing to pay for value-added advice and products they really need. ☺

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