



## **Small is beautiful...**

... and big is not necessarily best when it comes to successful provision of wealth management services

34

**By Thea George**

□ The past few years have not been easy for providers of wealth management services, with difficult investment conditions heightening pressures on profitability and intensifying competition to attract and retain clients. In such an environment, is it preferable to be a big firm, with broad product coverage and relatively deep pockets, or a small, niche provider with the ability to innovate and respond to changing requirements at speed?

It was this question that analyst firm Datamonitor sought to answer in a recent research report and, says analyst Laura Meachem, the conclusion of its study is that big is by no means necessarily best. "The crux of the report was to identify, given what's been happening in the market, whether if you're a big firm you'll be better off. Are smaller players at a complete disadvantage?" she asked during a recent roundtable discussion with *STP*. "The conclusion was that they are not. The smaller players can't compete against the larger players in the same way, but that is not to say they have no place in the market. The upshot is that size doesn't matter, as long as your strategy is appropriate for your marketplace and clients."

Datamonitor examined the strengths and weaknesses of small players versus large, and the opportunities and threats facing each, she explained. "The smaller players have some advantages and some issues," she said. "One of the key aspects is personalised service. It was reconfirmed by the survey that this is what firms believe attracts clients more than anything. This is an area in which smaller players have an advantage: if they have a headcount

of 30 and a small client base, the ratio of staff to client is smaller and the client feels like they are getting more value for money. When dealing with a larger organisation clients sometimes fear they might get lost. This is one clear advantage of being a boutique."

Another is the ability to focus on a particular niche and excel within it, Meachem continued. "Take the example of Ruffer, a small investment boutique which took the lead on absolute return and has done really well, or C Hoare & Co, which launched the first multi-manager portfolio to invest in more than one multi-manager specialist. This adds another level of cost and distance but it offers more variation in terms of selection, and it was a competitive differentiator because no-one else had done it.

"Although larger firms can offer a broad range of products and services and therefore choice, it is not possible to have expertise in every single area."

The bureaucracy within the larger players can make it harder for them to respond to changing client requirements, she added: with bigger firms hampered not only by bureaucracy but also ingrained legacy systems which make it harder to react to new business opportunities. "If you are smaller you tend to be less bureaucratic and can change much faster, effectively being able to shift almost instantly."

Smaller firms may also find it easier to attract and retain high quality personnel, Meachem suggests. "One trend over the past couple of years has been that a number of relationship managers and directors in larger wealth management organisa-

tions, as a result of a lot of M&A activity and general development, have become disheartened about the decision making capabilities they have, leading them to leave large wealth management organisations and set up on their own. This has led to the creation of many small boutiques and hedge funds, and these smaller players find it easier to give staff the decision making authority they want."

On the negative side, smaller firms have more limited resources. "Their marketing budgets are smaller, so it is harder for them to let everyone know how good their investment performance is," she said. The resource limitations within smaller firms can have very serious implications when it comes to the increasing compliance burden financial institutions face. "Compliance is increasingly challenging for smaller players because it is difficult to keep up with the cost. While many commend the intentions of the regulators, even some of the larger players are saying the compliance burden is becoming overwhelming and could offer more pragmatism and flexibility, while the smaller players really haven't always got the resources to do what needs to be done. One interviewee at a medium sized bank told us it's not just the cost, it's the time, the amount of monitoring and managing that needs to be done – it takes people away from other business issues that need to be addressed. The task is bigger than you imagine, and you have to understand all the regulations and train people up to deal with them."

Yet compliance requirements must be met. "Firms have to do it – there is no choice about that" □

☛ so to compensate for the increased compliance expenditure, they have to increase profit margins through other means," Meachem said. "Compliance is not just a factor for the smaller players but it is driving consolidation. The overriding trend from what we've seen is that if it gets too much, there can be a fairly radical reaction – to sell."

Another option is outsourcing, she suggested. "These firms are constantly looking for more and more efficient ways of running their businesses. There is increasing outsource-

of KBL Group European Private Bankers. "This is essentially a network of private banks across Europe, including Brown Shipley in the UK. The autonomy of the individual companies is maintained: so the framework is set up from Luxembourg but each of the players directs its own strategy and business development. They then have the resources of a parent while acting as autonomous players. This is a great model but it is not that common because few parent companies are happy to allow that degree of autonomy."

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**Laura Meachem Datamonitor**


ing, with investment firms turning to providers such as Bank of New York or State Street to offload parts of the back office to cut costs. Firms can consider outsourcing numerous functions, from the product side to reporting – anything that is not core or something a firm does not do particularly well, that it could save money on by outsourcing."

Outsourcing might not be such an easily available option for the boutique firms, though, commented Simon Tizard, sales and marketing director at Investmaster, who also participated in the roundtable. "For the outsourcing providers, the margins on the business are very small. The smaller players don't offer the volumes the providers are looking for and they will consequently get less good deals to outsource their administration," he said.

