

Strategic Growth in the German Wealth Management Market

Centres of Wealth

The German market for sophisticated wealth management seems to have been booming for some time, but that which at first glance appears to be tempting business turns out to be a hard fought battle when one looks more closely. Not every player harvests success. A regional sales concept is very much a part of a profitable growth strategy. Knowledge of the market is not only necessary for the entire market, but also in specialised form for the various regions.

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The potential of the High Net Worth Individuals (HNWIs) customer segment is often misrepresented, but still represents an interesting target for many institutions. In recent years substantial market share gains have been the result of takeovers rather than improvements in institution's offerings. To gain a sustainable, long term foothold in this market the fundamental requirements are adequate investments, a business model aligned to the critical success factors and an attractive offering that can be delivered by a regionally sensitive sales team.

Supply-Side Market Analysis

Wealthy customers appear fundamentally attractive for service providers, in particular for finance service providers. Due to their higher purchasing power, the product offering automatically assumes high yields – a new “gold rush” is a phrase often heard. As a result, different players with diverse histories are competing for these customers. This dynamic market, however, has witnessed very different approaches from the major players. ► 1

Within the group of universal banks, focus on the HNWI segment began with the large banks, followed by the saving banks and lastly the cooperatively organised institutions.

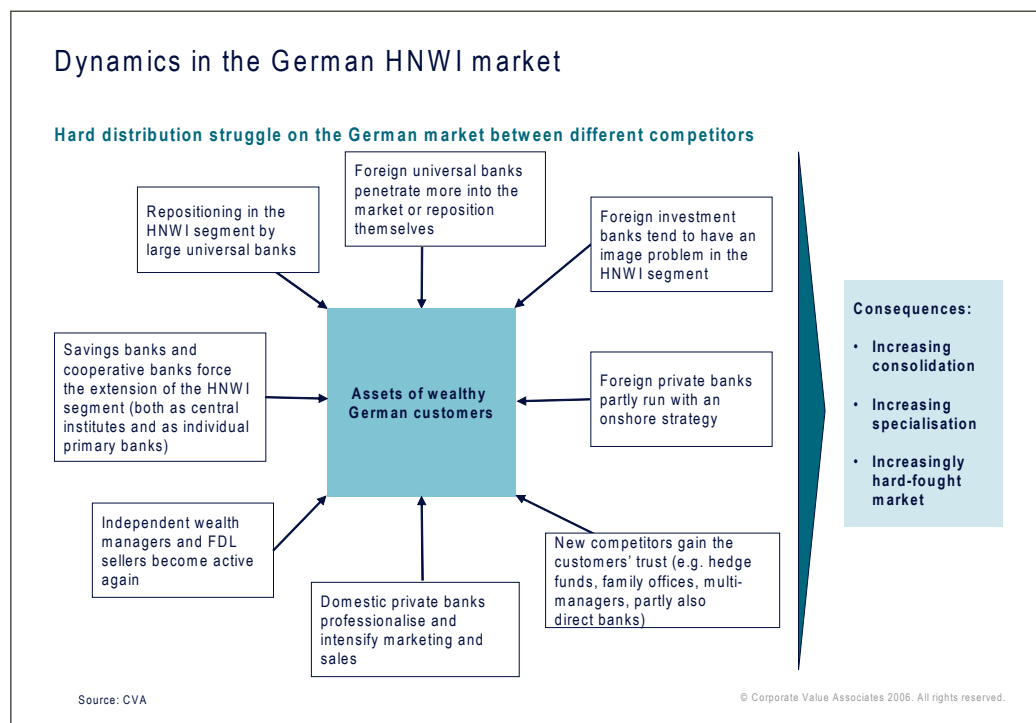
The private banks with their longstanding proven product offering and strong brands are also present in this market. However, only a few banks cover the whole of Ger-

many. Regional focus points are more typical for private bankers.

Generally, German banks know the regional characteristics of the market better than their foreign competitors and have the advantage of regional anchoring. Many German players are however not yet sufficiently well set up for high quality private banking. Smaller private banks have to battle especially with topics such as critical mass and presence and present themselves rather as small universal banks rather than as specialised institutes for wealth management.

