

## SEI Executive Connections Insights

# Can Segmentation Lead to Sustainable Profits?

SEI New ways.  
New answers.®

### The Problem with Segmentation in Wealth Management:

## One Size Never Fits All

Historically, private banks have focused their efforts on high-net-worth (HNW) and ultra-high-net-worth (UHNW) clients. As a group they are simply identified as millionaires, but each of these individuals has unique hopes, burdens and options. Then, the challenge for wealth managers is to match each individual client's demands to a set supply of financial solutions. But the key to successfully satisfying each client is to understand that one size does not always fit all when it comes to wealth management solutions. Good segmentation is vital.

However, recent studies found that industry professionals are struggling with segmentation and are very concerned about the future, while investors are not completely satisfied with the solutions and service they are provided. A 2012 study by McKinsey & Company explained that firms struggle to broaden their investment advice beyond traditional products, and clients frequently complain that their financial advisors do not even ask about their other assets. These clients are looking for a professional "financial quarterback," and private bankers are well positioned to fill this role.

Which leads to two questions: Is the current segmentation strategy driving the right levels of client satisfaction and loyalty, and can it ultimately drive profitability?

Segmentation, and effectively achieving it, is a critical fault line of modern wealth management. Firms that fail face increasing margin pressure, or—even worse—the fault line cracks, so they fall off pace, clients leave, and firms face a decline in competitive relevance.

With that scenario etched in the minds of all leaders in the market, this paper will explore the importance of understanding the future of segmentation and how businesses in wealth management can adapt to optimize their relationships with clients, thereby benefitting the clients and the firms themselves.

## Identifying Commercial Value in Segmentation

The science of segmentation is being challenged by many wealth management organizations. Some consider the traditional approach too standardized; others suggest that wealth investors vary too much to be segmented. The reality is that clients may have different needs but often can be driving to similar goals.

But it is important to remember what segmentation can help firms achieve. In addition to optimizing internal resource allocations, successful segmentation organizes clients in a format that enables an efficient commercial distribution of products and services. And perhaps most importantly, it can drive client satisfaction, loyalty and profitability.

These points are vital for the future winning business model in wealth management. With widespread analysis indicating that cost-to-income ratios are under pressure, it is important to achieve the right balance in resource allocation and clients. Firms must balance the cost to acquire and the cost to serve clients with the overall value the clients bring to the firm.

## Status vs. Needs: Revising Segmentation to Grow Revenue and Profits

Traditionally, the industry segmented individuals en masse on a relatively simplified basis of three points of reference: amount of wealth, source of wealth and age of wealth.

This approach was successful, helping the wealth industry obtain nearly \$18 trillion of HNW assets to manage. But the approach increasingly shows its limitations because it singularly focuses on status, often at a single point in time. This is static and it fails—on an institutional level—to get to the heart of what clients need next. Like those in any other industry, wealth management customers have evolved in their needs and their idea of value.

The past five years saw the emergence of a more dynamic layer of segmentation based on incorporating investors' behavior patterns. This assessment now goes beyond money. And it must.

This new dimension is uncovering demand opportunities by moving from simply recognizing status to actually understanding needs. It can also open new channels in which the industry can grow.

## The “Fourth Dimension” of Segmentation: Behavior

For behavior-based segmentation to be effective, wealth managers need to harvest and maintain the client knowledge that is typically held inside the minds of their client advisors. That is a tough task, but it is critical to the survival of the industry and the success of firms operating in it. Firms need to codify their knowledge of client needs—or else they lose.

Through a process of data capture, analysis and dialogue with the client, behavioral insights can enable wealth managers to anticipate future demand and develop value-based solutions with the customer.



# SEGMENTATION:

## The Benefits of Switching from Customized Investments to Model Based Investment Products

### Typical Segmentation

In the typical wallet-based business model, most resources are drained servicing clients in a **one-to-one relationship** regardless of need.

