

REPORT

GLOBAL WEALTH 2008

A Wealth of Opportunities in Turbulent Times



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Note to the Reader

This is our eighth Global Wealth report. Like previous reports, it begins with a comprehensive review of wealth around the world. The study covered 62 markets representing more than 98 percent of global GDP. Data on global wealth are from 2007, when the effects of the financial crisis were evident but not as severe as they would become in 2008.

Our overview of the world's wealth includes a look at the short- and long-term impact of the ongoing financial crisis, as well as the future of offshore centers. In addition, this year's report focuses on two special topics. First, it explores opportunities to reach clients in challenging markets. It includes profiles of clients and an overview of the competitive state of play in markets across Asia-Pacific, Latin America, and Eastern Europe. It focuses mainly on high-growth, emerging markets but also takes a close look at Japan. Second, the report examines how universal banks can position their private banks within the broader organization and how wealth managers, in general, can organize their front offices to support growth.¹ Our findings are based on more than 60 in-depth interviews with regional experts, family offices, and wealth managers, as well as on BCG's extensive work in the wealth management sector.

We welcome your comments on our insights, and we hope you find the report both interesting and useful.

Acknowledgments

First and foremost, we would like to thank the interviewees who shared their experiences in this dynamic sector. They provided details about specific markets and their own organizations, particularly their front-office operations. Our colleagues in BCG's Financial Institutions practice helped us size the global market and understand the nuances of specific regions and markets.

Contributors from Asia-Pacific included Nelson Choi, Daiji Horibe, Nimisha Jain, Kosuke Kato, Cherry Leung, Yasushi Motoshima, Tongjai Thanachanan, Saurabh Tripathi, and Minji Xu. Our experts in Latin America were Jorge Becerra, Alex Leimbach, Federico Muxi, Guillermo Peschard, Walter Piacsek, and Andre Xavier. In North America, Monish Kumar and Paul Orlander provided insight.

In Eastern Europe we relied on Stephan Dertnig and Wojciech Sass. In Western Europe our experts were Lionel Aré, Eric Brat, Robert Davies, Ludger Kübel-Sorger, Andy Maguire, Claus Miethe, and Andrea Walbaum. In the Middle East we called on Markus Massi and Sven-Olaf Vathje.

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1. The terms *private bank* and *wealth manager* are used interchangeably in this report.



Preface

The crisis that began with a sharp downturn in the U.S. housing market has since roiled financial markets around the world. Most wealth managers have been spared a direct hit, but many have become more concerned about finding new avenues for growth. Some wealth managers are exploring opportunities outside the most developed markets, which had the greatest exposure to the crisis. Others are looking for opportunities to improve their own organizations as a way to boost growth.

North America and Western Europe accounted for about two-thirds of the world's wealth in 2007. The remaining third was spread across more challenging markets around the world, where wealth has generally been growing at much faster rates than in markets on the beaten path. The ongoing crisis, which continues to cast a pall over larger and more established wealth markets, is likely to further increase the unevenness in growth rates.

To reach what we call the *other third* of global wealth, many wealth managers will need to enter or expand their presence in unfamiliar markets. The questions surrounding these opportunities are as complex as the markets themselves: In which regions is wealth expanding the fastest? Where can the highest concentrations of attractive high-net-worth clients be found? Which markets are easiest to enter? In each market, which client segments own most of the wealth? What kinds of investments do they prefer? What are the biggest barriers to growth?

Our study highlights a set of challenges that are common to developing wealth markets, but it also underscores the importance of knowing as much as possible about each specific market in order to reach potential clients. To this end, our study delves into individual markets in Asia-Pa-

cific (China, India, and Japan), Latin America (Brazil and Mexico), and Eastern Europe (Russia and Poland). We also revisited the Middle East, a market we explored in depth in last year's report.

