Innovation in private banking and wealth management

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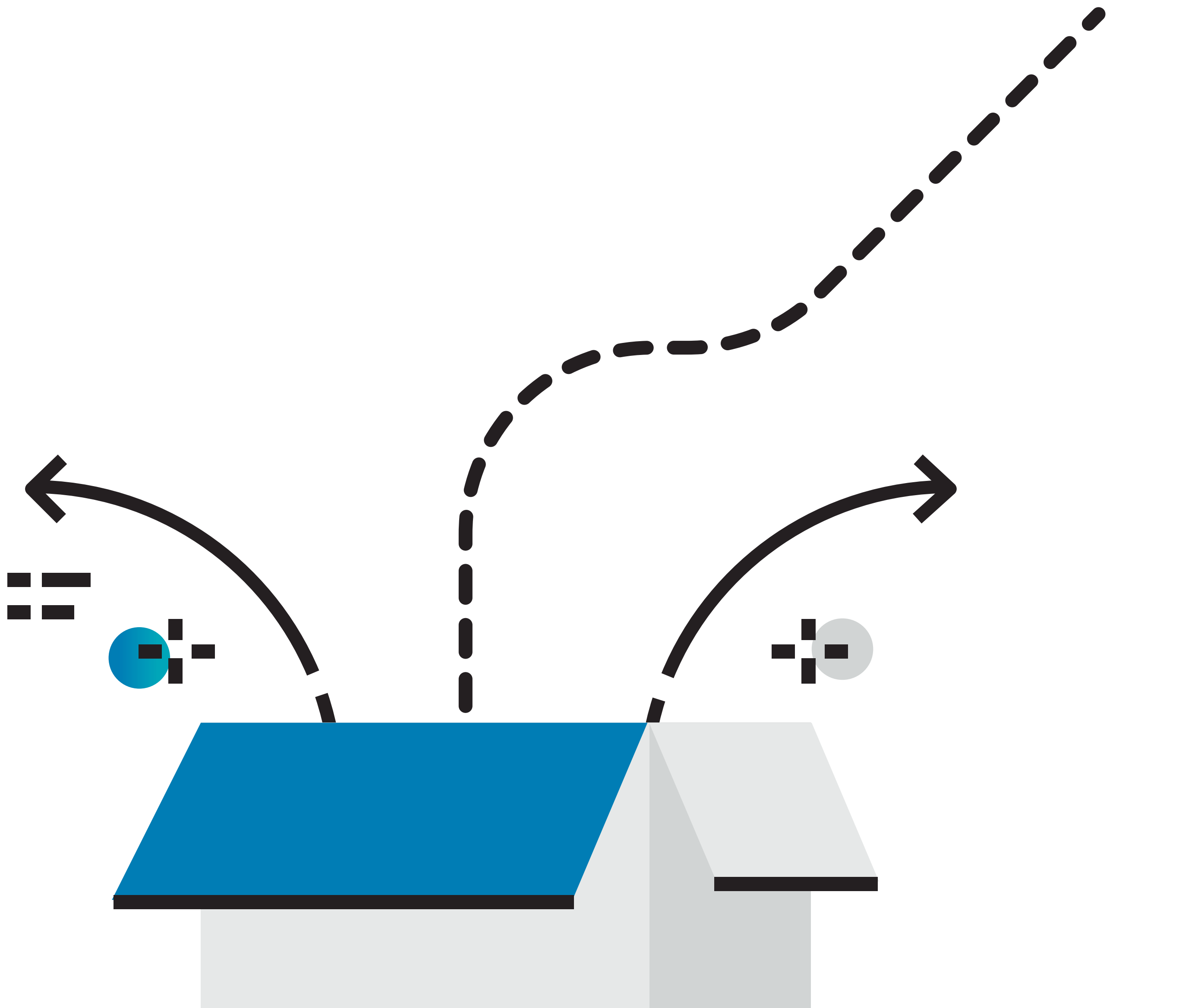
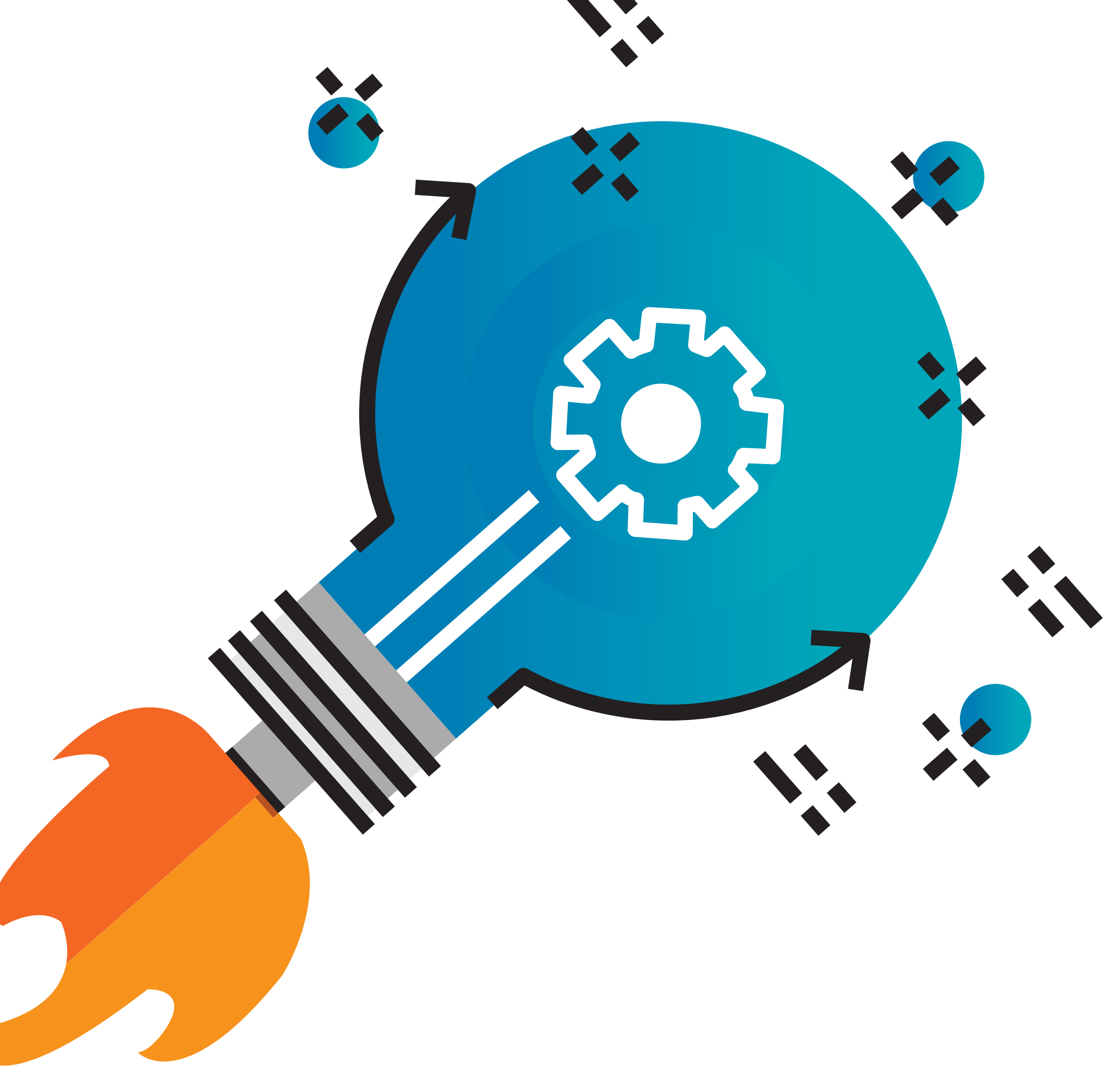


