

Wealth Management Is Now a Design Industry

By Scott Welch, CIMA®, and Ryan Krystopowicz, CFA®

Wealth management is “in.” Banks, wirehouses, and registered investment advisors (RIAs) are pouring resources into developing competitive wealth management offerings, hoping to capture a larger share of this rapidly growing marketplace. And many of these firms are going about it all wrong.

How?

By focusing too much on products and not enough on the client experience.

There are reasons people shell out premium prices for a cup of coffee at Starbucks, rooms at The Ritz-Carlton, Apple products, and trips to Disney World. Yes, the products offered by these firms are excellent and, yes, they all deliver good service, but the reason these firms are so successful is that they understand their customers do not keep coming back to buy a product. They are paying for an experience.

Wealth management is evolving in the same direction.

The value proposition decreasingly focuses on products or services, which are assumed or taken for granted. Increasingly, the emphasis is on the quality of the advice, the level of expertise delivered, and the ease with which information and service can be accessed—the wealth management experience enjoyed by the client.

Table 1 summarizes one way that high-net-worth (HNW) investors and families value their wealth management solutions.

Table 1

THE VALUE-ADD OF BEST PRACTICES IN WEALTH MANAGEMENT

	Module	Typical value added for client (basis points)
Suitable asset allocation using broadly diversified funds/ETFs	1	>0*
Cost-effective implementation (expense ratios)	2	30
Rebalancing	3	14
Behavioral coaching	4	0 to >200
Asset location	5	0 to 60
Spending strategy (withdrawal order)	6	0 to 120
Total return versus income investing	7	>0*
Range of potential value added (basis points)		Up to, or even exceed, 3 percent in net returns

* Value is deemed significant but too specific to each investor to quantify.

Source: Vanguard, “Putting a Value on Your Value: Quantifying Vanguard Advisor’s Alpha®,” <https://advisors.vanguard.com/iwe/pdf/IARCQAA.pdf>

... the reason these firms are so successful is that they understand their customers do not keep coming back to buy a product. They are paying for an experience.

This article summarizes several of the trends driving the HNW marketplace, with a particular focus on commoditization and true differentiation in the HNW space. It also suggests what a successful wealth management solution needs to offer, and why more firms find that outsourcing provides them with the best opportunity to remain competitive and deliver an appropriate wealth management experience.

To deliver a successful wealth management solution in today’s competitive

marketplace, a good place to start is with the idea of the “3 Ps” (platform, process, people) model, an adaptation of the “people, process, technology” framework applied across many industries.¹

PLATFORM

A competitive solution begins with the wealth management platform offered to clients. An appropriate framework here is the solution offered by many of the leading wealth advisory firms. These firms rarely compete based on product or price. They compete based on the quality of the advice they provide and the level of service they deliver.

The advice these firms deliver can be segmented into main categories—investment consulting services and a broadly defined suite of wealth management services tailored to the needs of the client base.

Investment consulting has its historical roots in the institutional world, where

pension funds, endowments, and foundations have long sought objective advice on how to structure and implement an appropriate investment portfolio.

In the HNW space, the deliverables of investment consulting can be summarized broadly as follows:

- Integrated wealth planning
- Investment policy statements
- Asset allocation and asset location planning (tax efficiency)
- Customized portfolio construction
- Manager search and selection (both traditional and alternative investments)
- Consolidated performance reporting

Most of these terms are self-explanatory, but the phrase “integrated wealth planning,” made popular by industry thought-leader Jean Brunel (2002), deserves further discussion.

The term refers to the fact that the institutional consulting model, with its heavy focus on unemotional asset allocation in a world where the time horizon theoretically is infinite and taxes don’t exist, is flawed when applied to tax-paying humans.

Brunel suggests that when dealing with individual investors, the concept of an “optimized” portfolio does not exist; instead, investors and their advisors are on a perpetual “path to optimization.”

Think of integrated wealth planning as a three-legged stool (see figure 1). One leg is the traditional concept of asset allocation, i.e., diversifying investments across multiple asset classes to minimize the risk of the portfolio for an expected or desired level of return. Many advisors today still sell asset allocation as the be-all and end-all of investment planning. But traditional asset allocation ignores two inconvenient aspects of dealing with individual investors: (1) they pay taxes, and (2) they frequently behave irrationally with respect to their wealth.