The other third of global wealth could be an attractive source of high-margin growth. Still, wealth managers should not expect emerging markets, which tend to have less developed supply and demand, to also have less competition. Instead, players need to prepare to fight pitched battles in these markets. They also need to have realistic expectations for growth, because many emerging markets are relatively small.

Our study also addresses some of the most pressing concerns about positioning and structuring the front office at wealth management organizations. The financial crisis has given a new sense of urgency to the questions that many wealth managers have about their front offices. Even in turbulent times, wealth management remains a relatively stable business and a valuable source of growing revenues. The front office is the focal point for client-facing capabilities that underpin that growth.

Wealth managers that hone their front offices and develop targeted strategies for new markets can set themselves up for strong growth, even in the face of continued financial turmoil.

Executive Summary

Our report begins with an overview of wealth markets around the world, which includes a look at the implications of the ongoing financial crisis. We then explore opportunities for wealth managers in challenging markets in Asia-Pacific, Latin America, and Eastern Europe. The report concludes with recommendations for how wealth managers can organize the front office for growth.

The Global Wealth Market: Staying on the Path to Growth

Data on global wealth are from the whole of 2007, when the effects of the current financial crisis were evident but not as severe as they would become in 2008.

- ◇ Still, the financial crisis started to intensify in the second half of 2007, and its impact on larger, more developed wealth markets became clear.
- ◇ Despite the financial crisis, we expect global wealth to continue growing, albeit at a slower pace.

In 2007, global wealth grew by 4.9 percent to \$109.5 trillion, measured in local currencies. It was the sixth consecutive year of expanding wealth.

- ◇ North America (defined in this report as the United States and Canada) remained the wealthiest region, with \$39.2 trillion in assets under management (AuM), but Europe was a close second, with \$38.3 trillion.²
- ◇ Japan was the second-wealthiest national market, following the United States, and its \$12.5 trillion in AuM

was only slightly smaller than the combined wealth of all the other Asia-Pacific markets.

- ◇ The smallest regional wealth markets were the Middle East and Africa, with \$3.4 trillion in AuM, and Latin America, with \$3.1 trillion.

The growth of global wealth, measured in local currencies, fell from about 8 percent in 2006 to about 5 percent in 2007. The impact of the financial crisis varied from market to market.

- ◇ Asia-Pacific (excluding Japan) and Latin America continued to post strong increases in AuM, both at 13.6 percent, owing to their rapid economic development. Wealth in the Middle East and Africa also grew at an above-average rate of 8.6 percent.
- ◇ In North America—the epicenter of the crisis—wealth grew by 3.8 percent in 2007, down from a growth rate of 8.9 percent in 2006. Growth was also relatively weak in Europe and Japan.
- ◇ Measured in U.S. dollars, global wealth grew by 9.9 percent in 2007. As in 2006, a weak dollar inflated the growth of AuM in many regions.

From 2002 through 2007, the share of wealth invested in equities grew from 32 percent to 40 percent, increasing the potential for higher growth and volatility.

² AuM includes cash deposits, money market funds, listed securities held directly or indirectly through managed investments, and onshore and offshore assets. It excludes wealth attributed to investors' own businesses, residences, or luxury goods. Global wealth reflects total AuM across all households.

- ◇ Equities, which comprise both direct investments in stocks and equity held by investment funds, accounted for \$43.5 trillion of global wealth in 2007.
- ◇ The rise of equities came at the expense of bonds and cash, both of which fell as a percentage of total AuM over the period—by three and four percentage points, respectively.
- ◇ In 2007, North America had the highest proportion of wealth invested in equities. Latin America had the lowest proportion, but the share of equities as a percentage of AuM more than doubled in the region from 2002 through 2007.
- ◇ Since the financial crisis deepened, in early 2008, wealthy households have been shifting their AuM from equities to more conservative investments.

Wealthy households—those with at least \$100,000 in AuM—represented about 18 percent of all households but owned 88 percent of all wealth.

