

Improving product, client, and advisor  
profitability in wealth management  
Using profitability reporting to drive  
top- and bottom-line improvements





# The profitability paradox of growth

Although client wealth levels suffered significant decreases following the recession in 2007-2008, total household wealth has steadily returned to prerecession levels.<sup>1</sup> However, despite notable growth in wealth, wealth managers are struggling to recapture the high levels of profitability they experienced in the past. Indeed, wealth management margins have decreased disproportionately to household wealth—with average pre-tax margins for the industry declining 37 percent in 2006 and 36 percent in 2007 to 16 percent in 2011<sup>2</sup> (see Exhibit 1).

There are numerous cases for this decline, including:

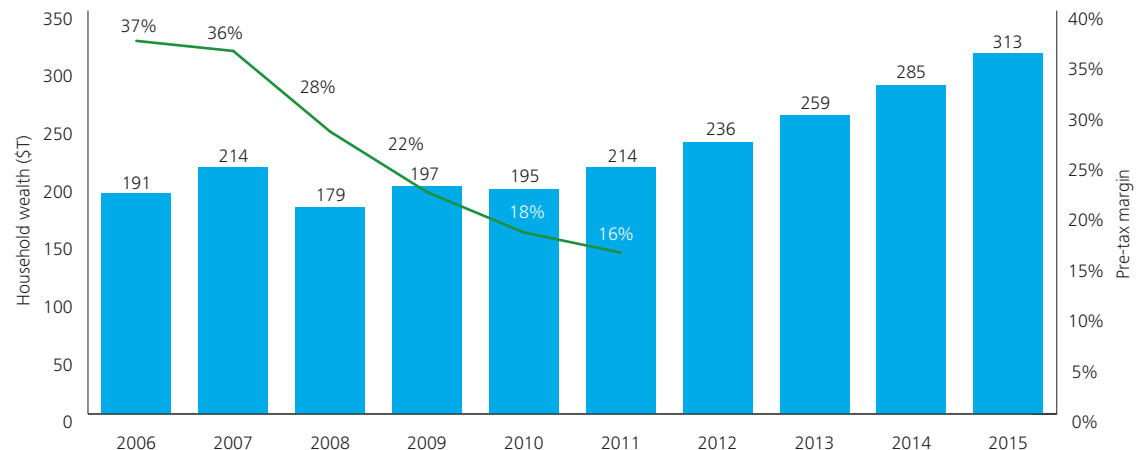
- Deflated asset levels have led to lower percentage-based management fee revenue. Since 2008, clients have grown increasingly conservative and price sensitive. Based on a Deloitte 2011 survey, 44 percent of clients said they were conservative in regard to their risk tolerance, compared to 22 percent in September 2008.<sup>3</sup>

- Many investors have de-risked and moved into low-cost, index-based products,<sup>4</sup> being reluctant to move back into the types of high-risk asset classes, such as equities, that tend to carry high operating revenue and margins.

Other challenges facing wealth managers are related to rising fixed and variable costs:

- Fixed costs in the form of regulatory compliance
- Investments in core service capabilities have often represented efforts to win back client confidence
- Expensive projects to update and modernize systems for risk management, reporting, etc.
- Increases in the number and diversity of products, with customization of investment services, have increased variable costs

**Exhibit 1. Global household wealth and pre-tax margin**



Source: Credit Suisse Global Wealth Report 2010

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Some market segments, including mass affluent clients, are still underexplored; there are areas for future growth that represent important opportunities. Managers should pursue targeted segments that can lead to increases in volume and profitability, instead of margin destruction. Analyzing the current business for improvements and beginning to take action to positively impact main profitability drivers can help managers return to healthy margins serving current and future clients.

To do so, a logically framed approach can provide a useful reference for guiding the improvement process.

As described in the sections that follow, this five-stage approach addresses fundamental issues and offers incremental points of progress to assist managers to:

1. Begin to assess the challenges of profitability
2. Undertake initial steps to track profitability based on reporting capabilities
3. Develop views of product profitability through the tracking and allocation of costs by activity performed (activity-based costing)
4. Translate an understanding of product profitability into client profitability
5. Use clear views into advisor profitability to identify main improvement areas

# Stage one: The challenges addressing profitability – where to start?

In light of industry forces, wealth managers are increasingly looking to understand the factors that contribute to greater profitability.

Many are seeking to identify “true” costs and revenues by product and service line (e.g., investments, fiduciary, trust, banking, custody) in order to clarify which products add to profit margin. Some wealth managers may be assessing the cost to serve various accounts to identify well-performing businesses, while also analyzing individual client relationships across different offerings. In addition, for some wealth managers, advisor profitability is under review. In short, assessing profitability is taking place along three primary dimensions: product, client, and advisor profitability.