Larger universal banks, on the other hand, have difficulties with pursuing a clear strategy or with transferring the expertise in the headquarters to the field and achieving a high quality product offering with the required consistency. For many of these banks, wealth management is not viewed with sufficient importance to be seen as a business area in its own right. Therefore they do not generally have a proven history or tradition in this area with the corresponding private banker portfolio. Many are novices who are still establishing their business.

While some German banks have keenly pursued a foothold in this market, the foreign players, with high levels of investment, have been the most competitive in trying to close in on this market. Some Swiss or Anglo-Saxon banks have a great deal of experience in the HNWI segment but as offshore players in Germany they have struggled to exploit this advantage and establish their name with potential customers and employees.



► 1

Anglo-Saxon competitors have reigned in their presence or pulled back to focussing only on the Ultra High Net Worth Individual (UHNWI) segment. Similarly, the ING Bank, not being able to fully exploit the BHF holding have exited, selling out to Sal. Oppenheim.

In contrast, ABN Amro acquired established German private banks (Delbrück, Bethmann and Maffei) and has been able to compete for customers very aggressively with their “money back guarantee” approach. While being the market leaders amongst the foreign banks, UBS and Credit Suisse have had to employ enormous financial resources to gain their position and the result has been a rather cold and unwelcoming customer experience. Smaller Swiss banks (e.g. Julius Bär or Sarasin) or LGT from Liechtenstein have continued to increase their presence.

In addition, bank-like players (e.g. independent wealth managers, multi-level marketers or funds of funds) are competing for the assets of the wealthy customers. These kinds of special players enjoy a high level of trust thanks to their independence and ability to achieve ambitious returns.

Thus heavy competition rages within Germany for the HNWI's wealth. As a result, the top ten banks control just 40% of the market. In addition, German customers have a tendency toward multi-banking. They seldom entrust their entire wealth to a single institution. They prefer to distribute it. Thus, the challenge for the banks is even greater to service the customer comprehensively. Significant market share gains are primarily generated via inorganic growth strategies and thus at the expense of existing competitors. Competition or new players' market-entry is increasingly achieved by poaching qualified employees or employee teams.

Demand-Side Market Analysis

This intense competition is mainly due to the assumption of an enormous market potential, steady growth paths and high revenue expectations. The German market for very wealthy private customers is regarded as the biggest in Europe. It is, however, notoriously difficult to quantify precisely. Official bodies and research institutes do emphasise that there are no valid figures¹ concerning this population group and, equally, diverse studies of the German market have been published which show significant differences with regard to definition and market volume. Sources are often quoted which mention a quantity of over 740,000 HNWI's.² But on closer examination, this number appears very optimistic. Banks could be tempted to storm onto the market hastily and euphorically, to grossly overestimate the market and to over-extend themselves with high branch costs.

With the use of suitable proxy variables, we have estimated the market on the basis of small regional reference values (e.g. district level) for which valid information is available. With the market estimation, one must consider three important facts: firstly, wealthy customers themselves seldom take part in surveys, secondly the third or fourth generation mostly live in different locations across the world, and finally at the moment little new wealth is being generated in Germany. It is rather the case that existing wealth is being redistributed. With the application of the regional analysis basis, the following picture arises: if we take a liquid financial wealth of at least 1 million euros (without property wealth, since this is not disposable) as a basis, we estimate there are approx 250,000 HNWI's with a liquid financial onshore wealth of around 600 billion euros. Additionally there is around 300 billion euros invested offshore.

