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Private Banking & Corporate Governance Efficiency

A comparative study of business models in Private Banking

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Abstract

Corporate governance is of primary importance in Private Banking. Since the client needs to ensure that the bank acts in his best interest, the choice of the banking institution to manage his wealth is primordial. In this paper, we argue that current business models in the wealth management industry show considerable discrepancies when it comes to corporate governance efficiency. Following a review of various governance mechanisms our results suggest that, some business models in the private banking industry are more efficient than others to align the interests of the bank with those of the clients. Eventually, a careful due diligence has to be undertaken before the client chooses its wealth management services provider regarding governance issue. We conclude that the best business model in private banking is dependent both on governance efficiency and on the client's characteristics.

Keywords: Business Model, Corporate Governance Efficiency, Private Banking, Wealth Management.

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1. Introduction

"I think more than anything we're looking for someone we can trust, and the higher you go up the wealth scale the more that is the case".

This extract from the report *The new world of wealth: Seven key trends for investing, giving and spending among the very rich*, unveiled by the Economist Intelligence Unit reminds us that the mindset of wealthy individuals has dramatically changed over the past two years.
Of course, being provided 'above average returns' are still high on their agenda. But following Lehman Brothers' fall in 2008 and the impact of fraudulent advisors such as Bernard Madoff, looking for someone that can effectively and safely manage their investments became of primary importance.

The private banking industry is a particular industry within the financial sector. Actually, it is one of the few that could experience growth in assets under management in times of financial turmoil. As such, this activity constitutes a strategic pillar for many banks. But being part of an apparently thriving industry does not necessarily mean that one cannot experience defection by clients. UBS, formerly the world leader in wealth management could not agree more.

After experiencing trouble with the US tax authority regarding possible tax evasion by some of its clients in addition to difficulties with its investment banking arm, large sums under management flew out of the company towards what investors considered being safer places for their wealth. Other large players such as Credit Suisse and smaller private banks (like cantonal banks in Switzerland) were the main recipients. Other wealthy investors even chose to set up their own structure to manage their wealth while some turned to independent financial advisors, conscious that unbiased advice may be their best asset in times of turbulent markets.

This suggests that while large and well-know financial institutions continue to lead the field in the wealth management industry, other structures also seem to be potential targets for wealthy individuals. *Trust* might be the key to explain investors' catalyst when it comes to the choice of their wealth manager.

While the linkage between trust and private banking performance may be perceived as pretty straightforward because it can be measured (with the amount of new assets under management for instance), less obvious are the reasons that drove the client to push the door of a given institution. Surely reputation, along with trust, is part of the winning equation for banks, but understanding the link between the client and his bank require to go beyond the boundaries of quantifiable facts.

Subsequent to our extensive research in this field in order to seek the 'missing link' that bound the client to the bank, corporate governance appears to be a promising field of study. Although rarely used in this industry to define the client/bank relationship, studying the impact of Corporate Governance Efficiency (CGE), i.e. the alignment of the client's interests with those of the wealth manager, on both parties can reveal interesting outcomes.

The purpose of this thesis is to shed light on the four more common business models currently in use in the wealth management industry. By focusing on Corporate Governance Efficiency, this research describes and analyses the corporate governance mechanisms that link the client to the bank with the aim to unveil a potential ultimate business model in private banking.

This research is organized as follows: After a brief description of the wealth management landscape, we go through a description of the models that will be analyzed in the subsequent section. The third section consists of the description of the foundations of private banking business model: corporate governance efficiency. Then, we discuss the comparative advantages and drawbacks of each model through a literature review. The following section deals with the analysis of our finding through the prism of corporate governance. The closing section summarizes this research results and provides recommendations for clients as well as financial organizations.

2. The wealth management landscape

Before focusing on the core subject of this research, i.e. corporate governance as a link between the bank and its client, it is worthwhile to provide a broader picture of the wealth management industry. This brief private banking landscape description is valuable to bear in mind for the analysis part and the recommendation parts of this research.

2.1 What is private banking?

The literature provides several definitions for the phrase *'private banking'*. Broadly speaking, we can define private banking as business in which wealthy individuals are offered bespoke investments solutions, advisory and other services to serve their needs and desire on a long-term scale. [Others definitions can be found in (Driga, Nita, et al. 2009); (Molineux and Omarini, 2005)]. More precisely, Balmer and Stotvig (1997), point out that originally, the expression private banking "*refers to those banks which are owned by a group of partners who have unlimited liability.*"

From an historical viewpoint, private banking is not a recent business although many retail banks and investments banks have opened recently their own private banking arm. The private banking history seems to be closely embedded to the development of commerce between countries (Cettier and Schmitt, 2009). In the case of Wegelin and Co. for instance, the oldest Swiss private bank in the world, the development of international trade between neighboring countries required capabilities that only banks can offer in the eighteenth century: knowledge about foreign currencies as well as public investment issues. And once the wealth of merchants was made, they typically turn to the bank that offered them sound advice for their business (Cettier and Schmitt, 2009).

Nowadays, the services provided may vary slightly from one bank to another. However, the variety of investments and services available in private banks typically range from classical investment solutions such as structured products and other non-investments solutions like art advisory services and property management (see appendix III)

2.2 The "Swiss myth"

Located in the heart of Europe, Switzerland appears to be one of the global benchmarks when it comes to wealth management.

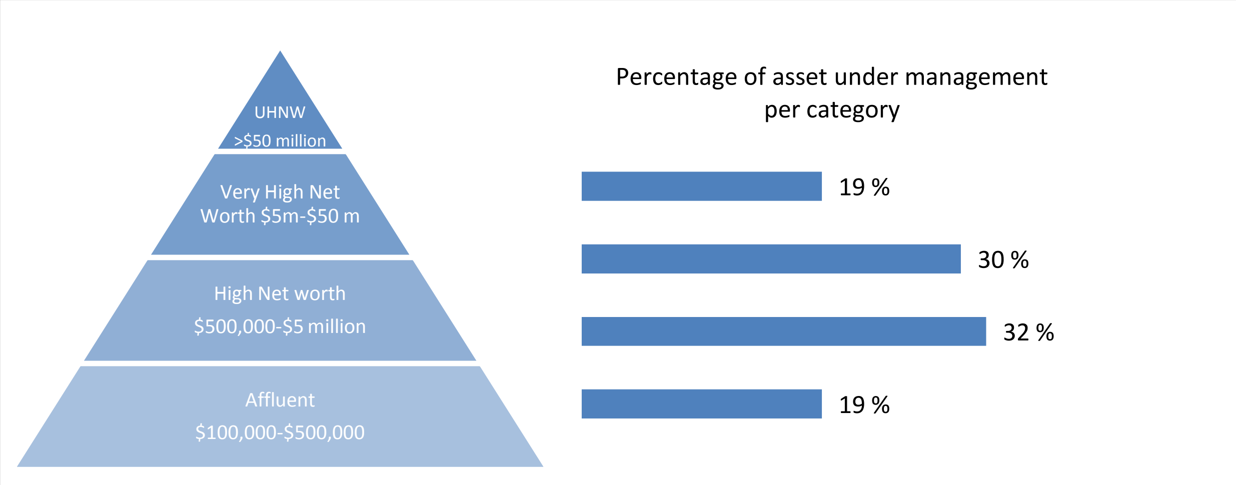
With a long standing tradition in wealth management of over 300 years, secrecy and strong reputation, especially abroad, Switzerland has traditionally led the field in private banking (Geiger and Hürzeler, 2003). The *international private banking study* published by the Swiss Banking institute and the University of Zurich, reveals that the most profitable banking institutions can currently be found in Liechtenstein and Switzerland, despite their apparent weaknesses such as the personnel costs per employee due to the high standard of living in those countries (see appendix IV). In clients' mind, the bank and the country of origin is clearly associated (Balmer and Stotvig, 1997).