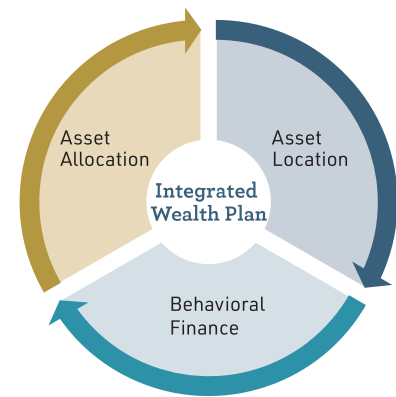
To factor these components in on the path to optimization, wealth managers need to incorporate the following:

Asset location. This refers to the integration of appropriate estate planning vehicles to minimize the taxes paid on the overall investment portfolio. Estate planning often is pigeon-holed to minimize wealth transfer taxes as money moves through generations. But proper use of estate planning and other tax-deferred or tax-minimization vehicles, e.g., individual retirement accounts, 401(k) plans, limited liability companies, family limited partnerships, trusts, etc., also can reduce income taxes paid along the way. By placing different types of investments within different tax-deferred and estate planning entities, investors can increase the inherent power of compounding within the portfolio.² Many wealth advisors tend to focus on creating the perfect investment portfolio, but the truth is that, in the long run, good tax and estate planning will trump good investment planning every time.

Behavioral finance. The field of behavioral finance, which essentially is the study of why perfectly rational investors frequently make irrational decisions with respect to their money, has been around for 20–30 years, but it is only in the past several years that the wealth management industry has attempted to turn the theory into practical applications. Today it represents one of the most talked-about and written-about concepts in the industry. With respect to the path to optimization for individual investors, behavioral finance helps an advisor develop a better understanding of an investor’s emotional makeup and frame of reference to create investment portfolios that work quantitatively and are emotionally comfortable for the investor. Most wealth advisors have experienced the frustration of creating an investment plan for a client that is never implemented or is abandoned at the first unexpected event. Many times, this is because the investor could not buy in to the plan from an emotional perspective.

Figure 1

THE COMPONENTS OF INTEGRATED WEALTH PLANNING



Source: Adapted from Jean Brunel, Brunel Associates

Successfully integrating asset allocation and asset location into an overall wealth plan that fits the emotional frame of reference of a specific client is clearly not a commodity. It is a critical step in delivering a differentiating wealth management experience.

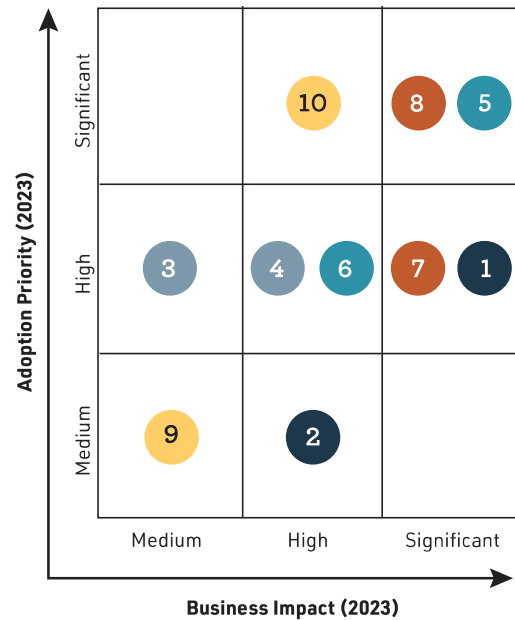
According to annual wealth management surveys from Capgemini and PwC,³ in addition to investment consulting, the successful wealth management platform also must deliver a broad array of services tailored to the needs of the affluent marketplace, such as:

- Access to alternative and private investments;
- Access to digital assets and digitized technology;
- Access to impact investing and environmental, social, and governance strategies;
- Access to outsourced chief investment officer services;
- Access to attractive loan rates and credit services;
- Negotiated access and price for managers and custodians;
- Access to top-quality estate and insurance planning;
- In-house or external access to high-quality trust services; and
- Internal or external access to bill paying, record keeping, and tax preparation.

Figure
2

TOP TRENDS IN WEALTH MANAGEMENT 2023—PRIORITY MATRIX

Changes in Industry Dynamics	
1	ESG regulatory standards aim to curb corporate investment greenwashing
2	Demand for outsourced chief investment officer services is on the rise
Creating and Enabling New Values	
3	Investor appetite for digital assets drives wealth industry capabilities beyond cryptocurrencies
4	Amid volatility, investors seek new portfolio strategies, such as direct indexing
Customer Centricity	
5	Wealth management firms refocus on the mass-affluent segment
6	As women increasingly control more wealth, firms must earn their trust and wallet share
Business Resilience	
7	Evaluating cybersecurity for future readiness
8	A digitalized core can bridge the gap between relationship managers' expectations and wealth management firms' automation capabilities
New Horizons	
9	The wealth management industry is consolidating to achieve scale
10	Family offices showcase bespoke services while facing regulatory dynamics



Source: Capgemini Research Institute for Financial Services Analysis, 2022

Figure 2 summarizes wealth management trends as we move through 2023 and beyond.