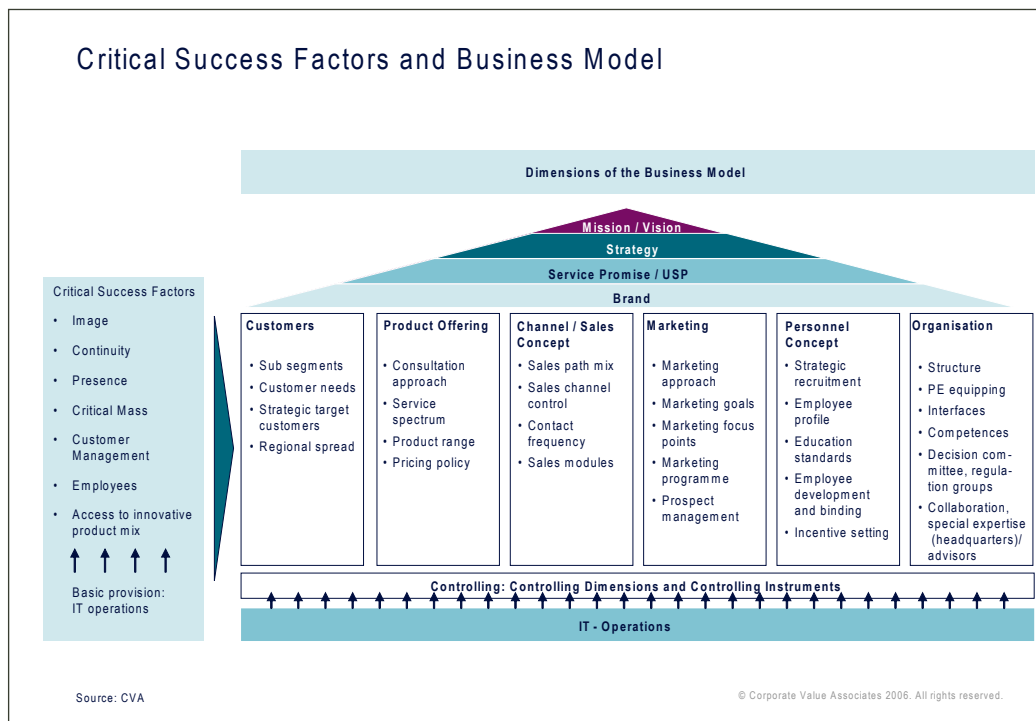
In the past, the German market for wealth has grown strongly.³ In the future, however, a lower growth rate of a 5% p.a. at most can be assumed. Issues such as provision for old age, inheritance, sale of companies and IPOs and also the regulation of succession in small and medium sized enterprises (SMEs) are seen as the drivers of growth in this market. In our view, however, they are primarily an issue of redistribution of wealth. Added to this, there will continue to be a flow of money offshore. The complex, confiscatory German tax law and political inconsistency as well as the new attractive finance opportunities abroad, promote the attractiveness of offshore investments.

The German private wealth management market is heavily regionalised and fragmented. This concerns both the geographical distribution and characterisation of the HNWI and the area presence and market share distribution of competitors.

Strategic Market Development

Not every bank is equipped for the management of complex customer wealth and all too often the promise of a “holistic service” descends into mere lip service. In-depth analysis of the market, reveals an interesting phenomenon: the selling propositions of most banks are very similar. Since the product and the advisor are almost the same, the banks have great difficulty with differentiation and clear positioning. At the same time, the customer is becoming more demanding, better educated and willing to move institutions. It is almost impossible to apply a simple segmentation to these complex customers in order to be able to generate standardised product offering.

In this intensely competitive market with increasing customer expectations, players can only prevail with attractive product offerings that can be delivered effectively to the customer. An attractive offering is one that provides incre-



► 2

ased value from the customer’s point of view. Thus an institution must be able to strategically define their product offering and then possess the ability to deliver the defined product offering. This means providing employees the optimal infrastructure and training as well as designing the appropriate incentive scheme and controlling tools.

To achieve profitable growth in servicing HNWI an additional element is required in Germany – the knowledge of regional distribution, their potential and history as well as

regional sales control. These core components require strategic guidelines, resources and infrastructure from headquarters to be used in conjunction with the in-depth knowledge of the regions. For this to work a permanent and open flow of strategic data between the two is essential.