According to Meachem, it is important for boutique firms to make decisions about their future ownership and direction. "Are you going to become a subsidiary of a large organisation? Or are you going to try and go it alone?" Another option is to be an autonomous subsidiary, able to draw on the expertise of other subsidiaries within the group, she said, citing the example

Another strategic option for smaller firms is to position themselves as specialist advisers. "Rather than finding a product niche, you can set yourself up in an area in which you have credible expertise and pick out the correct providers and products. In this role you are not manufacturing anything, but you are acting as a source of products and services for clients," Meachem said.

Further research by Datamonitor into the wealth management market more broadly has revealed a number of notable trends, she continued. "Compared to five years ago, customers are demanding more general contact – email, post, telephone and face to face *et cetera*. This is a noticeable change since before the crash. Clients are making sure they are in touch with their wealth managers far more regularly," she said, adding: "In Germany, every single wealth manager we asked said clients were more likely to change wealth management provider now than five years ago." Tizard wondered what proportion of wealth management clients do actually move wealth manager, suggesting it is probably quite small, and Meachem agreed that analysis of how long clients had been with their ☛

 providers indicates that few are customers of less than two years' standing, with most in the five to 10 year range.

Interestingly, Datamonitor's analysis suggests that poor service is more likely to drive a wealth management client to move providers than poor performance. Neville Margison, product director at Investmaster, another participant in the roundtable discussion, commented that one reason for this could be that many clients haven't been kept in the picture by their providers about investment performance. "Some firms hardly ever actually provide information about true performance," he said. "So when MiFID [the Markets in Financial Instruments Directive] forces discretionary firms to do performance benchmarking, that could prove to be a bit of an eye-opener," Margison suggested.

Meachem said it is key for wealth managers to communicate more effectively with their clients about performance. "Seventy-five per cent of wealth managers in the UK said their clients are demanding to know more about the management of their portfolios than they were two years ago," she explained. "According to one boutique we interviewed, it's very difficult to lose a client if you lose money for them in the first year, in the second year they start wondering and by the end of the third year, they start looking again at the management of their portfolio. What is important is that the wealth manager is clear and can explain what is going on, then the client may have a greater degree of tolerance. This is the whole issue about transparency: the client wants to know what is going on."

As well as demanding transparency, clients will increasingly expect their wealth managers to be responsive enough to amend their asset allocation strategies promptly when changes in the market require it, Meachem believes. "Where your strategy has gone wrong, you must be willing to say, let's go back to cash as every now and again, cash beats everything," she said. "It is about getting the asset allocation right to

get the best return. We believe the client will be happier to go back to cash than if you continue to pursue a strategy of playing the markets and losing money. If you keep your clients informed – if they can see their wealth manager is being proactive – that is better in the clients' eyes."

The subject of asset allocation came up a number of times during the roundtable. One suggestion was that collectives will rise in popularity as a means of more safely investing in equities. Said Meachem: "Unit

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#### Simon Tizard Investmaster

trusts *et cetera* will be viewed as a safer option for getting international equity and other asset class exposure." Tizard pointed out there are challenges associated with increased investment in collectives, because settlement processes in this side of the business are "a complete mess when compared with equities". Meachem continued that despite events of recent years, "there is still very much a feeling that equity is the long term asset class". "They have always given a good return over the long term and many wealth managers feel that people have relatively short memories, and a lot will come back to equities eventually."

"In the long term equities will show the best return," Tizard agreed. "But a lot of 'fund managers' are actually 'stock pickers'," he added. "Studies indicate that over time 80 per cent of investment return comes from asset class allocation, as opposed to picking stocks. I don't think a lot of companies think sufficiently about asset class allocation, or the needs of their clients." Tizard contended that in many cases smaller IFAs do a better job of trying to meet investors' specific needs than the bigger investment managers do.

"We've seen solutions pushed out by the product providers to the IFAs for client risk profiling and portfolio building which are very sophisticated," he said. "On the other hand I was recently at a client seminar run by a very large name in the UK private client investment management space, at which they were asked how they assess the risk profile of clients. The answer was that they ask one question – how much are you prepared to lose in a year? If the client says, for example, 10 per cent,

they are put in a block and get a balance of equities and fixed income accordingly. That was a very big investment manager, earlier this year, using this crude, unsophisticated and inaccurate method of risk profiling. This approach has to be almost insupportable going forward," Tizard said.

A final piece of advice to wealth management providers of all sizes on how to compete going forward is to seek to manage a greater proportion of a given client's wealth, said Meachem. "We asked wealth managers what percentage of a client's wealth they have, and the answer was an average of 37 per cent. There is quite a lot for them to still get hold of," she suggested. "Because there is so much competition and only a set number of high net worth clients around, not all of whom are with wealth managers, surely it makes sense to grab more of their money, by offering them a pension, or to manage their cash positions." This is one area in which outsourcing or partnering to get access to a broader range of products could make a real positive difference to a wealth manager's success in the future,  Meachem concluded.