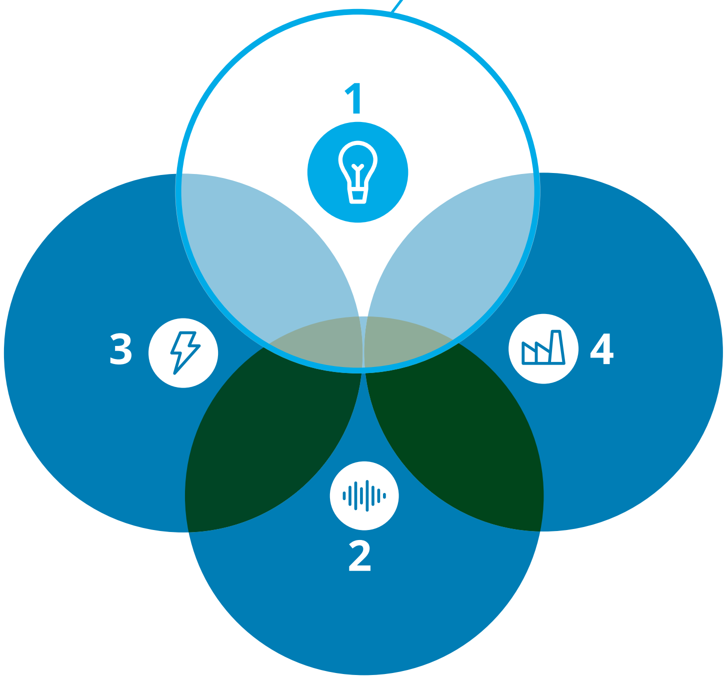


Since the year 2000, European wealth management has faced a constant decline in profitability, with profit margins falling by 40 percent, despite considerable market volume growth of over 60 percent in the same period. This shows that wealth managers are increasingly failing to serve clients successfully with the traditional business model.

Nevertheless, innovation ambitions in wealth management revolve around existing business challenges and rarely exploit opportunities to create value in new ways. Analysis indicates that the industry is facing an innovation gap that requires a change of key beliefs in leadership and the acceptance of new realities in order to be filled. Innovation needs to be formally embedded into a wealth management organization to embrace a successful change of the traditional business model.

What we mean by innovation?
In the context of a transforming banking ecosystem, innovation is often associated with other concepts and disciplines related to change, but their definitions clearly distinguish them:

Innovation requires an understanding of whether clients need or desire an invention, and also how it can be delivered
Innovation has to provide economic value, i.e., it must be able to sustain itself, and return in excess of its weighted average cost of capital
Innovation does not have to be new to the world, only to a market or an industry, and can be based on previous advances