- ◇ The AuM owned by wealthy households grew at a compound annual growth rate (CAGR) of 13 percent from 2002 through 2007.
- ◇ From 2002 through 2007, the wealth owned by households with more than \$5 million in AuM grew at a CAGR of 15.7 percent, increasing from \$10.1 trillion to \$20.9 trillion.

In 2007 the amount of wealth held offshore increased by 8.4 percent, to \$7.3 trillion, but it declined slightly as a proportion of total AuM.

- ◇ Offshore assets accounted for only 1 percent and 2 percent of AuM in Japan and North America, respectively, and for 9 percent and 10 percent of AuM in Europe and Asia-Pacific (excluding Japan), respectively.
- ◇ In Latin America, offshore assets accounted for 24 percent of AuM. In the Middle East and Africa, 28 percent of wealth was held offshore.

In 2007 the number of millionaire households—those with at least \$1 million in AuM—grew by 11.2 percent to reach 10.7 million.

Three of the five densest millionaire populations were in the Middle East.

- ◇ From 2002 through 2007, the number of millionaire households in Europe increased by a CAGR of 19.1 percent. In 2002 one in five millionaire households was located in Europe. By 2007 about one in four millionaire households could be found there.
- ◇ As in 2006, the United States had by far the greatest number of millionaire households, followed by Japan, the United Kingdom, Germany, and China.
- ◇ Small markets continued to have the greatest concentrations of millionaire households. In Singapore, an astounding one in ten households had at least \$1 million in AuM.
- ◇ Three of the five densest millionaire populations were in the Middle East—in Qatar, the United Arab Emirates, and Kuwait—while Switzerland had the highest concentration of millionaire households in Europe.

Most wealth managers have been spared a direct hit by the financial crisis but have still felt the effects of the turmoil.

- ◇ The crisis has prompted many investors to move their assets into more conservative products, resulting in lower margins for some wealth managers.
- ◇ The volumes of existing and new AuM have decreased, as clients have moved their assets elsewhere or have curtailed new investments.
- ◇ Most wealth managers have yet to take advantage of the opportunities created by the crisis to capture clients and assets.

The Other Third of Global Wealth: Accessing Clients in Challenging Markets

Many large and midsize wealth managers are stepping up their efforts to expand beyond North America and Western Europe.

- ◇ Together, wealth markets in Asia-Pacific, Latin America, Eastern Europe, and the Middle East had around

\$33 trillion of AuM in 2007—or about one-third of the global total.

- ◇ From 2002 through 2007, wealth in these regions grew at a CAGR of 10.2 percent, supported by strong underlying economic growth.

Wealth in Asia-Pacific totaled about \$25.5 trillion in 2007. Japan accounted for nearly half of this wealth.

- ◇ In Asia-Pacific (excluding Japan), AuM grew at a CAGR of 17.4 percent from 2002 through 2007. AuM grew fastest in India and China.
- ◇ Entrepreneurs represent the region's most prominent client segment. They tend to have a high appetite for risk and are quite speculative, but they also trust cash more than any other type of asset.

China has a relatively young but fast-growing wealth market. However, entrants must contend with restrictive regulations.

- ◇ From 2002 through 2007, China's AuM grew at a CAGR of 25 percent. In 2007 it grew by an astounding 36.8 percent.
- ◇ Several challenges stand out in this market: experienced relationship managers (RMs) are in short supply, regulations limit the scope of onshore offerings, and capital markets are underdeveloped.
- ◇ To target the rapidly growing wealth of entrepreneurs, wealth managers should study the industries that are driving China's economic boom, pinpointing where the wealth resides and where it will be generated in the future.

Although India's wealth market is underdeveloped, with a relatively small amount of AuM, it is attractive enough to be competitive.

- ◇ India accounted for just \$1.4 trillion of the \$109.5 trillion in global AuM in 2007, but the market has been growing rapidly.
- ◇ Low barriers to entry have led to increased competition and a broad range of offerings, but India's wealth

market is still relatively immature. Most wealth is invested in property or gold and is self-managed.