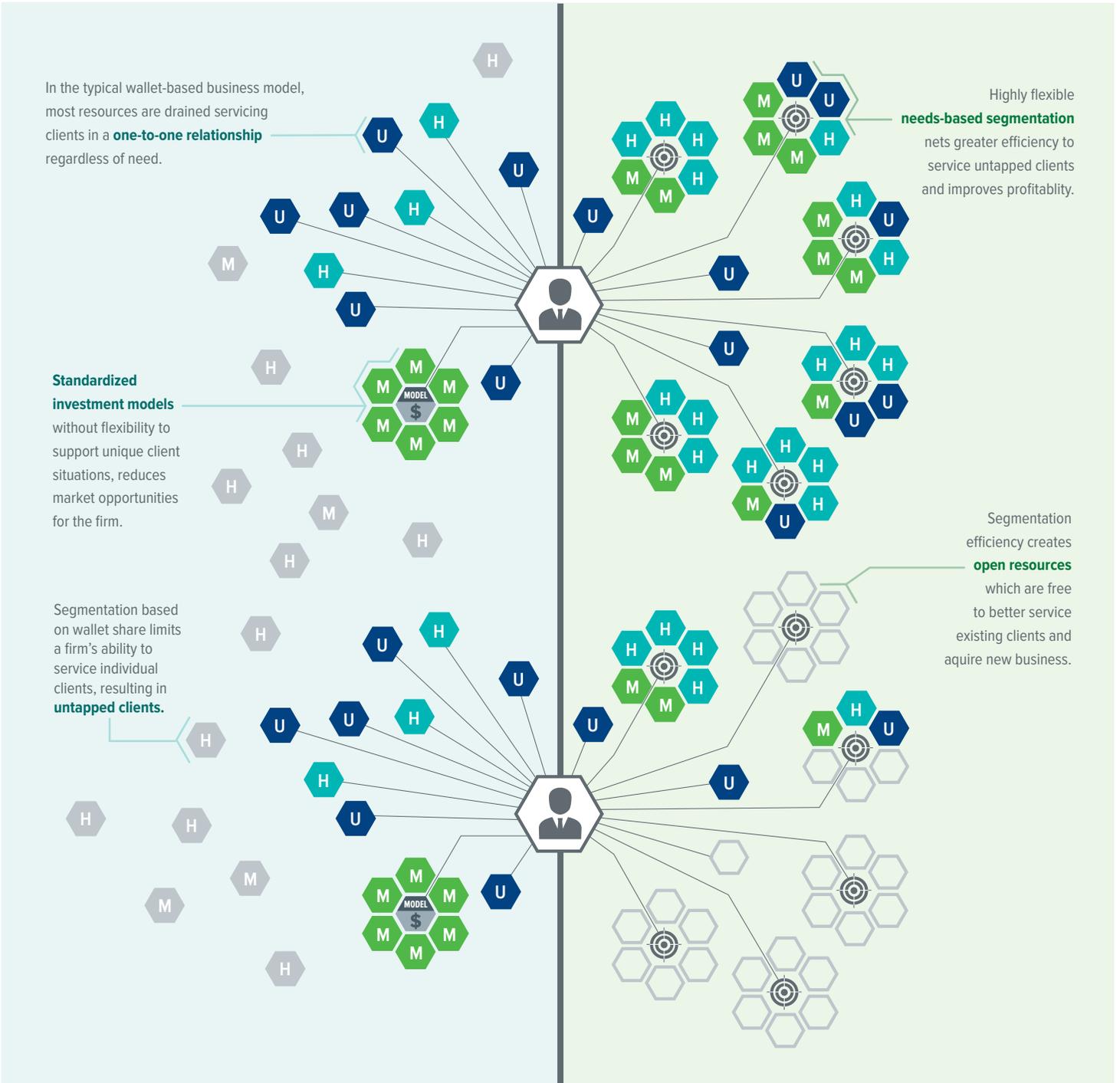
**Standardized investment models** without flexibility to support unique client situations, reduces market opportunities for the firm.

Segmentation based on wallet share limits a firm's ability to service individual clients, resulting in **untapped clients**.

### Behavioral Segmentation

Highly flexible **needs-based segmentation** nets greater efficiency to service untapped clients and improves profitability.