The challenge, however, is that it is often difficult to obtain a clear picture of profitability across these three dimensions. Achieving visibility into revenue by product class is constrained by complex methods of aggregation across various income streams from fees, interest income, trading, and other sources. Meanwhile, the underlying cost and revenue data relating to services provided to individual clients is often difficult to consolidate from the various accounting and management information systems that cross different businesses and functions. Thus, the true operating results for various profit centers are often hard to ascertain given complex, incomplete, or sometimes inaccurate cost and revenue allocations. Lastly, assessing the performance of individual advisors is difficult due to the scarcity and inconsistency of product and client data with which they are associated, while advisors’ activity, loading, and utilization entail costs that are difficult to quantify and track.

Once a strategic decision has been made to address profitability from both sides of the cost/revenue equation, a goal to identify and prioritize those initiatives that contribute to greater profitability can be set. It may then be possible to make decisive changes and investments that may boost profitability without compromising growth or quality of service within a wealth manager’s core market segments.



## Bottom line

Particularly with recent decreases in profitability, developing a commitment to gaining accounting transparency, along with a strong understanding of product, client, and advisor profitability, can increase efforts to highlight those areas that need further analysis and corrective action.



# Stage two: An approach for profitability – enterprise tracking and foundational reporting

How do wealth managers build capabilities to identify, assess, and act on product, client, and advisor profitability? Once a strategic decision has been made to address profitability from both sides of the cost/revenue equation, there follows a natural progression through the remaining four stages, starting with foundational enterprise tracking and reporting and culminating in a clear view of the performance of individual advisors, based on the clients they serve and the products they utilize. This approach (see Exhibit 2)<sup>5</sup> may have broad enough applicability to be used as a reference tool by many wealth management organizations ready to hone their view of underlying business profitability and take steps to improvement.

The foundational enterprise tracking and reporting stage comprises three incremental capabilities:

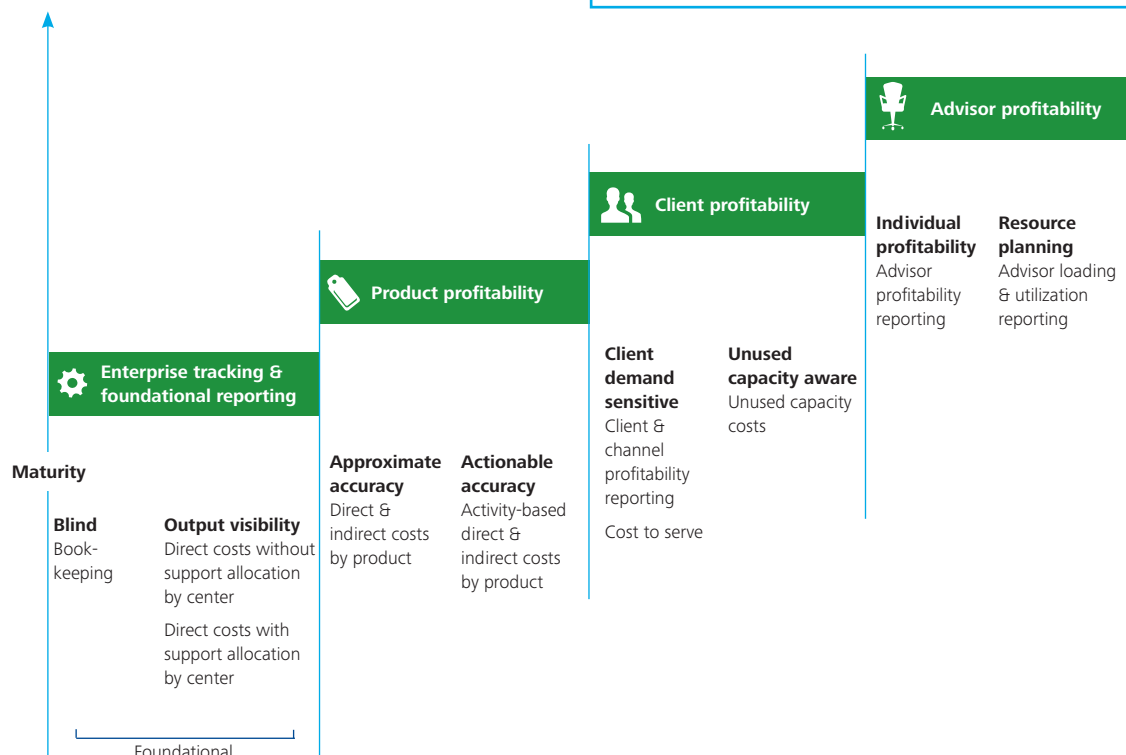
- Initially, nascent and even some more mature organizations “fly blind” with simple bookkeeping, which shows basic results of operational performance.