This may explain why Switzerland saw a massive inflow of new assets during the past two years. But other elements could also explain the leadership of this country in this industry. Economic and political stability, tax advantages, legal considerations and quality of life seems to be quite appealing to wealthy individuals according to Scorpio Partnership, one of the leading consulting companies specializing in the wealth management industry.

2.3 The client and the relationship manager

In private banking, the word 'client' is commonly preferred to 'customer' due to the nature of business as underlined by Balmer and Stotvig (1997). Actually, this word appears to be misleading since in private banking there is not really '*a* client' but *several* clients with distinctive goals and needs. Usually, private banks use the wealth and/or income of prospective individuals to segment them into 4 categories, ranging from the so-called *affluent* segment with around $250,000 of investable assets (so not including house or boat for instance) to *Ultra-High-Net-Worth* with more than $50 million to invest according to PricewaterhouseCoopers and its 2005 wealth management survey (see exhibit 1).

*Exhibit1 : **The wealth management pyramid.***



Source: Adapted from PricewaterhouseCoopers, Global Private Banking/wealth management survey 2005, p.10

The threshold to become a client varies dramatically from one bank to another but usually, a minimum of $1 million of investable assets is required in order to gain access to tailor made investment solutions in private banks as a rule of thumb although some banks may require substantially less. For example, £250,000 is required at Barclays Wealth Management to open an account and even £15,000 at Coutts & co. will be enough to benefit from the whole range of services offered by the private bank (Balmer and Stotvig, 1997).

Typical clients in private banking encompass various profiles with different needs. Examples include entrepreneurs, inheritors, sports star, actors and executives of large companies. Nevertheless, usual private banking services users seem to posses five core common characteristics regardless of their source of income. As such, distinctive common features are: a desire for control; complex financial and familial affairs, an extensive personal and professional network; the ability to deploy their capital effectively and philanthropic inclinations (Grove, 2007).

In order to deliver the client the best service/cost ratio, the wealth management organization needs to distinguish valuable clients from the others. To solve this question, many banks are applying a simple rule of thumb, as emphasized by Foehn (2004) : "*keep those clients who consistently generate a lot of sales and lose those who occasionally perform a few transactions with the bank.*" Although useful in most cases for the management, a relationship manager can arguably provide a better fine tuning in this rule by for instance incorporating essential notions such as referrals potentials. As a cornerstone of the bank, the relationship manager represents for most clients the 'true face' of the bank.

Sometimes compared to an 'orchestral leader' according to the metaphor used by Tieman (2007), his role is to be the matrix between the client's needs and the bank offering. Working for wealthy individuals and successful individual can be stimulating especially if they have global needs because it pushes him to be at the cutting edge of the industry. Still, the workload could be consequent when dealing with High-Net-Worth individuals (HNWI) and Ultra-High-Net-Worth individuals (UHNWI). Demanding, they can call the relationship manager 24/7; in some cases "*about anything from a stolen wallet to latest trend in the currency market, or what happened overnight on Wall Street. Sometimes, they are just for a view on the economy, or to chew over some political development*" (Tieman, 2007).

Apart from being a counselor for the client, his duty is also to implement the strategy drawn up by his employer. This dual duty may sometimes be in conflict with one of the parties' interest. We will investigate later in this paper the nature of this conflict as well as the possible way to prevent it. But for now on, let us consider the challenges that are arising in the private banking industry.

2.4 Challenges in private banking

The wealth management industry is unique in the banking landscape. Indeed, the research entitled *World Wealth Report 2009* conducted by Cap Gemini and Merrill Lynch, underline that this activity had significantly outperformed the other traditional banking activities in terms of revenues despite the financial turmoil of 2008.

Nevertheless, this industry is still subject to cyclical fluctuations and bank earnings and profitability are strongly embedded in the wealth fluctuations of the clients (Molineux and Omarini, 2005). During the period 1979-1994, most private banks experienced an impressive annual growth of roughly 15 per cent (Kay, 1994) and around 10 per cent growth per year during the period 2003 to 2007 according to the consulting firm McKinsey.

According to the *McKinsey European Private Banking Survey of 2009*, private banking remains a highly attractive business because of three distinctive features: an attractive growth rate over-time, a limited capital requirement and last but not least, the significant excess of liquidity it generates. Several retail banks throughout Europe, such as Lloyds in the UK, have acquired or set up their own private banking structure, in order to benefit from those features (Balmer and Stotvig, 1997). As a consequence, the private banking market nowadays highly fragmented where even UBS, one of the largest players in the industry has a 4.2% market share (Birchler, Cocca and Ettlin, 2009).

It is worthwhile to mention that the bottom line of the business is that it is design for growth because in wealth management, one of the key criteria to assess the health of an institution is to look at the assets under management. With high cost base structure due to the high degree of contact implied by the inner nature of the business (Birchler et al. 2009) in addition to decreasing margin following the intensification of the competition in the industry, the private banking landscape might change dramatically in the future. Mergers and acquisitions may rise as expected by Birchler et al. (2009).

3. Research methodology

3.1 Main contribution

On the one hand, an increasing number of private banks have, over the last decade, gathered data on a voluntary basis in order to better understand the industry and because they are useful benchmarks to compare your business with those of the competitors. On the other side this is a field that is rarely academically analyzed (Cocca, 2007), partly because it has traditionally been in the shadow of other banking activities such as investment banking or retail banking.

Hence, to date it seems that little research had been undertaken in that area, particularly regarding the study of current private banking models. As a consequence, this research aims at closing this gap by offering a research study that is both scientifically grounded and relevant for practitioner. Thus, this research can provide valuable insight to wealthy individuals, in order to choose the most appropriate wealth manager according to their situation. For practitioners, this paper can enhance their efficiency by identifying key elements that could attract and retain affluent investors.

3.2 Problem statement

The research purpose is to find out **why and under which condition(s) one of the main business models currently used in Private Banking may emerge as better than the others with a specific focus on Corporate Governance Efficiency (CGE).**

In other words, the aim is to find out which one of the four business models can efficiently align the interests of the clients with those of the organization managing his wealth.