- ◇ India's shortage of seasoned RMs is acute, owing to increased competition. This situation has led to high attrition rates, increased compensation, and the hiring of young, inexperienced RMs.
- ◇ Although India's wealth market is nascent, its wealth-management clients are both knowledgeable and extremely active.

Japan's wealth market is highly regulated and locally oriented, but it still presents an opportunity for growth—albeit a challenging one.

- ◇ Despite its size, Japan's wealth market remains relatively immature and difficult to access. Many potential clients have yet to be introduced to the concept of private banking.
- ◇ Japan has a large segment of wealth management clients with between \$1 million and \$5 million in AuM. Their investment needs are not quite as developed as their wealth. Many are starting to venture beyond basic deposits and cash investments, but low-risk products remain common.
- ◇ It will take significant investments to build a local presence. Entrants might instead consider partnering with a local player.

Latin America's wealth is gradually becoming more substantial and is expected to continue growing at an exceptional rate.

- ◇ Wealth is highly concentrated among millionaire households, which accounted for just 0.3 percent of all households in 2007; globally, millionaire households accounted for 0.8 percent of all households.
- ◇ Entrepreneurs are becoming an increasingly important client segment. They have confidence in their local economies and tend to prefer local banks and onshore investments.
- ◇ Local wealth managers are becoming more professional, while international players are converging on the region to build an onshore presence.

Brazil is by far the largest market in Latin America. Strong growth in Brazil's AuM has been driven by economic expansion.

- ◇ Brazil's local players are competitive. They rose to leading positions during the 1980s and 1990s, when high inflation and concerns about political and economic instability discouraged many foreign players from entering the market.
- ◇ Client preferences include a growing interest in international products, a preoccupation with performance rather than confidentiality, and a corresponding move away from offshore investments.
- ◇ Players remain concentrated in São Paulo, but entrepreneurs throughout Brazil are becoming wealthier. As a result, wealth managers are broadening their networks.

Mexico's wealth market has two valuable attributes: growth and stability. The competitive environment is heating up but is not yet overcrowded.

- ◇ Mexico's wealth market grew at a CAGR of 11.9 percent from 2002 through 2007, to reach \$714 billion.
- ◇ Mexico's banking sector is one of the region's most developed. Foreign players have built strong positions, and regulatory changes are paving the way for more competition.
- ◇ Entrants can gain ground by developing innovative offerings that are geared toward specific client segments or by rolling out integrated, one-stop offerings.

From 2002 through 2007, four of the ten fastest-growing wealth markets were in Central and Eastern Europe (CEE): Poland, Slovakia, Hungary, and the Czech Republic.

- ◇ From 2002 through 2007, the growth of AuM in CEE nearly equaled the growth of AuM in the so-called BRIC markets (Brazil, Russia, India, and China).
- ◇ The entire CEE market represents only 1.6 percent of the European wealth market, and the region's abso-

lute gains in AuM are very small compared with those generated in Western Europe.

Russia's AuM grew at a CAGR of 17 percent from 2002 through 2007, to \$950 billion, and is expected to continue growing at an above-average rate.

- ◇ The size and growth of the market make it attractive for wealth managers. International universal banks have rolled out private-banking services, and some smaller private banks have opened representative offices.
- ◇ Russia's billionaire households owned more than one-third of that market's AuM. Millionaire households, which owned two-thirds of all AuM in Russia, held about 32 percent of their wealth offshore.
- ◇ Players could use Russia as a base to expand into the Commonwealth of Independent States (CIS).

In 2007, Poland's AuM shot up by 38.7 percent, to \$302 billion, but its wealth market remains somewhat challenging compared with other emerging markets.