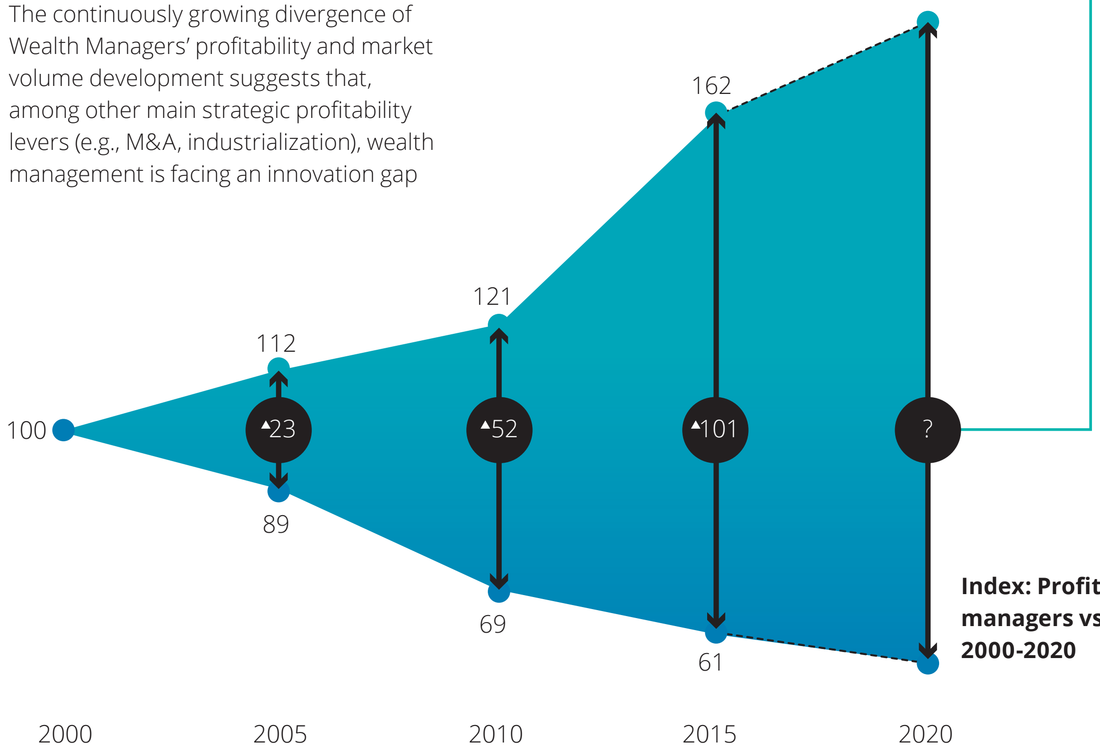
1. **Innovation**
   (separate from invention) is the creation of a new (to the market or the world), viable (creating value for clients, stakeholders, and the organization itself) business offering (ideally going beyond products to platforms, business models, and client experience)
2. **Digitization**
   is the transformation of business activities by the introduction and use of information technology
3. **Industrialization**
   is the concept of reducing the cost base and re-thinking the value creation process through the elimination of redundancies, smart sourcing, automation, and standardization
4. **Disruption**
   is a process whereby a smaller company with fewer resources is able to successfully challenge incumbent businesses; disruption typically originates in low-end or new-market niches

As opposed to digitization and disruption, innovation depends on the creation of economic value. While industrialization and innovation have this in common, innovation is much broader in its application and does not focus specifically on cost reduction. Disruption on the other hand can be considered contradictory to industrialization: while industrialization is a process for players with mature business models to defend their market shares and profitability, disruption is a process for players with new business models to gain shares of the market.

It's about time for innovation in wealth management

Wealth management has now reached a point where a mind shift has become essential. The profitability of European wealth managers has been in constant decline in recent years, with profit margins falling by 40 percent between 2000 and 2015. During the same period, the market size for private banking measured by the bankable assets of European millionaire households has grown by more than 60 percent. This increasing gap between profitability and market size shows that wealth managers are increasingly failing to serve clients successfully with their existing business models of an integrated value chain (average industry integration level of above 80 percent). This suggests that the industry is facing an innovation gap, since industrialization and M&A-the other two main strategic growth levers-have already been employed for years.

Innovation gap?
The continuously growing divergence of Wealth Managers' profitability and market volume development suggests that, among other main strategic profitability levers (e.g., M&A, industrialization), wealth management is facing an innovation gap



Index: Profitability of wealth managers vs. market volume, 2000-2020

- Market volume index (2000 = 100) represented by wealth2) of European millionaire households, 2000-2020
- Average profit margin index (2000 = 100) of European Wealth Managers, 2000-2020

...and the time is about right...

Typically, innovations result from a conscious, purposeful search for innovation opportunities, which are found only in a few situations, such as changes in the industry structure or demographics, or changes in the perception of an industry, economic incongruities, or the appearance of new knowledge. All these can be found today in the wealth management industry. An increasing number of FinTechs active in wealth management (+300 percent in the past three years) is disrupting traditional industry structures; millennials will form 50 percent of the global workforce by 2020, creating demographic change; and the global regulatory agenda has triggered the reshoring of assets, adversely affecting the prospects for cross-border wealth management.

...but ambition is lacking

Based on a comprehensive view of the wealth management industry, we identified 28 unique innovations from wealth managers and 11 from FinTechs, and mapped them according to their "type of innovation" and "innovation ambition" to create a clear picture of where and how innovation takes place in wealth management.