Since the problem statement is theory driven, we organize the literature findings to try to find if theoretically an 'ideal' private banking model seems to emerge. Then, we intend to compare these findings with 'real-life' examples before describing a tentative 'ultimate' model that could be implemented taking into account theoretical findings as well as real business consideration such as cost, feasibility and obviously corporate governance implications.

The link between the bank and the client is not as straightforward as it seems. Actually, on one hand, the client needs first to assess his needs while comparing them with the organization product and service range. On the other hand, the bank needs to make sure that the budget devoted to this client is optimal (in terms of time, product range, etc.) in order to balance the trade-off between large offering and the cost constraint that it implies. The bottom line is that a bank needs to devote its time and money only to the extent that the client will be satisfied and not beyond. The alignment of interests between the bank and the client may not be optimal and it is to better understand what causes this misalignment of objective that we have undertaken the following research.

3.3 Data collection

The following paper is based on a deductive approach i.e. derived from theory to data with the aim to generalize the findings.

Conducting our own report based on practitioners and client interviews would have been a thrilling experience. Unfortunately, due to the secretive nature of this industry, given our position, and the time constraint, conducting such data collection is an option that was unrealistic. The probability of getting biased or unreasonable answers and the reluctance of bank managers and relationship managers to talk about strategic issues was foreseeable. As a consequence, we choose to rely on data already available. Far away from being a burden, this choice offers several advantages. Those data are unobtrusive, which is particularly important when dealing with sensitive issue (Cowton, 1998), namely money in our case. In addition, they are undoubtedly of higher quality than data we could collect on our own and unforeseen discoveries might be expected (Saunders, Lewis, and Thornhill, 2009).

3.4 Research design

Both primary and secondary data were used in the process. Regarding primary data, reports, surveys and research papers they were gathered while secondary data were collected in books, journals and refereed academic journals. We also have been granted the access to a recent case study (and one of the few available in the field of private banking) written by

Bernd Schmitt and Patrick Cettier from Columbia Business School. These various sources were very important during the analysis because it allowed me to double check the information provided. In case of contradictions between papers apparently using the same samples of data, the choice has been made to prefer research papers and refereed academic journal over other sources in order to enhance the relevance of this research.

In the analysis part, we use both qualitative and quantitative data from the selected literature. The benefit is that crossing both methods provides a better paper.

To facilitate the reading of this thesis for people not familiar with private banking terminology, a glossary is provided in appendix I. Besides, for each private bank's name that appears in this paper, appendix II provides the pages and examples as an illustration.

3.5 Limitations of the study

It is important to mention that they are other models such as life insurance companies and mutual fund companies that might have been included in this research since they are also targeting the same clients. However, due to time constraint and lack of relevant data, we choose to focus exclusively on four business models, namely *Independent Advisor*; *Integrated Private Bank*; *Pure Player* and *Family Office*.

Furthermore, some of the models identified are widely spread around the globe (integrated banks for instance) while some would be country-specific (especially small '*pure players*', a Swiss specialty). In this thesis, we focus primarily on the European market and more precisely Western-European markets such as Germany, Belgium, France, Luxembourg and the UK. Due to the long-standing tradition of excellence and reputation of Switzerland in this industry, a particular focus will be given to the model of banks from Switzerland. As a consequence the analysis provided as well as the recommendation may not be applicable in other countries, especially in emerging countries.

4. Model description

In order to narrow down our research, we have analyzed the four main business models available in private banking according to their value propositions.

4.1 The independent financial advisor

Sometimes called '*asset manager*' or '*financial advisor*', an independent financial advisor can be defined as a person, or a very small team that provides financial recommendations for a client.

This structure is based on the idea of the 'pay as you go' system: when a client needs some advice on a particular investment opportunity, the independent financial advisor will provide the service in exchange for a commission; or on a fixed fee basis if the client requires a more holistic approach.

In addition, since they are basically too small to construct proprietary investment product, the advisor will select, in line with its recommendation a series of state-of-the-art investment products or services from larger private banks and sell it to the client in exchange for a fee. Hence, with this so-called 'brokerage system', the financial advisor will earn money on the basis of the number of transactions made.

There is apparently no specific threshold to set up this kind of structure although it is usually required in many countries to hold a specific license to be able to practice as a financial advisor. In addition, this kind of structure seems to be designed to cope with a large scope of customers that range from affluent investors to High-Net-Worth individuals.

4.2 Integrated banks

Sometimes refereed as '*hybrid*' structure or '*universal bank'*, integrated bank is the structure that has been adopted by large banking organizations such as UBS, HSBC or Goldman Sachs to name but a few. Moreover, according to a joint study undertaken by KPMG and Universität St.Gallen in Switzerland, their value proposition is not solely based on secrecy but rather on cross-selling opportunities between the arms of the bank. Accordingly, the international management consulting firm Oliver Wyman, points out that "*these institutions derive the lion's share of revenues from a combination of wealth services and investment banking. Some players in this group are also active in retail banking, but normally are confined to their home market. This model rests on the view that significant synergies can be extracted from a well orchestrated coordination of these lines of business*". Integrated banks deal with the entire range of client that goes from affluent until UHNWI but tend to focus on clients with at least $1 million of investable assets.

4.3 Pure-players

As underlined by the KPMG/Universität St. Gallen Study, "*client orientation and centricity* "is of primary importance for those banks. Besides, "*they also rely on discretion and secrecy advantages coupled with a solid brand reputation and stability. They also believe that providing 'independent' advisory to their clients is important and are prone to expand "open architecture' offering*" i.e. the use of third party investment solution. Put differently, the alignment of interests between the client and the bank is seen as their priority over short term consideration.

Pure players typically include private banks with Swiss origins. It is important to mention that, in Switzerland many banks can be seen as pure players but only a few are allowed to use the name 'private banker' since it is a protected term (see appendix V). Swiss private bankers can be defined by a fair degree of transparency and an entrepreneurial spirit that differentiate them from other private banks. This point can be illustrated by this quotation, extracted from the business case written by Cettier and Schmitt (2009). It describes the particularity of Swiss private bank since "*Wegelin, unlike Wall Street bank, is still privately owned. With unlimited personal liability, the interests of each of the managing partners are aligned: they participate fully in the upside as well as the downside. The bank thus focuses mostly on asset and wealth management, has a limited credit portfolio, a conservative balance sheet, and no investment banking activities. Proprietary trading is highly restricted and used primarily to test new investment strategies with the bank's own money before offering them to clients*."

Pure players usually target the 'top of the pyramid' of wealth with a clientele mainly build up with high net worth and ultra high net worth individuals. Examples of pure players include Pictet & Cie, EFG international, or Lombard Odier.

4.4 Family office

We should start by underlining the fact that there is not only one type of family office structure but at least two, namely Single Family Office (SFO) and Multi-Family Office (MFO). Simply put, a single family office is a structure set up by one family to manage the financial and fiscal matters of the family while a multi-family office gathers several unrelated families with the purpose of managing in common their wealth. Since in this study we will focus primarily on single family office, it is worthwhile to get working knowledge of this structure.