- Then, businesses can begin to gain output visibility by understanding profit centers’ direct costs and starting to clearly quantify and allocate overhead supporting costs.
- Larger and more mature organizations likely find it worthwhile to closely analyze the efficiency of systems and processes to confirm that they are providing a clear view of the aspects of the business that are needed to make decisions on profitability.

**Bottom line**

Determining that fundamental reporting capabilities to track and properly allocate direct costs are adopted should likely be the first step to take. This could facilitate the development of more mature profitability assessment capabilities, in addition to providing supporting compliance for organizations’ increasingly demanding requirement

**Exhibit 2. Profitability approach and levels of maturity**



# Stage three: Product profitability

In the third stage, wealth managers can get a view on product profitability. One method can provide approximate accuracy by determining cost allocations for direct and indirect expenses of distinct products. Alternatively, an organization can take further strides toward more actionable reporting accuracy by tracking “activity-based costs” by product. Activity-based costing, while perhaps requiring more initial time, effort, and investment to implement, may provide a truer view of costs by looking at the consumption of resources relative to core business activities such as client advisory services, product execution, client service, technology, and operations. Furthermore, tracking costs by activity facilitates the allocation of product and service revenues to the proper sources within the organization.

Each of these business activities can be divided into drivers, which serve as units of measure to determine the consumption of resources for each activity. Based on which types of personnel roles are needed to execute required activities in proportional allocations, costs can be mapped to distinct activities and subsequently tracked via well-understood drivers. Exhibit 3<sup>5</sup> offers examples of how activity costs can be linked to products and services. For example, in establishing a new product for a client, given the operational resource costs associated with onboarding, product setup, account opening, and account maintenance, management may determine that the number of new accounts is a main driver to follow in linking costs to a specific line of products or service. This may then become a metric for allocating costs associated with product execution, which can be viewed by various product groups to monitor profitability.

**Exhibit 3. Linking activity costs to products**

Costs (key roles)	Activities	Key drivers to product	Products
Relationship managers	→ Client management	→ Not allocated to products	Managed investments
Financial advisors		# of clients	
Portfolio managers		\$ total client positions (TCP)	
Sales traders	→ Client advisory	→ # of entities	Self-directed investments
Trust officers		# of products	
Wealth advisors			
Portfolio managers		# of accounts	
Lenders	→ Product execution	→ # of facilities	Fiduciary & trusts
Trust officers		# of new products	
Risk management, compliance		# of trades	
Client service reps	→ Clients Service	→ # of accounts	Banking
Specialized support groups		# of clients	
		# of transactions	
		# of trades	
Loan operations support		# of accounts	
Trust operations support	→ Technology & operations	→ # of jurisdictions	Lending
Operations		# of transactions	
Technology		# of users	
Corporate overhead			
GWIM management	→ Business management	→ % of direct costs	Custody
Finance, legal, HR			
Marketing			

Of course, establishing a main metric for tracking may create incentives for personnel, so it is important to gain wide agreement from significant stakeholders on the proper formal drivers to establish, how to measure them, etc. Understanding how the behaviors and priorities of relationship managers, financial advisors, account traders, and other individuals may change in response to established drivers is important to avoiding negative unintended consequences and promoting more collaborative approaches to client service. With significant drivers and the measurement process in place, activity-based costing can allow a growing wealth management organization to take the next step to transparency maturity.



**Bottom line**

The proliferation of product types in response to clients' desires for broader investment exposure at reasonable costs, including extensive customization, means that having a reliable costing framework for individual offerings is crucial. Otherwise, organizations will be either in the dark (without profitability visibility) or in the red (without profitability at the end).





# Stage four: Client profitability

With a view on activity costs by product, management can use the appropriate driver to allocate costs to individual clients based on product usage and gain an understanding of “demand-sensitive” client costs to enter the fourth stage of the profitability approach. As such, the organization may therefore have a general view on the profitability of different distribution channels (e.g., local branches) and broader client groupings (e.g., high net worth individuals).

In addition to demand-sensitive costs to serve clients, true client profitability should also consider opportunity costs and explicit expenses associated with unused capacity dedicated to serve clients. This can include idle time-of-service representatives, low information technology systems usage, or other similar fixed outlays that may be underutilized. These expenses are not easy to measure but can reveal significant cost improvement opportunities.

