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Next Generation Private Banking: Agile and industrialized

Plight of the Private Banking Industry Today

At the dawn of the 21st century, in a prosperous city of South Asia there was a Tailor. This tailor was a master of his craft and believed that to excel he must focus on «High Quality Personalized Service». He was right and earned the client's trust very early in the game. In absence of traditional advertising as he was in a service oriented business, the growth of the business was based on referrals.

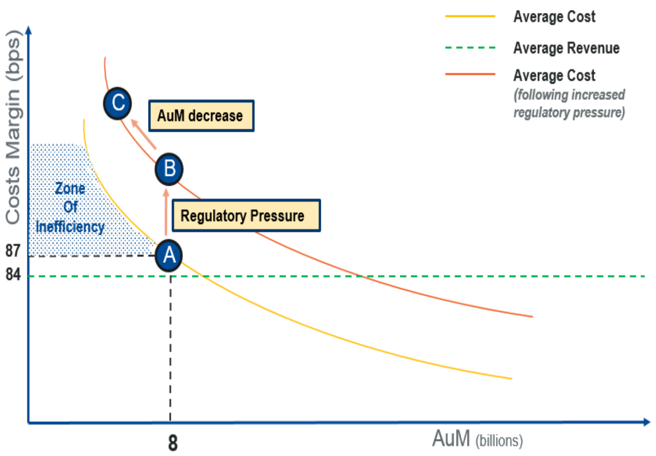
The customer base was growing steadily and tailor's confidence in his services soon transformed into his ambition to serve more clients. As the volumes increased so did the hassles maintaining accounts, keeping track of customer orders, following up on customer requests and other overheads. The tailor had to succumb to the new circumstances. He began cutting down on client interaction and became less and less personable. Not surprisingly the clothes produced were ill-suited and the customers dissatisfied. The business started to crumble.

The more astonishing part for the tailor was that not all the tailors on the same street failed just like him. He overheard his employees use the word «industrialization». The tailor understood that his competitors despite the Tailor's superior skillset managed to thrive. Although he did not understand fully but he believed the success of the competition could be attributed to «industrialization».

The tailor's business although not directly related to Private Banking has striking similarities. As surreal as it may seem, the Private Banking industry is confronted with similar challenges. Perhaps the solution lies in understanding the problems in further detail.

The Challenges faced by the Private Banking Industry

It is common wisdom that the success of a Private Banker just like the Tailor is in demonstrating trust and integrity, high level of technical skills, market awareness, closer relationship, understanding of the client and strong referral from existing clients. But in the Private Banking industry of today the back-office and IT processes drive away focus from «customer focused» front-office processes which in turn leads to the lack of differentiation and commoditization of



services. The Relationship Managers (RM) are finding it increasingly difficult to focus on providing value services to their clients.

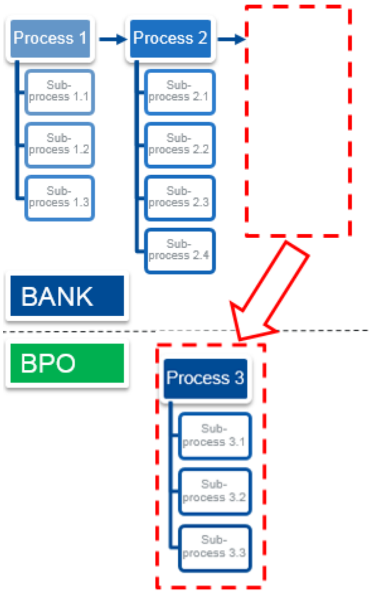
The Post-Financial crisis era is not favorable for a Private Banks traditional operating model either. The cost have been increasing prohibitively due to the increase in the regulatory pressures. As a result of regulations, the Private Bank has to continuously adapt its existing processes and re-train the employees to manage changes. The re-alignment is an expensive affair. As a result the Cost curve for the Bank moves to a higher level from A to B (Cost Margin vs. AuM graph above).

The local Private Banking business' volatile revenue structures are contrasted by rigid cost structures, thus making the industry very vulnerable to downturns. The inelastic cost structure is largely attributed to the investments in infrastructure and personnel during the time of growth but the phenomenon is not reversible during the recession. The decrease in revenue during a slow-down and the resulting relative increase in transactional cost owed to missing economies of scale is the shift from B to C as seen in the figure. The low business elasticity and the cost rigidity is further pronounced due to the transaction based revenue model of the banks.

The other critical element in the cost structure is the non-Front Office (IT & Back Office) overheads. The non-Front Office cost per analysis are a result of largely operational activities and are related to non-value add processes. Managing the risk associated with the non-value add processes also adds to the cost.
On an average, Asian banks with less than USD 8 billion in assets, reported an average cost margin of 87bps. With average revenue margin of 84bps (as seen in Fig.), profit margin will be unsustainable for small and medium-sized banks. High costs owing to consistent regulatory pressures will persist to sustain high growth in Asia. In this post-financial crisis era, the Private Banks are struggling to keep up with the back office costs, dwindling volumes, and lack of service differentiation.

So can an Asian Private Bank still thrive in this climate?
Imagine the CEO of a Private Bank that desires not to look into IT Operations or Back Office proceedings on a daily basis. He is extremely customer focused and the agenda is central to creating «Client Service Differentiation». This CEO understands that the complexity and prohibitive costs added by the back office and IT infrastructure is making the business unsustainable. He prefers that the 'Back Office Operations' although critical for the Private Bank's success reside in an external entity, as seen in the Industrialization model on the right. The CEO motivates the employees to invest time and effort in learning more about their clients. With the CEO's approach client service is deemed to improve.

The situation is not unique to a specific Private Bank but the market tendency is to move away from traditional operating model and more towards an «Industrialized» model. The traditional model was based on 3 broad divisions; the front office, the middle office and the back office. The Private Bank today manages internally the entire spectrum of operational activities irrespective of its area of expertise.



Under the new operating model a careful selection and outsourcing of processes such as standard and repeatable processes and non-customer touch points such as Back Office is recommended. Certain other processes which involve industry wide standard knowledge such as corporate action or payment transactions are also a great candidate to outsource under the Industrialization model.

The Industrialization design principle is «Value Chain Fragmentation». In the figure process 3 has been identified based on the proposed criteria. We must however be aware that the proposed operating model is not just simply about reducing the cost (labor cost arbitrage) but about freeing resources (cash and personnel) to ensure that the bank is able to focus on customer centric activities rather than transactional aspects. Significant reduction in non-value add processes, continuous and focused transformation leads to service improvements and differentiation for Asian wealth management firms. This «Value Chain Fragmentation» approach precisely addresses the problem areas as mentioned in the previous section.

The Industrialization model provides an effective method to keep check on the cost increase due to regulatory pressures therefore reversing the effect. The «Cost Margin vs. AuM Curve» as described earlier therefore will shift back from B to A. Declining transactions, which the second issue reported, is also prevented to a large extent by efficient operating model. Better relationship management and focusing on value add areas helps the bank increase the AuM and reverses the shift from B to C as seen on the «Cost Margin Curve» for Asian Private Banks. Thereby regaining transaction volumes, building customer trust, improving the setup to handle regulatory changes, and bringing down the costs and risks associated with back-office and technology infrastructure allows the Private Bank to be profitable and thrive again.

Contact us

Solution Providers is happy to discuss with you the model for the Next Generation of Private Banking. Please contact our topic experts Yves Roesti yves.roesti@mailsp.com or Abhi Soni abhi.soni@mailsp.com.