For Amit, Liechtenstein et al. (2008), "*single family offices are professional organization dedicated to managing the personal fortunes and lives of very wealthy families. […]their charge was-and still is-to protect their particular family's investments and assets for both current and subsequent generations. Since the beginning, affluent families have been attracted to SFOs, rather than to commercial banks, investment companies or other wealth optimization services, because of their promise of exclusivity, privacy and customization*." Broadly speaking, family offices have a very large spectrum of functions although 4 primary functions are the common feature of most family office (see exhibit 2).

Exhibit 2: ***The 4 primary functions of family offices***

1. ***Centralization of records*** : all financial statements, bill paying, tax planning;
2. ***Business management***: purchase and sale of business holdings, distribution of financial information, administration of tangible assets such as real estates and yachts;
3. ***Family management***: family governance, education, philanthropy, wealth transfer planning;
4. ***Investment related functions***: investment policy setting, asset allocation, monitoring.

Source: McCann & Lavayssière, (2008), Wealth, How the World's high-net-worth growth, sustain and manage their fortunes.p.112

Hence, a family office significantly differs from traditional private banking product offering by being significantly more holistic to cover all the matters related to the daily life of wealthy individuals (see appendix VI). Such structures typically focus on Ultra-High-Net-Worth individuals and families and are quite costly to set up. As a consequence, only families with at least $20 million of investable assets might consider this type of organization while Pompian (2009), believes that any family with over $50 million should understand the benefits of this model.

5. A general framework on Corporate Governance Efficiency (CGE)

Trust. It is nowadays the key element in private banking. But trust is only a word we use to describe the psychological mechanism that links the client to the bank or his relationship manager. To fully understand the linkage between those two parties, we need to go deeper into the motives of both parties that push them to enter into contract.

For the bank, its motive is to attract the assets of wealthy individuals and provide advice, products and services for a fee. For the client, the purpose is to find the best possible provider in order to manage and hopefully sustain and growth the current wealth. Those goals do not seem conflicting but when one adds a third party in this relationship, namely the relationship manager that works for the bank, the outcome might be slightly different. The alignment of interests of each may not be optimal because each party knowing that his interest is at stake might show a different behaviour.

The following section provides the reader with the necessary background to fully appreciate the scope of corporate governance issues within the private banking context.

5.1 Goal Misalignment

Jensen and Meckling (1976) provide a thorough overview of this issue in their research paper called *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*. For them, the whole issue can be summarized as follow:

> "*An agency relationship [is] a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent. If both parties to the relationship are utility maximizers, there is good reason to believe that the agent will not always act in the best interests of the principal. The principal can limit divergences from his interest by establishing appropriate incentives for the agent and by incurring monitoring costs designed to limit the aberrant activities of the agent. In addition in some situations it will pay the agent to expend resources (bonding costs) to*

> *guarantee that he will not take certain actions which would harm the principal or to ensure that the principal will be compensated if he does take such actions. However, it is generally impossible for the principal or the agent at zero cost to ensure that the agent will make optimal decisions from the principal's viewpoint*".

In the context of private banking, the purpose is obviously to ensure that the private bank, i.e. the agent, will act in the principal's best interest, i.e. the client. As pointed out by Peng (2009), the main reason for this possible conflict of interest is mainly due to information asymmetries. This is particularly relevant in the wealth management industry because, as underlined by Akerlof (1970), such issues arise when the client knows less about products and services than the provider. The question is then to find a commitment device that can be powerful enough to reduce this information asymmetry and ultimately realign all the parties' interests. This is what we mean by corporate governance efficiency.

5.2 Contracting as a governance mechanism

The formation of a proper contract between the client and the wealth management firm that will clearly define the rights and obligations of both parties may be promising. Nevertheless, the terms of this contract can be impeded by the intervention of a third party - the relationship manager- because of his role that can be ambiguous. On one side, he is committed to the bank that provides his income and consequently should follow its strategy. On the other side, he cares about providing the client with the best advice possible regardless of the bank prerogatives.

A possible solution to this situation may be to draw a long-term incentive contract between the bank and the relationship manager. Provided that this contract also matches the client's interests, the interests of each of the three parties could be realigned (Shleifer and Vishny, 1997).

Besides, still according to Sheleifer and Vishny (1997) this contract "*can take a variety of forms, including share ownership, stock options, or a threat of dismissal if income is low*." But monetary incentives may not be the optimal incentives when it comes to the realignment of stakeholders.

5.3 Corporate culture and share value

Corporate culture is an interesting concept to analyze here. Powerful links that can tie the employee to the bank, corporate culture may also be a promising tool to align the interest of the employee with those of the bank. If value sharing is also added to the equation, the alignment of interests may be very strong between the client, the relationship manager and the bank.

A possible caveat with monetary incentives such as above average wages, stock options and equity stakes is that people tend to "*respond too well*" to them (Akerlof and Kranton, 2005). Even worse is that fact that companies would only "*get what they pay for*" according to Gibbons (1998).

In *Identity and the Economics of Organizations*, Akerlof and Kranton (2005) show how an organization can change individual's preferences regarding pecuniary considerations by providing the example of new recruits at West Point, the U.S. Army School, for future army officers. With this well documented example, they show that this organization, that is not necessarily attractive for its salary, can be perceived as extremely eye-catching once the program is over due to a newly common value that bound the new officers to the US army. From a bank viewpoint, this example might have its appeal.

Actually, several private banks set up their own programs (Barclays Wealth, Credit Suisse or RBC Wealth to name but a few) for new recruits that come to work in the bank straight out of university. And in many ways, this training program can be seen as similar to the West point one: with duration from 18 months to 3 years, those programs aim at providing both the technical and soft skills necessary to perform efficiently in their new environment. However, such programs target usually only newcomers in the wealth management industry and very seldom latecomers. In this last case, it seems extremely important for the bank to scout and take on professionals that already share common values with them.

Prendergast (2007) believes that the recruitment of workers that share common values with the organization can significantly enhance its efficiency. In addition, for Brekke and Nyborg (2008), this selective recruitment through a careful selection may also be seen as a strategic leverage for the firm. By recruiting the best element that fits the organization values, banks may experience significant efficiency improvement due to the fact that those employees would take on increased responsibilities. Ultimately, this may considerably benefit to the company while the others may be driven out of the market.

For Grant (2008), common culture and value sharing constitute the backbone that may lead to solving cooperation and coordination issues. But reputation can also be a powerful leverage.

5.4 The alignment of interests through reputation

In private banking, reputation is important. From a theoretical standpoint, *"reputation-building as a very common explanation for why people deliver on their agreements even if they cannot be forced to*" (Shleifer and Vishny, 1997). Private Banks provide advice as well as products and/or services. In return, the client rewards the bank for its involvement through the form of a fee. Let us now consider the following example.