From this more integrated cost accounting, an individual client margin becomes a relatively simple calculation based on the revenue per client and product usage. Subtracting from a client’s product usage revenue the sum of the explicit costs of a client’s product usage and implicit costs of a wealth manager’s excess capacity, client profitability can be derived before being compared to the same product usage revenue to arrive at an average margin figure. Becoming capacity-aware in this manner gives the wealth manager a full view of client profitability and marks the final position in the fourth stage of the approach.



## Bottom line

With more clients having multiple financial arrangements, such as demand deposits, with an organization beyond its traditional wealth management practice, understanding the total profitability of individual relationships can help the improvement and tailoring of advisory and other client-related services.

# Stage five: Advisor profitability

With client and product profitability clarified, the profitability of advisors, identified in our approach as the final stage, is a function of the associated revenue and costs for each client served. This information can be combined with other traditional performance metrics, such as assets under management, number of new clients, and number of products per client, etc., to yield important insights. With a “current-state” view of individual performance, the organization can continuously monitor profitability over time.

This monitoring allows for more insightful advisor and other resource planning, taking into detailed account personnel loading, utilization, etc. Setting targets for metrics that allow clear evaluations of individual contributions can help improve organizational results. This process can be captured in a scorecard tool that shows results of reporting period metrics, which can be kept at individual levels or aggregated to desired branch and/or regional levels. Variances from targets, both positive and negative, can reveal important opportunities for improvement. For example, if the majority of a particular product’s usage is stemming from an individual office, this may merit further investigation to understand root causes and either share good practices (if the product is particularly profitable and can be used more extensively at other offices) or reduce volume incentives (if the product is being overused by advisors). At an individual level, significant discrepancies in advisor loading may indicate the opportunity to restructure teaming arrangements, consider different approaches to collaborating on client service, or otherwise modify roles and responsibilities.

Undoubtedly, using a customized scorecard to identify and prioritize improvement initiatives is not a one-time exercise, and management will likely want to monitor the impact of whatever actions are taken with regular reporting. Similarly, the underlying assumptions chosen for cost accounting, particularly the definition of core activities

underlying profitability calculations, should be re-evaluated on a regular basis as the business evolves. In short, a profitability program may require a tool in place that brings sustainability with well-defined stakeholder roles and processes for generating reports, refreshing data sources, and revisiting assumptions.



## Bottom line

A full, transparent view of advisor profitability can enable the identification of opportunities for top- and bottom-line improvement. In addition, this same clarity could be leveraged to track top performers and take actions to retain them. This could allow companies to reduce the risk of “losing” revenue and profit, especially during times in which talented advisors are chased by organizations competing for growth



# Taking action: Leveraging profitability reporting to identify and implement profit-enhancing initiatives

The purpose of tracking profitability is to identify high-impact opportunities to invest, divest, and reduce costs where appropriate. Mature capabilities to track product, client, and advisor profitability may uncover a broad range of opportunities that could be seized to increase profitability.

As shown in Exhibit 4, wealth managers may wish to follow a five-step approach to identifying and implementing profit-enhancing initiatives. The first step to take is to leverage profitability reporting to identify areas of the business that can be improved. This starts with a set of qualitative and quantitative observations listed and grouped into major functional segments that begin to provide an assessment of the current state of the business.

The second step focuses on developing a shared vision of the future state of the business. This phase often involves multiple functional departments across the organization (e.g., front office, operations, risk, compliance, and legal) so that diverse, often conflicting, perspectives are taken into account and significant stakeholders are engaged. Setting specific and measurable objectives during this phase is of particular importance because it may establish clear points of reference and guidelines throughout the following steps of the process.

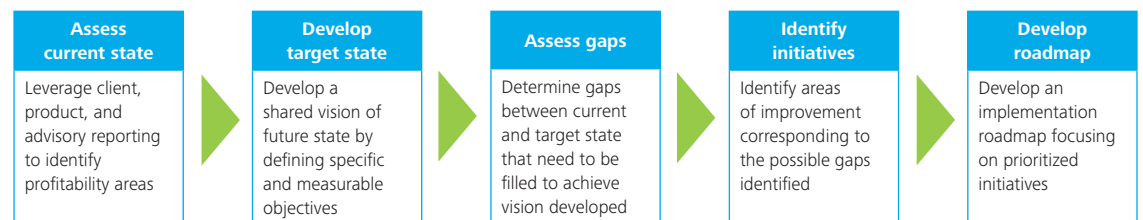
The third step consists of comparing the analysis of the current state of the business with the target state vision and determining gaps that may need to be addressed to reach the target state. This step is vital because it connects the problems identified in previous steps to answers in the following steps. Gap definitions need to be very specific and broken down by functional areas as much as possible to help involved parties identify the root cause of the issues.