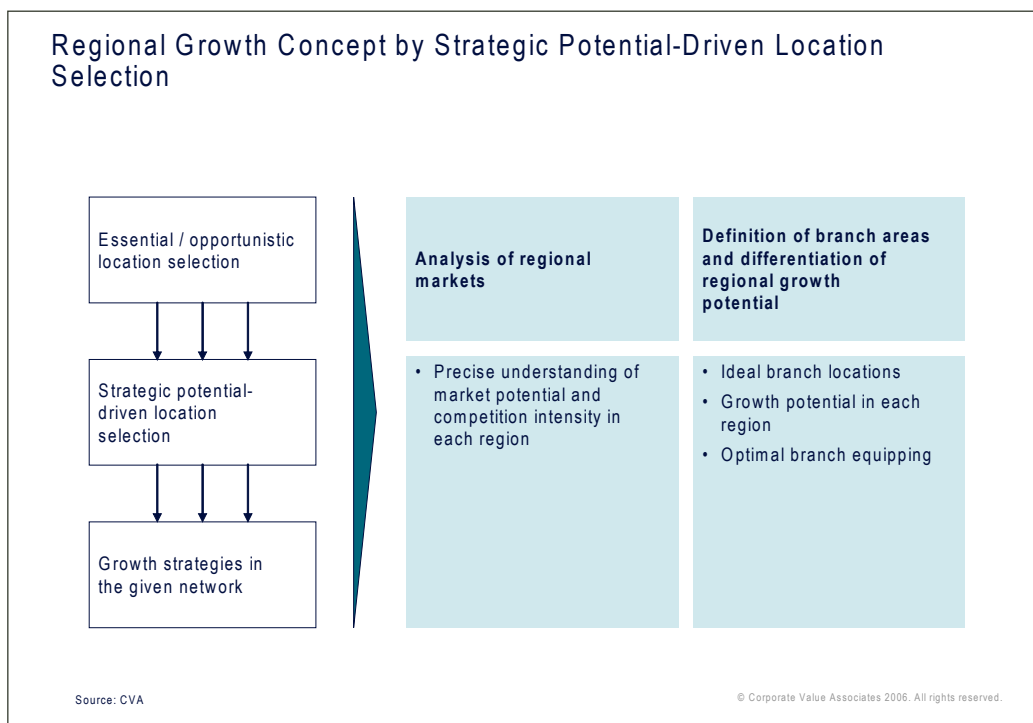
Performance Management: Supply Definition and Corporate Structuring

The primary goal is to win customers, to keep them and to satisfy them. A bank's image and product offering are not decisive factors on their own. The customers are increasingly expecting more. Recognising clusters, homogenous expectations, and also the differentiated characteristics is a central challenge in fulfilling customer expectations on the highest level and in developing innovative and compelling product offerings and services. It is necessary for institutions to respond to individual customer expectations.

In addition, there are a number of other key success factors: ► 2

- Error-free processes enabled by a suitable IT infrastructure
- A convincing image (brand) is important as a stable and quality player. The customers have high expectations regarding trust, safety and exclusivity as well as consistency. The organisation and positioning of the brand are central to employee and customer acquisition (although their importance is diminishing.)

- The credibility of a bank is based primarily on personnel and strategic continuity. Frequent personnel changes are damaging to long term success.
- Presence is to be guaranteed both in terms of location and enterprise size. A detailed regional analysis is required to plan local presence and locations and to staff them effectively. Here, a three level growth model is of assistance. ► 3
- Critical mass is required for profitability and ensuring long term growth.
- Customer management must guarantee quality in the customer relationship and is a central key to success. The player must think and act in terms of the customer. Few banks are successful with customer management in practice. Strategic advisor-customer matching offers optimisation potential. Customers leave their bank mainly for the reason that they are dissatisfied with the service, advice or performance.