The key word in all these services is “access.” It is not required—and often not desirable—for a given firm or practice to deliver these services through internal or captive channels. As wealth management becomes more complex and customized, many firms are developing expertise in specialized and niche-oriented services.

The comprehensive platform described above is necessary but not sufficient for success. These services are not automatic differentiators in today’s marketplace, but not offering them is, or soon will be, a negative differentiator.

PROCESS

The second leg of delivering a successful wealth management solution is creating an appropriate process for delivering the platform. The traditional model of a salesperson handing off to a portfolio manager is exactly the wrong model for delivering the platform described above.

To its credit, the wealth management industry is moving in the right direction on this front. Increasingly, practices are focusing on building teams with different areas of specialization to service a common client base, and compensation structures are changing to reward professionals who deliver the entire practice to the client and not just their area of expertise.

This model is illustrated in figure 3. Some firms have made great strides in this direction; others have a way to go.

Putting the right process in place, of course, requires more than just changing the organization chart and compensation structure. Many firms and practices today place a heavy emphasis on client attraction, i.e., bringing new clients in the door, but they have minimal to no formal processes in place to retain the clients already in the house.

From a profitability perspective, the dirty little secret of wealth management is that it generates lower operating margins than other types of firms in

the broader financial services industry. It historically was not as scalable (though that is changing due to technology advances and firm consolidation), it requires more qualified and higher-priced professionals to deliver successfully, and the cost of dealing with external managers and service providers can be more expensive than in-house solutions.

To be successful, then, wealth managers need to make heavy investments in technology and place an increasing emphasis on operating efficiency and bottom-line growth, not just top-line revenue or growth in assets under management.

This point also highlights an ongoing difficulty for publicly held banks and financial service providers in providing an appropriate wealth management solution. It is more profitable, both absolutely and on a recurring revenue basis, for firms to sell captive product. So, although some practices may recognize that offering an “open architecture” solution, i.e., offering both internal and

third-party solutions, is more appealing to clients, it may be the wrong solution for shareholders. This is known as the “agent-fiduciary conflict,” and it is not an easy conflict to resolve.

A final aspect of the process is the cultural one.

No amount of change to the product mix or delivery system of a wealth management offering will succeed if the firm does not focus intensely on creating a corporate culture and mindset that aligns business practices and behavior with the overall business strategy.

PEOPLE

The final aspect of delivering a successful wealth management solution is people, and there are several aspects to making sure the right people are in place.

THE BDO-CRM CONUNDRUM

Industry and psychological research suggests that roughly 10 percent of wealth management applicants possess the appropriate personality and psychological profile to be successful business development officers (BDOs).

“Making it rain” is a rare and valuable skill.

At the same time, roughly 50 percent of candidates have the appropriate makeup to be successful client relationship managers (CRMs). Statistically, then, only (0.1×0.5) percent—one applicant in 20—has the goods to excel at both client acquisition and client servicing.

The implication is clear: Wealth management firms must hire and retain both types.

Successful CRMs must be able to deliver the firm’s solution in a seamless and professional manner, and they must be able to harvest internal leads that come their way from other specialists within the organization and develop strong relationships with center-of-influence referral sources.

Figure
3

WEALTH MANAGEMENT TEAM SPECIALIZATION



On the flip side, the stereotype of the successful BDO is an extrovert with strong empathy, well-developed knowledge and understanding of the firm’s offering and value proposition, high “EQ” (emotional quotient), discipline and persistence, and highly developed interpersonal skills, combined with a high tolerance for failure.

Those traits still may be necessary but, given the increased relationship management responsibility implicit in delivering an integrated wealth management solution, they no longer are sufficient.

CREDENTIALIZATION

One manifestation of the increasingly complex solution demanded by HNW clients is that it becomes more difficult to be a generalist and makes wealth management an industry well down the path of specialization and niche players. Even a CRM whose primary responsibility is to marshal specialists to meet client issues needs more than a general level of expertise.