- ◇ The private-banking business has yet to be fully professionalized, but it continues to develop. The prospect of switching the Polish currency to the euro is intensifying competition.
- ◇ Most wealth-management clients are unfamiliar with investment products. Still, they tend to be aggressive when it comes to their investment portfolios.
- ◇ Only about half of the people who qualify for private banking actually use these services. Wealth managers have grown mainly through client acquisition.

The wealth management opportunity in the Middle East is concentrated in the six markets of the Gulf Cooperation Council (GCC): Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and the United Arab Emirates.

- ◇ In 2007 the total GCC market had an estimated \$1.5 trillion in AuM, and the average AuM of a wealthy

household was an estimated \$1 million—well above the global average of about \$400,000 for wealthy households.

- ◇ The region shows signs of continued economic growth and diversification; the GCC governments have upheld their efforts to expand their economies beyond oil.
- ◇ Wealth managers that are interested in establishing a presence in the GCC market will have to pay attention to several challenges, including the need to provide customized offerings and the increasingly competitive environment.

The Front Office: Organizing for Growth

The position of a private bank defines its role, its functions, and how it is perceived by clients. There is no single best-practice model for positioning a private bank within a universal bank. Instead, there are four discrete models.

- ◇ Most large international banks have positioned their private banks as standalone businesses, to emphasize their focus on wealth management.
- ◇ Global and regional banks that lack a traditional focus on private banking or a large client base often position their private banks within their retail banks. This approach is intended to facilitate referrals and create scale benefits.
- ◇ Some players position their private banks within their corporate or investment banks. This approach aims to keep the client's wealth in a single institution and tap product-development synergies; sophisticated wealth products increasingly rely on investment-banking products such as derivatives.
- ◇ A hybrid approach divides wealth management clients between the first two models. Wealthier clients are served by a standalone private bank; less wealthy ones are served within the retail bank.

Private banks located within larger banks are meant to reap the rewards of strong referral management. Many universal banks, however, struggle to implement effective systems for gathering leads.

- ◇ A lack of clear rules and management oversight can hamper efforts to track and manage referrals.
- ◇ Banks can devise effective referral systems by relying on five design principles: gain commitment from management, provide incentives, build trust and familiarity, take a top-down view, and establish continuity.

Wealth managers have found success using a range of front-office models. Although best practice varies, four dimensions must be addressed in the design of an effective front office.

- ◇ *Client Segmentation.* Wealth managers frequently structure their front offices to serve specific segments of clients based on AuM, region, risk tolerance, profession, or other criteria.
- ◇ *Internal Organization.* RMs operate either in teams or individually. A team approach ensures that the client interacts with more than one RM. The individual approach is used mainly by U.S. brokerage firms.
- ◇ *Client Acquisition and Management.* Wealth managers should develop incentive systems that strike a balance between client acquisition and management and that emphasize the strengths of individual RMs.
- ◇ *The Approach to Serving Clients.* The approach that the front office takes to serving clients can range from pushing products to providing advice. Some players have adopted a broad approach, which includes everything from straightforward transactions to holistic wealth planning.

Product proliferation has forced private banks to pay more attention to the interface between the front office and product experts.

- ◇ RMs need to understand and feel comfortable with products before promoting them. At the same time, product experts should be able to draw on RMs' knowledge to craft new products.
- ◇ Despite the importance of connecting RMs and product experts, it is not uncommon for small and midsize private banks to have little coordination between these groups.

- ◇ Many larger players have created positions to bridge the gap between the front office and product experts. Banks use different names to describe these employees; we refer to them as product specialists.

The most successful models for ensuring interaction between RMs and product specialists share several characteristics.

- ◇ RMs must always know who supports them for specific product-related topics. Ideally, they should meet with product specialists regularly.

- ◇ Regardless of where product specialists reside within the organization, they should always have a functional link to the business that develops products.
- ◇ The compensation of product specialists should include product-related incentives, defined by the business that develops products, and client-related incentives, defined by the front office.