Segmentation efficiency creates **open resources** which are free to better service existing clients and acquire new business.



-  Ultra-high-net-worth client
-  High-net-worth client
-  Mass-affluent client
-  Untapped client
-  Resource
-  Client goals

# How Do We Make This Happen?

## 1 Change the Model to Deepen Institutional Market Share

Traditionally, the advisor-client relationship is a marriage between a single advisor and a client. The strength of this relationship model is a key part of the value proposition for many firms. However, its strength can also be a major weakness. It is often too rigid and can be too manual. Additionally, the compensation is often geared to influencing the behavior of the advisor: They will typically focus on the early stages of the relationship in which the possibility of sales is highest.

The reality is that the consumer's idea of value has evolved and now extends beyond this advisor relationship.

Effective segmentation—including goals-oriented understanding and advice—will be a vital element of future growth-oriented business models. With it, firms will be able to predict needs on an institutional level much earlier, based on data trends and ongoing dialogue with the client. As a result they will have a greater chance of retaining and growing their clients' wallet share in the long term.

Consider the case study on the following page to find out how another industry aligned its products and solutions to end-clients' behaviors.

## 2 Focus on the Next Big Opportunity

There is also another factor to consider in future segmentation: building a strategic focus on the high-net-worth segment and the high end of the mass affluent—the next group of high-net-worth investors.

Though private banking has historically focused on UHNW investors, it is thought that in the coming years these high-net-worth investors will be the fastest-growing, largest and most profitable segment in the market. McKinsey & Company's 2012 report, "A Tale of Two Millionaires" predicts that core millionaires will generate more than 80 percent of net new revenue growth in wealth management by 2015.

*This stat from McKinsey & Company specifically refers to "Core Millionaires", defined as \$1M - \$10M in AUM.*

If firms serve this market with the current model, they'll try to deliver a full suite of customized solutions that, frankly, may not be necessary or what the client really needs to reach the goals they are trying to achieve. The end result is a lot of time spent unnecessarily serving each client uniquely, which leads to a significant profit drain on the firm.

But there is a largely untapped opportunity for firms to create a unique client experience for these investors at a lower cost to serve. A model-oriented solution with investment strategies that are tailored to a certain amount of common goals, can expand a firm's offering and deliver a perceived premium solution at a much lower cost, ultimately driving increased profitability at the firm level.

For firms to realize these economic benefits of segmentation, the challenge will likely be in evolving their business model. Firms should consider employing technology that enables flexible model-based portfolio construction and simultaneously provides advisors with the tools and resources they need to execute the segmentation strategy effectively, efficiently and easily. This could open up the opportunity to cater to more of the high-net-worth market, resulting in much greater revenue margins for the firm than if they focused solely on the UHNW segment.

## 3 Deliver an Innovative and Differentiated Client Experience

Having the tools to capture data and analyze business trends is a must in today's wealth management world. However, what you do with that information will also make or break you in a highly competitive industry.

In the car insurance industry (see case study on page 5), Progressive has cornered the market and even won an award (*Voice of the Customer*, Forrester research) for listening to their clients. They have developed solutions such as digital statements and one-stop shopping for car insurance and homeowner's insurance, and they were the first company to introduce pet insurance—all in response to customer feedback.

All these examples demonstrate that Progressive segments their client base not according to size of wallet or basic demographics, rather they segment according to the needs, behaviors and goals their clients have expressed. As a result, Progressive has become one of the leading car insurance brands in the market today.

# A Behaviors-Segmentation CASE STUDY

## The car insurance industry

At its core, the broker-based model of wealth management places enormous power in the hands of the advisor. The advisor's manual interpretation of (or sometimes the lack of interpreting) clients' needs effectively predicts the products and services that are sold. Advisors possess tremendous power to determine whether or not a particular solution is bought.

The car insurance sector has a similar history. For decades, the role of the insurance broker was paramount. They shaped the sector. Their heavy reliance on this broker relationship dictated how the automotive insurance firms interacted with their end-client audience. In fact, the insurance industry based its premiums on very basic factors that were often sourced by the brokers themselves: driving record, credit record, education level, location of the driver and vehicle, and a demographic assessment of the driver.