Wealth managers' lens

Innovations addressed today are mainly configuration- and experience-driven, and revolve around the core business with only outliers touching transformational ideas

FinTech lens

FinTechs accelerate the change of the traditional business model in wealth management although they are not as transformational as commonly presumed.

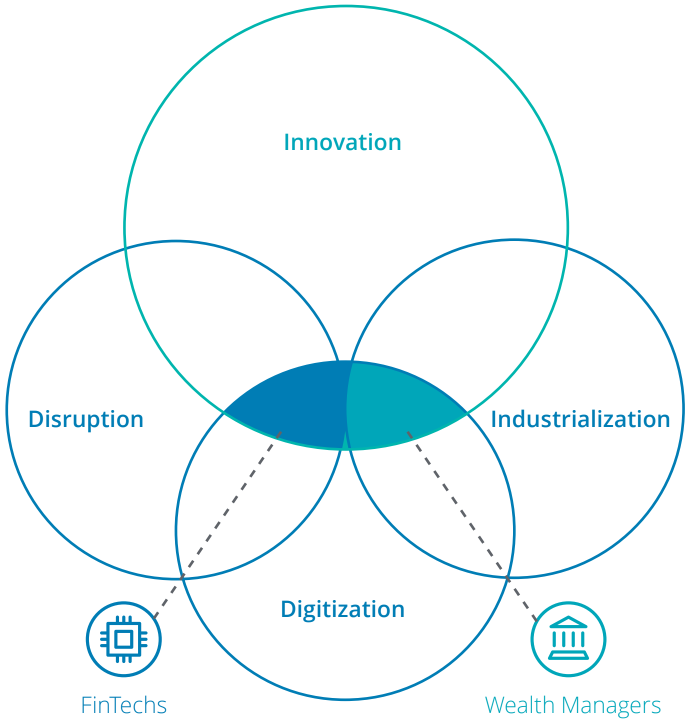
Summary: Focus areas of innovation
The innovation ambitions in wealth management combined from wealth managers and FinTechs revolve mainly around the existing core business (82 percent) with only limited adjacent (12 percent) and transformational (6 percent) innovation efforts; the main innovation types addressed today are clustered around process (18 percent), structure (14 percent), and client engagement (15 percent).

The focus on process and structure can be attributed to the wealth managers' industry-wide strategic priority of reducing costs through standardization and digitization, triggered by increasing economic pressure and technological advancement.

Innovations in the area of client engagement are mainly driven by FinTechs and concentrate on enhancing the existing processes, still mainly on client experience that is dependent on personal interaction. Having realized that wealth managers might be a more attractive client segment than private clients, which is in great need of digital solutions, FinTechs increasingly specialize in offering flexible, innovative B2B solutions to wealth managers to help them close their digital transformation gap and thus have a strong focus on the innovation type process.

In conclusion, it seems that innovation in wealth management still plays a subordinate role, with most innovations being responses to existing business challenges rather than innovations based on the identification of opportunities to create value in a new way.

Categorization of innovations in wealth management



Enabling innovations that can change the business model...

While eliciting a change of business model typically requires the employment of multiple types of innovation, with a focus on shifts in the profit model and client engagement, efforts in wealth management concentrate mainly on digitizing processes and structures in the existing business model. Instead, wealth managers could exploit innovation opportunities in a more transformational way by re-designing instead of reorganizing their infrastructure (e.g., through Cloud Computing, Open APIs, Orchestrating), deepening their understanding of client needs (e.g., through Social Listening, Instant Client Feedback), identifying new sources of revenue (e.g., supplementary Client Care Services, Digital Security Services) and refreshing their brand (e.g., through Sub-branding, Ingredient Branding).

...requires a shift in the leadership's mental model...