Because of its current strategy, that favors a particular product over another, the bank would be reluctant to recommend this last investment opportunity that perfectly matched its client's needs because on the short run, it would imply lower earnings for the bank. Then, the issue would be to find a way to realign both the interest of the bank with those of the client. The answer would undoubtedly be 'assets under management'.

Private Banks are dependents on their amount of assets under management since without it, they would simply not exist. The bank needs to attract those assets by various strategies: acquiring new clients, demonstrating consistent over-performance or repatriating assets of existing clients currently in others wealth management firms to the bank (Bachmann and Hens 2008).

Reputation appears to be a potent leverage regardless of the strategy implemented in order to sustain and increase those assets under management. It can not only comfort the client that his assets are in safe hands, but also discourage the bank to drive away from its clients best's interests (Shleifer and Vishny, 1997). However, as pointed out by Bulow and Rogoff (1989), reputation is not flawless. As a consequence, sometimes breaking the moral contract that bound the bank and client may be more efficient for one of the party than completing it. In such a case, legal protection may be the only way to ensure that both parties will truly complete their respective obligations.

5.5 Legal protection

As underlined previously, in some special circumstance, it might be rational for one of the party to deliberately default from its obligation instead of fulfilling its duty (Bulow and Rogoff (1989). Legal enforcement is in this case the only tool, besides arbitration, that could force the faulty party to realign his interests with the other party.

Most of the activities undertaken by the bank on the client are made through contracting and thus allow any party to enforce their rights before the courts in case of violation. This is particularly relevant for 'private bankers' in Switzerland. Because they have unlimited liability on their professional as well as personal belongings, the legal protection that bounds the client to the bank seems to be extremely strong. Besides, since they usually invest along the client, the alignment of interest, i.e. corporate governance efficiency, is obvious.

Whatever the organization ultimately chosen by the investor, establishing a clear contract that is binding and enforceable for both parties may be the key to an optimal governance system (Shleifer and Vishny, 1997).

5.6 Establishing the link between CGE and private banking

Typically, according to Shleifer and Vishny (1997), in *A survey of Corporate Governance*, a "*good corporate governance system should combine some type of large investors with legal protection of both their rights and those of small investors*."

So, in order to align the interests of every party, the optimal corporate governance system could include the following elements. (1) Long term incentives contract that matches the objectives of the relationship managers with those of the bank, in line with the client's needs. (2) The recruitment of relationship managers that fits the corporate value of the bank can seriously constitute a competitive advantage over other financial institutions. As such, this should be carefully planned. (3) Strong reputation appears to be a notorious commitment device for the bank, capable to impede any willingness to deviate from the client's best interests. And (4) a contract that clearly defines the rights and obligation of each party. The prospect of retaliation in case of default has to be high enough to ensure a total compliance with the terms agreed.

6. Literature review on corporate governance

Every private bank aims at providing the whole spectrum of wealth management services from the distribution to the reporting (see exhibit 3). This concern has two purposes. As a private bank, one wants to make sure that the client receives truly integrated advice and by being able to deliver this customer centric added value without the help of outside parties may be perceived as a clear strength (Geiger and Hürzeler, 2003). On the other side, it is the best way to ensure that your institution will extract increasing revenues through rising number of transactions.

This view has been challenged in the last 10 years, when large private banks like Credit Suisse, started to outsource to third party some of their product and services. They claimed that is was the best way to provide state-of-the-art wealth management services by making sure the client would be provided bespoke private banking services, all along the value chain (Geiger and Hürzeler, 2003).

Exhibit 3: ***The value chain in private banking***

- Prospect contacting and client acquisition
- Need Analysis
- Sales of Services and Products (including stocks and Bonds)
- Maintaining relationship

- Investment Planning
- Financial Planning
- Tax Planning
- Retirement Planning
- Estate Planning

- Bank accounts, Custody accounts, Retirement account
- MM, FX, Bonds, Stocks, Futures, Options
- Loans
- Mutual Funds
- Discretionary Asset Management
- Structured products
- Alternative investments
- Insurance products
- Trusts, Foundations

- Fund Transfer
- Clearing and Settlement
- Custody
- Brokerage
- Collateral Management
- Document Handling
- Reporting

Source: Geiger and Hürzeler (2003), The transformation of the Swiss Private Banking Market, p. 8

An increasing number of private banks understood the advantage of offering third party investment solutions along their own products and services. As a consequence, nowadays, regardless of the business model chosen, banks offer pretty much the same 'tailor made services'.

As a consequence, differentiation is becoming a major concern in this industry because clients have increasing difficulties to distinguish one bank from another when it comes to the actual services provided. Lassar, Manolis, et al. (2000), demonstrated that in the case of private banking- that is a high contact service- "*when the technical or core element of the service (what is actually delivered) is fairly stable, and level of service failure are low, the customer is able to devote more attention to how the service is delivered*". Hence clients would pay more attention to the 'functional quality', i.e. how the service is provided, rather than on 'technical quality' i.e. what is provided.

Corporate governance efficiency especially emphasizes on functional quality. Long term incentives, reputation, corporate values and legal protection might be combined in order to align client and bank's interests. Studying comparatively each model with a special focus on CGE could be the key that leads to a better understanding each model value proposal.

6.1 Reputation and corporate values: strengths and weaknesses of each business model

As underlined previously, reputation and corporate values are strong governance mechanisms. Efficiently integrated within the business model, they constitute a great advantage to your organization. As a consequence, let us now focus on a comparative study on each business model with a particular focus on reputation and corporate values.

With a long standing history in private banking, **pure players** -especially the ones that originate from Switzerland- seem to offer a particularly strong case when it comes to reputation. Pure players benefit from a strong image in potential clients' mind that can add to their appeal.

Reputation takes time to build and a blink is sufficient to lose it (Herbig and Milewicz, 1995). Besides, it is strongly correlated to sales performance (Shapiro, 1982). As a consequence, pure players have a lot of incentives to perform well to maintain this outstanding reputation of privacy, security and customized services (Balmer and Stotvig, 1997). Corporate values and reputation are closely embedded in this model thanks to the training offered in several banks (Julius Bär and Pictet & Cie for instance) to new recruits.