The distribution of importance of each factor became relatively rigid. The accepted norm was to base calculations of premiums largely on past performance and the assumed level of the driver's maturity. Indeed, as much as 60 percent of premium calculus was centered on the driving record, age and marital status of the insured person. However, once the gender of the driver and make of the car was included, this brought the premium calculus up to nearly 78 percent (source: car-insurance.com).

### The Variables for Calculating a Premium

For its time, this segmentation approach was reasonable. But it was increasingly criticized for mismatching products. It was also challenged for being prejudiced against specific drivers; brokers ignored many that did not fit into strict segmentation models.

In the 1980s, the insurance firms accepted that the rigid approach to their risk assessment and product development might be affecting their market growth potential. So firms began to think outside the box—almost literally.

By the early 1990s, with advances in car technology, many insurers had begun to focus on assessing the behavior patterns of the drivers in a much more dynamic manner. Put simply, they empowered the driver.

Although still in its infancy, telematics—the so-called black box for vehicles—installed in a car can trace a driver's patterns and correlate this with their future premiums.

### The Role of Telematics in Assessing Behaviors

Increasingly, through the assessment of drivers' behaviors, individual clients can now influence their access to specific insurance products. And with the telematics technology installed, the insured driver is also increasingly engaged in providing more detail about their needs directly to the insurer. They started to receive better access to a wider range of insurance products as a direct result of providing better information. A good driver in a good location, for instance, would also earn access to better contents insurance or medical insurance. The consumer is the "winner."

More important for insurers, the trace material provided by both telematics and the insured drivers' regular updates of their personal-needs information enables insurers to identify other drivers with similar patterns and target them more effectively.

Moreover, telematics is helping insurers gain more control of their end-clients. The brokers remain important, but they are now augmented by improved data that helps them understand the modern segmentation of their clients and prospects. This allows them to be better organized in their approach.

Q

**How can wealth management take a lead from this industry and the innovations they have delivered in the areas of segmentation and the customer experience?**

## A Disruption: The Power of the Platform

### The sum of the segmentation debate is this:

Segmentation can assist a wealth management business in becoming more commercially effective and profitable by evolving with—and eventually ahead of—its customers.

The key to achieving this lies in developing a technological environment that supports advisors in becoming more efficient in the use of their most limited resource: time. Enhancing the efficient collection, management and analysis of client data can lead to better segmentation and higher profit margins.

Other industries, such as car insurance, aviation, lifestyle and retail, are all active adopters of behavioral segmentation. They recognize that organizing solutions according to their customers' behaviors is vital to their growth and success.

Research suggests that the game-changer for leaders in these industries was the building of an institutionally-robust segmentation process. This often started with an effective business-model change driven by enabling technology and ended with an understanding of customers' goals that were then matched against current and future corporate capabilities. It is simple to say, tough to do and often considered a disruption to business as usual; but without this disruption, business as usual will likely be the biggest impediment to future growth.

As it is for those in so many of the industries listed above, the key for wealth management leaders is to have an appetite for change and a solution in place for providing the content and capturing enthusiasm their clients want. Then they can organize themselves and their product offerings accordingly—both now and into the future.

#### Sources:

McKinsey & Company, "A Tale of Two Millionaires," 2012.

Scorpio Partnership "Global Private Banking Benchmark 2013."

Scorpio Partnership, "The Futurewealth Report, 2013."

**SEI** New ways.  
New answers.®

For more information:  
Email [seiwealthplatform@seic.com](mailto:seiwealthplatform@seic.com)  
Call **1-855-475-0373** to speak with a team member.  
Visit [seic.com/wealthplatform](http://seic.com/wealthplatform)

1 Freedom Valley Drive  
P.O. Box 1100  
Oaks, PA 19456

[seic.com/wealthplatform](http://seic.com/wealthplatform)

*SEI Executive Connections is a community for bank executives and industry experts, which provides business intelligence and opportunities to interact on banking topics and trends.*

*Information provided by SEI Investments Company, through its subsidiaries and affiliates.*