Innovations come to a halt, or fail, for many different reasons, but most often it is because superficial changes to improve performance are not sufficient to affect a fundamental transformation. Innovation requires change at a deeper level-a change of the leadership's key beliefs-as these typically affect attitudes and culture throughout the organization. Wealth management is built around traditional assumptions, behaviors, and beliefs about how to create value that drives the strategies leaders deploy and guide their decision-making. These assumptions and key beliefs need to be exposed to the new realities of today's world and the future by monitoring trends and their implications, and recognizing the urgency and importance of innovation.

If leaders are to drive innovation effectively, they should have a mindset that favors collaboration and is not functionally-focused; this mindset rarely occurs without encouragement: innovation leaders need to be developed alongside innovation capabilities, starting with a structured approach to enact a mind-shift.

1. **Expose**
   Challenge prevalent key beliefs and expose the leadership to facts and new insights into how others in the industry operate under adopted key beliefs.
2. **Understand**
   Engage leadership around the urgency and importance of transformational innovation in wealth management.
3. **Identify**
   Identify opportunities and disruptive threats, and how trends could change the existing business model.

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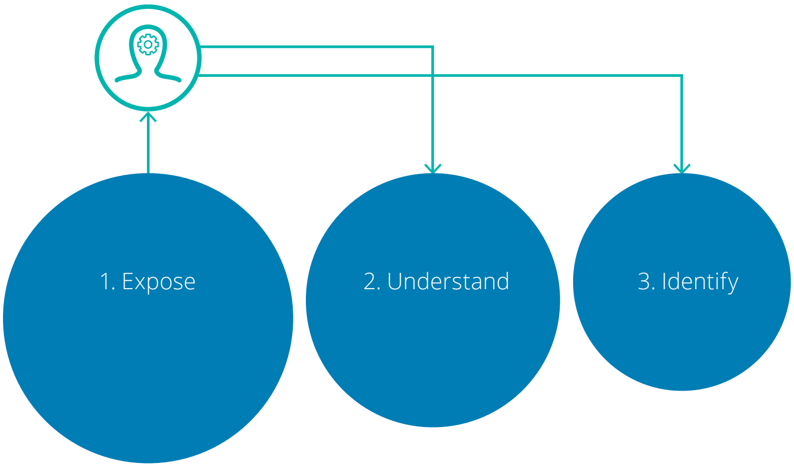

To the point:

- Wealth managers seem to be increasingly failing to serve clients successfully with their existing business models.
- The situation in wealth management with a changing industry structure and demography favors innovative ambitions.
- Innovation in wealth management predominantly focuses on existing business challenges rather than on opportunities to create value in a new way.
- Enabling transformational innovation requires a mind shift of senior management as well as a formal embedment of innovation in wealth management organizations.

...and an effective innovation system

Once the leadership is on board, innovation needs to be formally embedded as a management discipline and the corporate culture needs to be opened up toward divergent thinking. This calls for a systematic change that, based on an analysis of successful leaders in innovation, requires four building blocks to be in place: approach, organization, resources and competencies, and metrics and incentives.

A tailored approach should be built around clear definitions and methodologies for the work to be done in generating innovation, and innovation should be managed as a portfolio. Accordingly, the appropriate talent and capabilities need to be acquired and nurtured. In this context, and as a starting point, wealth managers should clarify the role of partnerships.

Innovation building blocks and critical capability levers

Approach
Innovation strategy: Defining goals for innovation and thematic opportunities to pursue
Pipeline and portfolio management: Managing innovation initiatives in a pipeline and portfolio
Process: Moving innovations from abstract hypotheses to business cases and launched businesses

Organization
Senior leadership: Engaging senior leaders with innovation
Governance: Defining how and by whom innovation decisions are made
External connection: Setting up mechanisms for identifying and leveraging external capabilities

Resources and competencies
Funding: Devoting financial resources and installing mechanisms for accessing the funding
Talent management: Attracting and deploying the right skills at the right time
Innovation tools: Providing software, tools, and techniques for different aspects of innovation

Metrics and incentives
Rewards: Installing monetary incentives, formal and informal recognition of contributions
Innovation metrics: Defining targets and indicators to guide decisions and measure progress
External attraction: Fostering and incentivizing other organizations to participate in innovation