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The Profit Challenge for Wealth Managers

By S.L. Mintz

A steady wind behind global investment markets in 2012 gave an uneven lift to the performance of wealth management firms, The Boston Consulting Group has reported in its annual survey of Global Wealth management, subtitled "Maintaining Momentum in a Complex World."

With stock and bond markets posting strong gains, global wealth-management firms boosted their assets under management by 13%. But, BCG found, the firms' earned less for each dollar under management, the result of intense competition and complex rules and regulations around the world.

The report found that millionaire households worldwide—defined in terms of U.S, dollars available to invest—edged close to 14 million in 2012, or a little less than 1% of all households. Millionaires in the U.S. outnumbered peers in Japan—the No. 2 market for millionaires—by more than four to one. Billionaires, too, grew in number, and both groups are on track to gain still more members.

The number of ultra-high-net worth households—those with at least $100 million in wealth—increased 7% in 2012, to about 12,000. The U.S. clocked in with the largest billionaire population, followed by the U.K. and China. Projections call for ultra-high-net worth assets to grow at a compound-annual-growth rate that exceeds nine percent, ahead of eight percent growth for investors with $5 million to $100 million.

Foes of the financial system might use the report to brandish fresh evidence that one percent of all households hold in their hands almost 40% of global wealth. Conversely, some may see cause for optimism. The report's headline could have declared truthfully, "Richest Countries Getting Richer; Poorer Countries Getting Rich Faster."

North America and Europe retained status as the world's wealthiest regions, while increasing rivalry puts pressure on wealth management profit margins. Asset growth in newer regions outpaced North America, Europe and Japan – the old world – by more than two to one. Buckle your seat belts as the trend accelerates. Nearly all wealth added in the old world relies on the performance of existing assets. In emerging regions, most of the credit by far goes to net new wealth created from scratch in new businesses serving an increasingly affluent population hungry for western amenities.

On the strength of strong economic growth, BCG expects Asia Pacific nations (ex Japan) to become the world's largest wealth market in 2017. By then, China should take a bow as the world's second wealthiest nation. Newer economies enjoy a singular advantage. Whether for embedded cultural reasons, habit or lack of alternatives, their citizens save more. Savings rates promote direct investment that in turn energizes local economic growth visible in rising GDP rates and strong equity markets. BCG partners were unwilling to distill investment advice, but if its sources are accurate the handwriting on the wall does not require much interpretation. Go east.

Against that bountiful backdrop, the elite cadre of global financial institutions must find ways to reinvigorate flagging return on assets, defined as revenues divided by yearly client assets and liabilities. It slipped last year by 4.1% to 81 basis points (a basis point is one one-hundredth of a percentage point). The decline, though slight, looks surprising in a bumper year for wealth management, and it won't be easy to correct. Fierce cross-border rivalries, myriad jurisdictions with arcane rules and regulations, and local investment appetites needing local investment strategies impose costs that erode margins.

Because old-world wealth resides predominantly in existing financial assets, successful wealth management firms will have to play a "share stealing" game, BCG predicts. This climate forces wealth managers to satisfy competing objectives: ramp up catering to clients while stripping costs from global infrastructures.

So long as wealth management firms post sluggish returns, selective investors can find products and services at bargain rates. Better yet, built-in barriers tend to block charging clients more – not that some won't try. As a cure for what ails the wealth management industry, raising fees does not look like a very good remedy. Every boost makes it harder for managers to match or exceed market performance, when fees are included in calculating returns.

Shoring up return on assets need not reach into customers' pockets, says BCG principal Anna Zakrzewski. Instead, wealth management firms must abandon a one-size fits all approach to managing global wealth and embrace more targeted strategies. The sooner they catch on the better for everybody. The exercise is familiar to sophisticated packaged-goods companies that prune unprofitable goods and services or exit markets not meeting expectations.

Likewise, wealth management firms should focus on markets where potential is greatest even if it means, in the short run, relinquishing some revenues in less profitable or unprofitable sectors where rules and regulations constrain operations, the report suggests. The hunt for better returns may force retooling of existing practices.

Scrapping the playbook sounds alarming to wealth managers who see themselves at the hub of all financial assets. Do not despair, Zakrzewski advises them. Some solutions can expand horizons and margins. Her case in point, savvy Asian firms are transforming a wealth management business model rooted in broker dealer relationships. Embarking instead on advisory relationships that prevail in North America secures access to a much larger share of every Asian client's assets. Done right, fees can remain stable while profits increase.

Bottom line, Zakrzewski assures wealth managers resistant to change, "in every single region you can be successful. It's a very profitable business model and you can make more than the average profit margin." Would that were always so for clients.