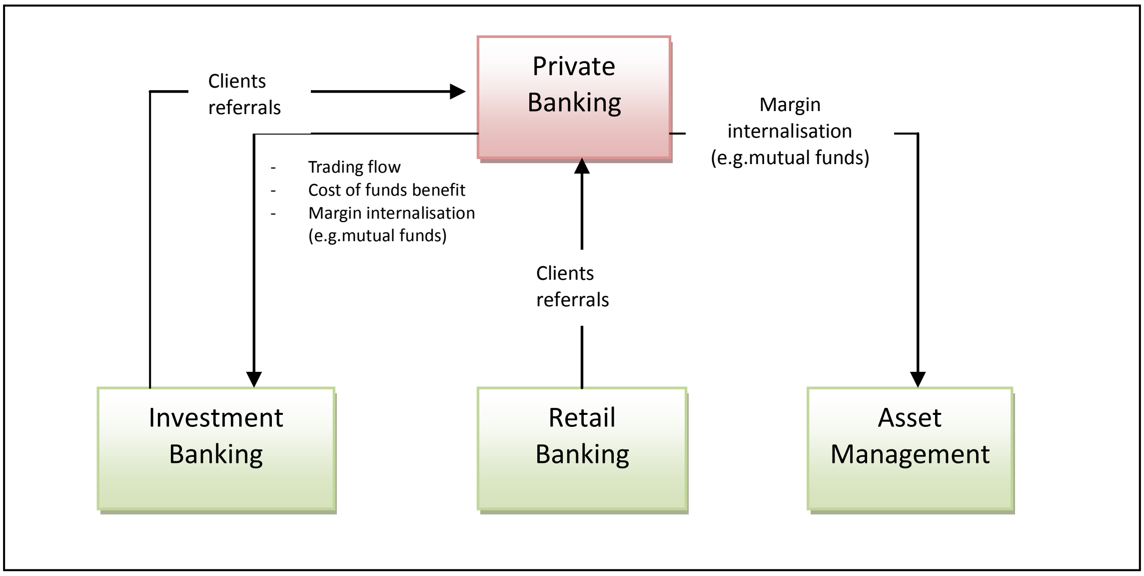
Moreover, let us recall that this business model is mostly built on private banking activities and do not get income from other traditional banking activities such as retail banking or corporate investment banking. As a consequence, we can arguably say there is very little incentive for pure players to deviate from their clients' best interest because reputation along with corporate values is the best catalyst for their image and subsequently their income.

The same reasoning could be applied for **independent advisors** regarding reputation. Of course, they use a 'brokerage system' in which the client pays for each transaction or advice provided. So, it may be quite tempting for them to, sometimes, not act in the long term client best interest by providing recommendations that on the short term can increase their earnings. But here is the caveat. By doing so, especially if the client is also followed by another bank, the risk of damaging the reputation of the organization appears to be fairly high compared to short term benefit because of potential negative words of mouth.

Richins (1983), showed that the impact of negative feedback from dissatisfied clients have a significant impact on purchase and repurchase decisions. In addition, as underlined by File & Prince (1994), the absence of negative comments is one of the main criteria used by clients to select their wealth management service provider. Thus, in a long term perspective, it is in the best interest of the independent advisor to provide sound advice regardless of short term considerations. So reputation is a strong commitment device for the independent advisor. Regarding corporate values in relation to that model, we did not find any relevant evidence that could impact the client/advisor relation.

The **integrated bank** business model differs significantly from pure players. By using this model, private banks hope to extract some synergies between the different arms of the bank. In its report *The future of private banking: A wealth of Opportunity*, the consulting company Oliver Wyman revealed that, the private banking division of the bank can benefit from client referrals originating from both the investment banking and the retail banking arms (see exhibit 4). Using the same idea, the margin on structured product can me 'kept in house' using the using the private bank "*as a distribution platform for the group's investment banking and asset management products*".

Exhibit 4: ***Integrated business model and synergies***



Source: Oliver Wyman (2008), The future of private banking: A wealth of opportunity? P.26

Empirical evidence, in the literature, that supports benefits for private banks using this model in order to extract synergies is scarce and sometimes contradictory. For Molineux and Omarini (2005), it remains unclear whether the private banking arm can really see a performance increase through cross-selling opportunities between the bank's divisions. Cocca (2007), who analyzed a sample of 273 banks, concludes that due to economies of scale and scope, cross-selling opportunities and client referral, especially between the investment bank and the private bank arms, synergies could be extracted from this model. In addition, he points out two interesting remarks in his paper *Size effects and integrated business model in private banking*:

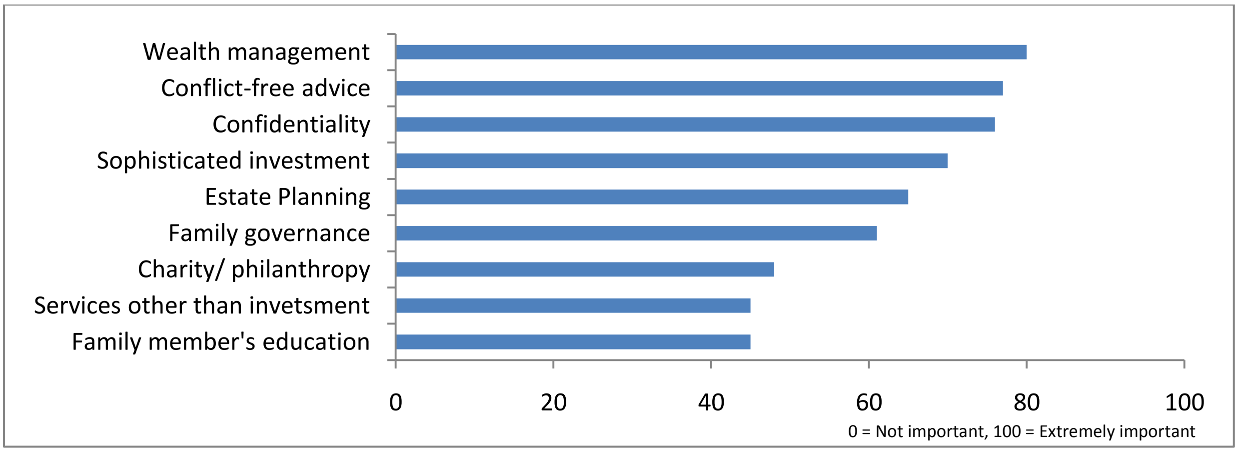
- *"As a private bank, it is not necessary to own an investment bank, but access to investment banking product and know-how is needed.*
- *As recent history demonstrated, there can be serious disadvantages in having an investment bank closely linked to private banking operations."*

As a consequence, provided that the private banking arm is aware of the potential caveats of this model, substantial positive effects can also be extracted to the benefit of the bank overall performance (Cocca, 2007). Nevertheless, almost every large integrated private bank suffers from the same criticism in the minds of wealthy investors: to be '*product-pusher*'. Because large banks tend to provide advice as well as product and service distribution, a conflict of interest between the bank and the client may arise. The bank may try to sell proprietary products that could provide higher margin even though they do not entirely match client's needs. But most integrated banks are aware of this potential conflict of interest. That is why, the use of open-architecture i.e. including third party products and services, is on the rise (Geiger and Hürzeler, 2003).

Sensitive to this potential conflict of interest that could impede the private bank's willingness to provide an unbiased service, an increasing number of wealthy individuals are considering **family offices** as an interesting structure to manage their wealth (Avery, 2009). State-of-the-art products and services as well as independent advice have their appeal in times of uncertain transparency.

By setting up their own family office - the so-called Single Family Office (SFO) - or by gathering several families to create a Multi-Family Office (MFO), affluent individuals are seeking several benefits (see exhibit 5).