The result? The industry has seen an explosion in “credentialization” as wealth advisors pursue advanced degrees and industry certifications to remain competitive.

Consider the following partial list of programs and certifications now available:

- The Certified Investment Management Analyst® (CIMA®), Certified Professional Wealth Advisor® (CPWA®), and Retirement Management Advisor® (RMA®) certifications offered by the Investments & Wealth Institute;⁴
- The Chartered Financial Analyst® (CFA®) certification offered by the CFA Institute;
- The CERTIFIED FINANCIAL PLANNER™ (CFP®) certification offered by the Certified Financial Planning Board;
- The Personal Financial Specialist™ (PFS™) certification offered by the American Institute of CPAs; and
- The Certified Trust and Financial Advisor (CTFA) designation offered by the American Bankers Association.

This list does not even consider certification programs offered by individual wirehouse and banking firms. Many of the larger wirehouse firms, for example, have instituted rigorous internal certification programs that financial advisors must complete before they are allowed to work with HNW clients.

This is not a fad. The emphasis on advanced education and specialized training will soon become an industry-wide requirement for advancement. Conversely, firms that do not offer appropriate certification and education opportunities for their advisors will find

it difficult to retain top talent who have embraced the new paradigm and demand training as part of an employment package.

FRAMING THE WEALTH MANAGEMENT EXPERIENCE

Advisors know they often need to wear multiple hats to deliver a superior wealth management solution. These hats are critical to running their businesses. But the burden of all these hats can make an advisor feel like the business is running them.

This begs the question: Which hats are most important? A framework based on Maslow's hierarchy of needs can help answer this question.⁵

Maslow's hierarchy of needs helps us to understand human motivations. We've adapted this hierarchy to create an advisor value pyramid, as provided in figure 4, to show the values that clients put on the products and services that advisors offer.

With Maslow, the functional needs at the bottom of the pyramid are food and shelter. With investors, the functional needs are related specifically to their portfolios. Once these needs are met, they look to advisors to help meet their emotional and life-changing needs.

Research suggests that, with in-depth knowledge of their clients, advisors are

the only ones who can deliver these emotional and life-changing values. This is in stark contrast to functional needs, where leveraging software and third-party expertise is more practical.

Using Maslow's hierarchy of needs as a framework, advisors should assess where their time is best spent within the pyramid. The goal is to offload as many hats or tasks as possible related to the functional level and spend more time delivering the emotional and life-changing services clients value most.

For example, many advisors use model portfolios to satisfy functional needs. Leveraging the expertise of third-party managers achieves these functional needs for clients.

THE ARGUMENT FOR OUTSOURCING

All the trends identified and discussed in this article point to an inevitable conclusion: Outsourcing of wealth management services will grow in coming years.

Consider the benefits of outsourcing in comparison to the alternative methods for creating a successful wealth management solution, i.e., building it organically or buying it via acquisition:

- It allows firms to focus on business development and client relationship management, while still delivering best market practices;

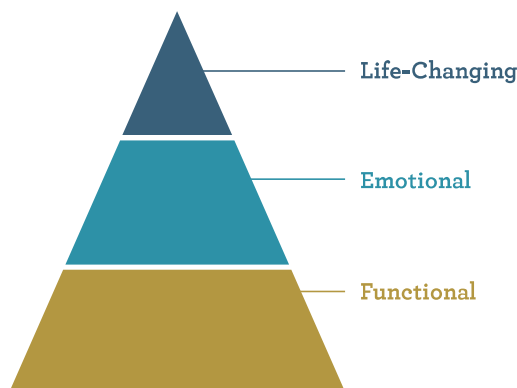
- Partnering with proven providers allows a wealth management firm or practice entering this competitive space to hit the ground running;
- It may actually maximize net profitability by reducing operational, staffing, and compliance requirements;
- It allows the firm's internal focus to be on professional development and education; and
- It allows the RIA or wirehouse practice to quickly evolve away from sub-optimal legacy systems and service platforms.