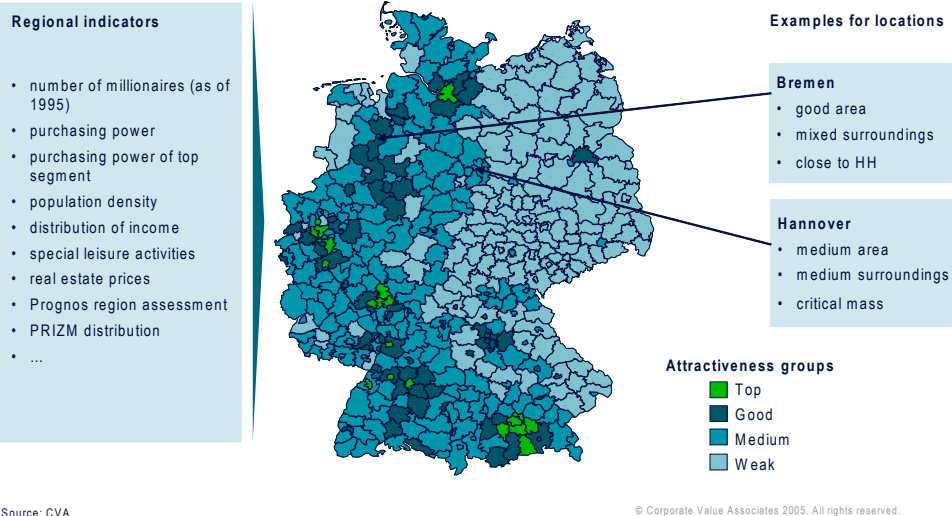


► 3

- Private Wealth Management is a people business i.e. the employee plays a central role. In Germany, a hard battle is currently being fought for good employees. The identification and binding of employees is one of the biggest challenges and therefore should be strategically planned by top management. From the viewpoint of personnel development, appropriate investment is to be made, since consulting to HNWIs demands even more complex expertise and social competence. Here, other industries should provide inspiration as models for the future: from top management consulting through to the "model employers" in e-business.
- Finally, the product offering has to be mentioned. It is our opinion that it is not really the breadth of an institution's range which is decisive for success, rather it's their access to an innovative product mix and ability to individualise their product. Wealthy Germans have invested around two thirds of their wealth in property (while it is usually the liquid wealth that is interesting for private wealth management), extensive property consulting and financing is, a very significant component of comprehensive financial planning in Germany.

Regional Market evaluation (2005)

For the assessment of the regional market attractiveness, a number of relevant indicators is designed, from which the locations are planned



► 4

The management of this business is extremely demanding and requires a well-thought-out, appropriate business model. Its dimensions can be portrayed as a building ► 2. Here, the strategic positioning and the formulated product offering definition form the roof, the coordinated, integrated components the pillars which are carried by the foundation, controlling and IT operations. These dimensions must reflect the critical success factors and resources of the institution and the market situation.

Presence and Regional Sales Concept

The German private wealth management market is strongly regionalised. While in France a large part of the HNWI's live around Paris and in England around London, in Germany, they are fairly dispersed. Additionally, the origin of the wealth is very different depending on the region (e.g. around Stuttgart there are more entrepreneurs, in Frankfurt there are investment bankers and in Hamburg, import/ export traders who have passed their money from generation to generation).

Many players are almost omnipresent. To visibly reach the German customer a broad branch network is required which creates a large logistical and financial challenge. A profitable physical presence is made even more difficult with the German HNWI's tendency to multi-bank. A regional sales concept with growth phases offers a potential solution.

An area-wide bank service presence and flexible accessibility combined with a global network of concern companies and services to correspond with the global

orientation of the customer are essential. The commercial size (global buying power, financial capability and placement power) is also significant. The customer must also sense the exclusivity and size of a player: in their range, in their total presence and in the everyday performance of their advisors and employees.

The development of the business model requires central know-how and central control. A significant aspect of this is the availability and dissemination of information – a challenge in any service business, particularly given the importance of tacit knowledge. In an environment where market share is gained by poaching employees and their knowledge, the appropriate organisational structures are crucial, not just for supporting the employees, but ensuring a key asset of the organisation is retained.

Proximity to the customer has to be ensured. Mobile and digital communication and cost control, have transformed branches in many people's minds into an expensive fixed-cost apparatus and not as a customer contact point. A detailed regional analysis is required in order to strategically plan local presence and their locations, and to staff them effectively with sufficiently qualified personnel and back office. The final factor is securing the cooperation between the central (information) resources and the regionally spread sales employees and advisors.

Decentralised, Regional Sales Expertise

Germany is regarded as an expensive location, mainly because of the high branch density. The core matter of concern of each and every bank is to grow in the right place with the right customers. If a bank wants to orientate itself around the HNWI segment, the sales concept in particular, dependent on the regional market attractiveness, should be planned and implemented. The local expertise and sales' knowledge of the customers is a significant component of this analysis. The early inclusion of sales staff in this planning process, particularly in setting of regional targets, noticeably improves the likelihood of success.

The strategy of regional growth consists at three levels, depending on the development phase of the player. ► 3.

The first level of the location selection is determined by "opportunism". This contains the essential and opportunistically chosen locations: for one institution it may be Frankfurt/Main as the banking centre with other locations chosen as they can gain critical mass by taking over teams from competitors.