Exhibit 5: ***Benefits of setting up a single family office in Europe.***



Source: Amit et al. (2008) Single family office: private wealth management in the family context, p.12

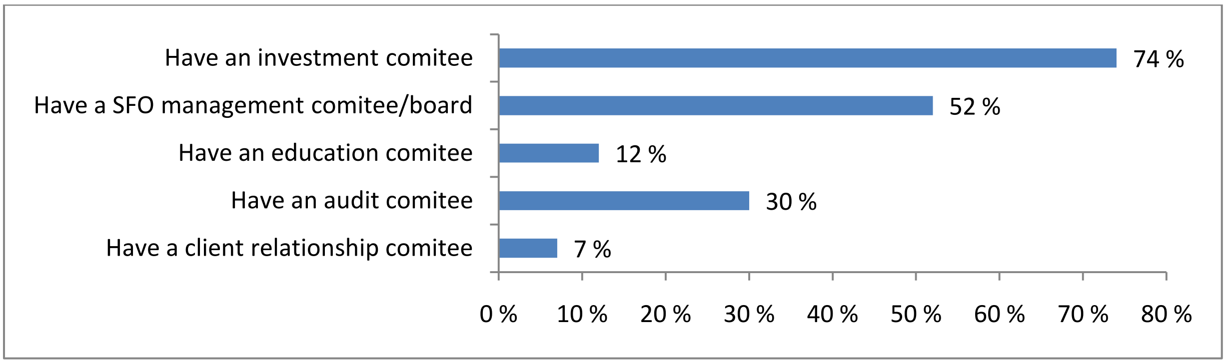
Some are similar to what the previous business model can offer, that is wealth management of family's assets, access to sophisticated investments (like hedge funds) and estate planning. Other offerings are more specific to this business model and examples include family governance, philanthropy and family member's education (Amit et al. 2008).

In the last 10 years, creating a family office has been seen as extremely trendy (Fazzi, 2010). But when it comes to corporate governance considerations, does this business model really stand out from the crowd?

Reputation cannot really be discussed here given the secretive nature of this structure and the subsequent lack of relevant data. However, underlining corporate values as governance mechanism is worthwhile. Amit et al. (2008) found, by studying a large sample of family offices on a global basis, that governance mechanism to ensure that the family wealth is well and timely managed is particularly efficient. (1) *Accountability* of the professional that works in those organizations along with (2) *objectivity* in investment recommendations in addition to (3) an *internal or external supervision board* are the main reason brought up in their study.

Although the board composition to ensure that the needs of the family are met varies greatly from one family office to the other, the level of wealth under management "*does not affect the governance structure*" (Amit et al.2008).

Exhibit 6: **Type of Single Family Office governance in Europe**



Source: Amit et al. (2008), Single family office: private wealth management in the family context, p.21

Since the governance mechanism in family offices is robust to varying wealth levels, this model seems to be particularly efficient to align the interests of the family with those of the professional working for them.

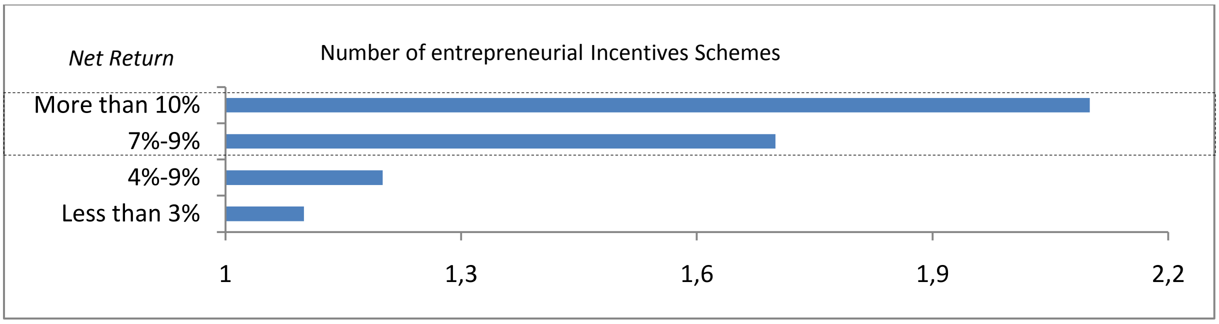
6.2 Long term incentive contracts and legal protection: the business model propositions compared

The private banking business is subject to an increasing level of scrutiny from regulators like any other banking and finance related activity. Nevertheless, **family offices** are "*subject to minimal regulation*" as pointed out by Leleux, Schwassat al. (2007). Despite the fact that they manage private wealth, like any other of the three models depicted previously, setting up a family office is a private matter and as such, regulations applicable to banks, insurance companies and pension funds to name but a few are not applicable to this structure (Leleux et al. 2007).

This lack of regulation, at odd with the usual practices in this industry, does not seem to be a hurdle when it comes to corporate governance. Surprisingly, frequent communications and entrepreneurial incentive schemes between the professionals running on a daily basis the family office can efficiently supplement and even surpass this apparent weakness of weak legal protection for the family (Amit and Liechtenstein, 2009).

Regarding communications, Amit and Liechtenstein (2009) found out that when managers and the family have weekly communication on investment results, a significant increase in the organization performance, in terms of annual return of interest, can be experienced. This suggests that close communication between the *agent,* i.e. family office managers, and *principal*, i.e. the family members, can greatly improve the organization's effectiveness. Moreover, incentives schemes carefully designed to attract and retain the SFO's chief executive officer (C.I.O.) can significantly influence the organization's performance. Even though the CIO's background differs from one family office the other (see exhibit VII), family offices that combine several entrepreneurial incentive schemes significantly outperform SFOs using less than the average of 1.5 incentives scheme such as cash bonuses, profit sharing and co-investment opportunities (Amit and Liechtenstein, 2009).

Exhibit 7: ***Number of entrepreneurial incentive schemes and performance***



Source: Amit and Liechtenstein (2009), report Highlights for "Benchmarking the SFO: Identifying the Performance Drivers", p.13

Co-investment, especially, is perceived as the best device that families can use in order to align their interest with those of the family office's managers. SFO's managers, by investing a significant "*part of their personal fortune in the asset class they are responsible for (the hedge fund manager in the hedge fund investment, the equity manager in the equities, etc.) and a smaller part in all other asset classes […] if they lose money for the principals, it hurts them even more*." as underlined by Amit and Liechtenstein (2009). As a consequence, they have very little incentive to deviate from the family's original needs and objectives.

The entrepreneurship spirit, it is also what seems to drive **pure players** organizations. Let us recall that one of the main features of pure player's value proposition is on the same side as the client by providing truly holistic wealth management services. In the case that the bank operates under the laws as 'private banker', this value proposition can take another dimension.

According to the Swiss Private Banker Association (SPBA), this trademark was originally created *"in 1997 in order to avoid the widespread and abusive use of the term "private banker" by persons or establishments not fulfilling the legal requirements, the Swiss Private Bankers Association (SPBA) registered the collective trademark "private banker" (singular and plural in different languages) with the Swiss Federal Institute of Intellectual Property."* Nowadays, 14 private banks in Switzerland can use this trademark to distinguish themselves from the other private banks that operate under limited liability.