The fourth step focuses on the identification of possible initiatives that may be executed to close the gaps and achieve the target state. Initiative selection is based on specific objectives, potential scope, timing, and required payback. Initiatives related to spend reduction and organization simplification typically provide significant quick-hit opportunities, but they need to be prioritized against target state objectives.

Exhibit 5 shows some illustrative high-level profit-enhancing initiatives that were identified by financial services providers based on observations made on an organization's profitability. Implementing these initiatives could ultimately reduce costs and increase revenue by streamlining business processes (e.g., automate client onboarding), improving resource allocations (e.g., target client retention resources on many profitable clients), and enhancing pricing (e.g., incorporate client consumption of services into pricing model).

The fifth step consists of developing a set of practical activities to be performed and milestones to be reached to effectively implement the initiatives previously identified. The focus should be on both quick wins as well as on long-term sustainable initiatives to make profitability an ongoing process. The roadmap should strike a balance between complexity and risks versus the magnitude of the transformation, and also evaluate improvements against the transformation timeline. Clear owners and accountable parties should be identified and empowered to enable effective delivery upon expectations. During this phase, the creation of a "transformation summary dashboard" that tracks accomplishments against objectives on a quarterly or monthly basis can help monitor progress and prioritize remediation actions as needed.

**Exhibit 4. Recommended approach to identifying and implementing profit-enhancing initiatives**



Whether in times of crisis or steadily growing business, identifying important decisions that may maintain or increase profitability in terms of product offerings, client service, advisor performance, and overall business activity is crucial to improve. Given the margin decrease and the numerous challenges the industry has been facing for the last several years, wealth managers could benefit from adopting a methodological approach to gain insight into current performance and take actions to improve profitability. By looking at profitability from a product, client, and advisor perspective, wealth managers could adapt their reporting capabilities accordingly and identify clear areas of improvement to increase top- and bottom-line results.

**Exhibit 5. Illustrative output: Observations and profit-enhancing initiatives**

	Observations	High-level initiatives
<b>Business process management</b>	Client onboarding activities performed by client management contributed more than 20 percent of the overall client management cost the first year	Assess value of all handoffs. Eliminate or reduce extraneous touch points. Automate onboarding workflow
	Advisor-assisted trades are three times costlier for existing clients as opposed to new clients	Analyze the level at which financial advisors assist existing clients
	System allocations as a percentage of overall expenses are lower than the 25 percent typically seen for the industry	Examine opportunities to further leverage technology to automate manually intensive processes
	Printing, mailing, and shipping represent 30 percent of overall communications expenses	Investigate alternative print and distribution options, including electronic delivery and print outsourcing
<b>Resource allocation</b>	Client retention efforts are not currently tracked on a per-client basis	Target client retention resources on most profitable client relationships
	Although it is the highest of all segments, the law firm segment average of 17 clients per financial advisor is lower than the industry average of approximately 30	Identify nonstrategic activities to operation functions to enable financial advisors to manage a higher number of client relationships
	24 percent of the overall transition expenses are related to client management support after the client is onboarded	Investigate involvement in transition. Analyze variation of transition costs across new plans sold into existing products versus plans requiring custom development
	60 percent of relationship management activities are not focused on strategically managing the client relationship	Investigate involvement in nonstrategic client activities that may be better performed in operations or client service
<b>Pricing enhancement</b>	Ad-hoc communications and investment consulting are not currently tracked to specific clients	Identify client consumption of all instances of consulting services to incorporate into pricing model
	70 percent of custom communication campaigns are consumed by tax-exempt clients, which represent only 36 percent of the client base	Assess availability of standardized communication materials for tax-exempt clients and price products to include communication costs
	Personalized and custom communications represent 20 percent of overall communications expenses	Align customized services with most profitable clients or those clients actually paying for customizations

Source: Deloitte analysis

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## Endnotes

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<sup>1</sup> Credit Suisse Global Report 2012, Company Data, Deloitte Analysis; Scorpio Partnership.

<sup>2</sup> Credit Suisse Global Report 2012, Company Data, Deloitte Analysis; Scorpio Partnership.

<sup>3</sup> Deloitte Mass Affluent Survey 2011

<sup>4</sup> Deloitte Mass Affluent Survey 2011

<sup>5</sup> Deloitte analysis.

<sup>6</sup> Deloitte analysis.

<sup>7</sup> Deloitte analysis.

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