The second level contains the strategically determined growth locations. This is based on a planning process for the expansion of the location network. Building on this, is the third stage, where specific growth strategies in the network are implemented. It is, again, critical that there is a thorough knowledge of the market potential at each location and that planning growth strategies can be developed for each individual location.

A player can, particularly in the second level, recognise and achieve valuable growth opportunities by careful analysis of the regional markets and a coordinated branch concept.

For this, one must first identify and evaluate the regional market potential, the competitive situation and dynamics, prioritise between further strategic locations and develop individual strategies to gain locations. The determination of the optimal branch size and a clear understanding of the regional success factors are further components of this second level.

In evaluating the regional market attractiveness, one should not only concentrate on the presence of millionaires or potential customers with top incomes, but rather consider a multitude of relevant indicators, such as the general purchasing power, the purchasing power of the top segment, population density, the income distribution, the distribution of HNWI-typical recreational activities (e.g. riding, golfing, hunting), property prices, Prognos regional evaluation, distribution of the PRIZM milieu types etc. This results in a regional map of Germany clustered according to the attractiveness of these groups. ► 4

All existing and planned locations are now entered into this map and the regional purchasing power is correspondingly evaluated. It will become obvious if there is overlapping or coverage shortfalls and where immediate action is required in branch planning. The regional market is described with all characteristics and thus one gets a "fact sheet" for every existing or planned location. ► 5

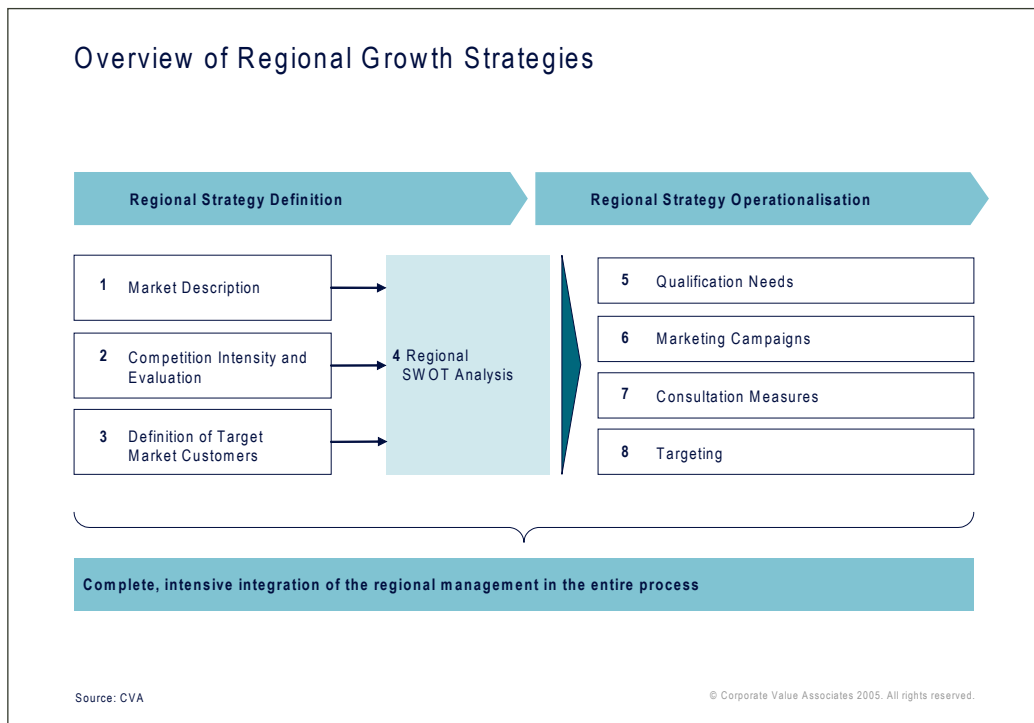
Sample fact sheet with example of location Bremen