Consider the findings of several industry surveys:

- Advisory focus on "the client experience" results in a 93-percent higher median client size.⁶
- Advisors who outsource at least 90 percent of their assets save an average of 8.4 hours per week on investment management.⁷
- Ninety percent of investors welcome third-party models in their portfolios; 70 percent of investors believe third-party models will help improve their portfolio performance; 75 percent fewer investors would consider leaving their advisors if they used third-party models.⁸
- More than 50 percent of advisors currently outsourcing their investment management have reported a decrease in operating costs since they began outsourcing, with 40 percent

Figure 4

ADVISOR VALUE PYRAMID



- + Helps me reach my life goals/dreams
- + Keeps me motivated that I will reach my financial goal
- + Gives me a sense of financial optimism
- + Provides access to financial expertise
- + Financial health
- + Reduces stress and anxiety
- + Grows my financial portfolio
- + Provides a variety of investment strategies
- + Provides reliable and trusted financial information

Source:

seeing declines in costs of 5 percent or more.⁹

- More than 80 percent of advisors reported both stronger client relationships and increased client retention as a direct result of outsourcing; 67 percent of all advisors increased the number of client referrals.¹⁰
- Seventy-seven percent of advisors who outsourced said that they have seen growth in their total assets under management (an average of 27-percent growth); 72 percent said they experienced higher personal income (an average 26-percent increase); and 67 percent said they experienced lower operating costs for their practice (an average 17-percent decrease).¹¹
- Advisory practices that dedicate more than 70 percent of their time to client service and asset gathering report 3.5 times the number of new clients and twice the asset growth of those that don't.¹²

THE WEALTH MANAGEMENT EXPERIENCE

The current and future state of the wealth management industry can be summarized as follows:

- HNW families increasingly demand an objective and consultative wealth management solution;
- There are very few products and services that cannot be outsourced effectively;
- It will be increasingly difficult to differentiate yourself based on investment products because so many institutional-quality outsourced solutions are available;
- Technology improvements will allow an ever more seamless delivery of outsourced products and services; and
- Niche players will continue to develop as outsourced service providers because specialization means differentiation and higher margins.

Wealth management is now in a post-product, post-service stage of

development. Wealth management is now a design industry. Think of Starbucks, Disney, Apple, Whole Foods, Nordstrom, the Four Seasons and Ritz-Carlton hotel chains. What do they have in common?

Do they sell a quality product? Absolutely. Do they deliver quality service? Of course. But what sets them apart—and allows them to charge a premium price—is the overall experience clients enjoy in dealing with these firms.

Wealth management is now a design industry. Think of Starbucks, Disney, Apple, Whole Foods, Nordstrom, the Four Seasons and Ritz-Carlton hotel chains.

So how does this translate to the wealth management industry? What is the appropriate wealth management experience? In a highly competitive marketplace where products are widely and cheaply available, and where everyone claims to offer excellent service, offering a wealth management experience means having the most talented people operating as a team in the most conducive environment and delivering best-of-strategies solutions for specific client needs.

The wealth management practice that can capture this experiential magic in its wealth management offering will be the firm that succeeds. ●

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ENDNOTES

1. See, for example, B. Simon, "Everything You Need to Know about the People, Process, Technology Framework" (June 14, 2019), <https://www.smartsheet.com/content/people-process-technology>.
2. See, for example, D. Rogers and S. Welch, "Tax-Aware Investing—An Interview with Douglas S. Rogers," *Investments & Wealth Monitor* 30, no. 1, January/February 2015: 5–10.
3. See Caggemini, "Wealth Management Top Trends 2023," <https://prod.ucwe.caggemini.com/wp-content/uploads/2022/12/Top-Trends-Wealth-Management-2023-1.pdf>; and PWC, "Next in Asset and Wealth Management 2023," <https://www.pwc.com/us/en/industries/financial-services/library/asset-wealth-management-trends.html>.
4. Disclosure: As of the time of publication, Scott Welch sits on the Investments & Wealth Institute's board of directors.
5. Maslow's hierarchy of needs is a motivational theory in psychology consisting of a five-tier model of human needs, often depicted in a pyramid. See, for example: <https://www.simplypsychology.org/maslow.html>.
6. See M. Satter, "'Client-Centric' Advisors Have 93% Bigger Accounts: Cerulli," *ThinkAdvisor* (December 20, 2018), <https://www.thinkadvisor.com/2018/12/20/advisors-focused-on-client-experience-have-93-bigger-clients-cerulli/>.
7. See "The Impact of Outsourcing," AssetMark, <https://f.hubspotusercontent40.net/hubfs/2512747/Impact%20of%20Outsourcing%20-%20AssetMark%20Study.pdf>.
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9. See endnote 7.
10. Ibid.
11. Ibid.
12. See "The Value of Time: Quantifying How Client Focus Increases the Value of Your Business," SEI and FP Transitions (September 2016), <https://docplayer.net/42941077-The-value-of-time-quantifying-how-client-focus-increases-the-value-of-your-business.html>.

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