Hard factors		Soft factors	Bank specifics
Bremen Good area		<ul style="list-style-type: none"> Client structure Competitors (concentration and assessment of success) <ul style="list-style-type: none"> Deutsche Bank (++) Commerzbank (+) Credit Suisse (+) Neelmeyer (++) Berenberg (+) MM Warburg (+) ... Characterisation: city with rich tradition etc. Economic high-lights: <ul style="list-style-type: none"> positive effects of shipping & trading history location Airbus ... Trends/ developments 	<ul style="list-style-type: none"> Overlapping/ coverage of other branches? Location with moderate distance: <ul style="list-style-type: none"> Hamburg Hanover ... Brand awareness of the bank Subjective perception Regional SWOT analysis Target/ current status team assessment <ul style="list-style-type: none"> constellation location Bremen vs. Locations nearby anchoring in local networks ...
<ul style="list-style-type: none"> Number of millionaires 0,3% (#170) purchasing power index 1,20 purchsing power index top 10% 1,27 Prognos index 42,50 number PRIZM group 11 6% real estate index 1,03 number of top earners 0,07% 	Vicinity of Bremen Mixed area: <ul style="list-style-type: none"> 2 good areas: <ul style="list-style-type: none"> Osterholz (share of mill. 0.2%) Oldenborg 7 medium areas: <ul style="list-style-type: none"> Ammerland Bremerhaven Cuxhaven Diepholz Vorden Rotenburg Delmenhorst 1 below average area: <ul style="list-style-type: none"> Wesermarsch 		

Source: CVA

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Overview of Regional Growth Strategies



► 6

The regional strategy is defined and operationalised based on these facts and with the input from the regional sales employees and advisors. Building on this precise market description, the competitors are evaluated regionally according to their market share, development, strategy, business model, pricing policy, presence, presentation and target customers. Building further on this, each regional target and target customer group is identified. By doing this, one achieves a regional strategic analysis e.g. a SWOT overview. Where necessary, the development of the regional sales concept can be synchronised with the strategic planning process. Experience has, however, shown that this approach seldom improves the quality of the information. Besides the definition of the regional locations, the resource coordination takes place in this strategic information process step. Among other things, the required personnel qualification needs will be recognised and measures for this set up, and regional marketing campaigns will be defined.

Regional characteristics and potential should also be considered in the type networking and marketing support provided to sales teams e.g. in Hamburg, one should become a member in trading guilds, whereas in the Frankfurt area in IPO circles or private equity interest groups. Different support can give very different results depending on the specific cultural aspects or characteristics of the HNWI in that region. The better one understands that these have to be responded to, the more successful the sales concept is in practice. ► 6

The result is a regional sales concept with accepted sales targets and appropriate networking and marketing support for the sales employees. In combination with the strategic business model definition described above, this approach ensures that the employees can achieve their targets and that growth can be achieved profitably. The sales control can now be directed both according to the centrally

established overall concept of the bank and the specific regional requirements.

Conclusion

In a market of undifferentiated and unsatisfactory common place offerings, it is vital for a bank to test their unique selling proposition and its attractiveness from the customers' point of view. Many institutions, will need to develop a regional or target group specific niche strategy as a first foray into this market and to ensure they do not overextend themselves.

Growth with simultaneous cost control is a challenge in the German HNWI market. Using a regional sales concept with a strategically focussed interaction between headquarters and regional units, growth can take place at a pace that corresponds to the institution's size and the market conditions thus guaranteeing a sustainable success.

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Footnotes:

- ¹ Statistics often used as a basis are, besides macro-economic surveys from the German Bundesbank and tax statistics from the Federal Office of Statistics (Statistisches Bundesamt), the Income and Consumption Sample Test (Einkommens- und Verbrauchsstichprobe (EVS)) from the Federal Office of Statistics, the Socio-Economic Panel (SOEP) of the German Institute for Economic Research and expert opinions and reports derived from these, such as the 2nd Poverty and Wealth Report of the Federal Government, cf. Ammermüller, A./Weber, A./Westerheide, P. (2005). cf. Bach, S. et al. (2004), cf. Haisken-DeNew, Frick J. and J. (2004)

² E.g. Merrill Lynch/Cap Gemini Ernst & Young (2005) or Datamonitor (2004).

³ According to Datamonitor by 8% p.a. from 1997 to 2002 and according to Merrill Lynch/Cap Gemini Ernst & Young (2001) around 10% p.a. between 1996 and 1999. According to the German Bundesbank, the aggregated financial wealth of all households between 1995 and 2004 has grown annually by 5%. Merrill Lynch/Cap Gemini Ernst & Young (2005) has calculated a growth of 0.6% for Germany for the year 2003 to 2004.

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