Appending the designation ‘private banker’ after the name of the bank implies that the bank complies with the SPBA regulations (The conditions for banks to be allowed as a ‘private banker’ are summarized in the article 4 of the SPBA statutes; see appendix VIII). The unlimited liability of several managing partners constitutes the main element of those regulations. This unlimited liability means that managing partners will share the upside and the downside of the banks’ performance.

This particular status can increase client trust into this organization because in case of failure he will have a safety net. For managing partners with unlimited liability, this personal financial risk can be perceived as a strong commitment device to act in their best interests which is closely embedded with those of clients. As put by Konrad Hummler, one of the managing partners with unlimited liability at Wegelin & co., “fear for one’s existence can be very motivating.” (Cettier and Schmitt, 2009)

The legal rights provided to clients by this status in addition to the pressure on managing partners’ shoulders appear to be a strong commitment device to align both parties’ interests on a long term perspective. But **integrated banks** do not operate under the unlimited partnership status. Thus, we may wonder how they can overcome this apparently weaker legal protection.

Certainly, integrated private banks establish clear contracts between them and the client for every single investment operation undertaken that is binding for each party, but when it come to the alignment of interests, no evidence was found regarding the efficiency of this device. State underwriting on the other side can provide stronger legal protection.

During the past 2 years, several integrated banks have seen their revenues plummeting, due to poor results in their investment banking arm. This situation led to increasing skepticism from clients using their retail banking as well as the private banking services. As a consequence, they experience a large drop in their share price since many of them are quoted on the stock market. To reassure their clients, some banks like Royal Bank of Scotland, undertook talks with the national government to benefit from state underwriting (Webster, Gilmore, et al. 2008).

According to the consulting company Booz & company and its survey *Private Banking beyond the 'perfect storm*', state underwriting can have a positive impact on the bank because it reassures clients on the bank future prospects. As a consequence, clients tend to be more inclined to keep and in some cases increase their assets within those banks, because state underwriting is perceived as a solid safety net in their mind. However, they revealed that "the sustainability of these asset shifts was questionable" because clients may shift those assets to other banks once their perception of the current economic climate improves.

Thus, state underwriting of integrated banks may provide higher legal protection for clients. But this effect, far away from been sufficiently documented, does not offer the guarantee that it improves corporate governance effectiveness between the bank and the client. As a consequence, it appears that reputation and corporate values are the few commitment devices that a private bank using the integrated business model can use to align their interests with those of the clients. Can the same conclusion be applied to independent advisors?

The business model of **independent advisors** differs significantly of the one offer by integrated banks although some characteristics are common. Considering comparable features, like integrated bank, independent advisors are issuing contracts as soon as an investment recommendation is provided or a product is sold. That is for them an efficient way to ensure the client understands the process as well as a legal requirement. In addition, it provides for both the agent and the principal an efficient protection in case of legal claim (Bachmann and Hens, 2008).

Long term incentives contracts, which are the attributes of the others business model previously analyzed, do not apply here. Let us recall that independent advisors commonly use a brokerage model in which the client pays a fee for each transaction. By using this model, a major focus is given to frequent transactions with a broad base of clients at the expense of long term relationships. Under those assumptions, it is thorny to really identify how the independent advisors and the client can align their interest. But we should not forget that the activity of independent advisors is correlated with positive word of mouth. So even though legal protection and long term incentive contracts are not the best devices to align both parties interest, reputation can surely play that role.

To summarize our findings so far, it is important to keep in mind that each model possesses its own corporate governance mechanisms. Sometimes several mechanisms are combined while in other business models, only one device seems to be the best catalyst to align the interests of the agent with those of the principal. The following exhibit is the summary of the efficiency of each in comparison to each model.

Exhibit 8: ***Corporate Governance Efficiency by business model***

	Corporate Governance Efficiency			
Business models	**Long term incentive contract**	**Reputation**	**Corporate values**	**Legal protection**
Independent advisor	Quite weak	Very strong	No evidence found	Medium
Integrated private bank	Strong	Strong	Strong (through graduate programs for instance)	Medium (strong in case of state underwriting)
Pure player	Strong (very strong if the bank invests along with the client)	Very strong	Strong (through graduate programs for instance)	Strong (very strong in case of unlimited liability of partners)
Family office	Very strong	Do not apply	Very strong	Weak (unregulated activity)

Source: Author's research.

The task for any wealth management organization regardless of its business model is to convince the clients that they are the most appropriate structure so that financial recommendations, products and services offered perfectly match the client's needs and preferences. The Corporate Governance Efficiency, that can be translated in four main mechanisms in private banking, can provide an idea of which structure is the best regarding solely corporate governance considerations. Family offices and pure player business models show constant strong incentives to align the interests of the agent with those of the principal meanwhile integrated bank and independent advisors appear to be weaker.

It is tempting as of this point in the research to draw a conclusion on the best business model. However, it would be hasty and somewhat misleading to compare each model according to their value proposition compared to corporate governance efficiency, without considering the clients requirements to access to each business model. Facts such as the costs to access to each model, perceived efficiency and prestige are also to be considered.

7. Beyond corporate governance efficiency: a closer look at the client's requirements.

Our findings on each business model compared to governance efficiency are quite clear. Family office and pure player's business models lead the field. However those results seems to be at odds with the conclusions drawn by *Euromoney Magazine* in its 2009 and 2010 private banking surveys.

7.1 The CGE findings challenged

According to *Euromoney*, which ranks the best global private banks according to qualitative (from front office staff) and quantitative criteria (average AuM growth, net income…), between 2008 and 2010, out of the 20 best global private banks, 18 of them are integrated banks while 2 operate according to the pure player model namely Pictet & Cie and Julius Bär (see appendix IX). And the same observation holds for the best services for affluent investors compared to their level of wealth (see appendix X).

Of course, none of the family offices and independent advisors depicted previously is featured in this ranking because of their relative insignificance in their assets under management as well as their lack of international footprint inherent to their model. But how can we explain the relative absence of pure players in this ranking?

Schmid and Walter (2009) demonstrated that individual investors through the stock market, value pure players with a premium compared to integrated private banks. Consequently, it implies that when affluent individuals are looking for their potential future wealth manager, other elements than Corporate Governance Efficiency attract their attention. The prestige offered by being a client at a well-known private bank can be part of the equation. Trust may also rank high in their agenda. For Murphy (2009), trust, especially after the turbulent past two years is of primary importance when private investors are looking for a banking institution to manage their wealth. From the bank's perspective, client acquisition and retention is the main issue because their sustainability depends on it (Molineux and Omarini, 2005). So the main task for wealth management institutions is to provide the clear evidence that they provide a truly value added service that would go a long way towards improving the client's confidence in their organization.

According to the Boston Consulting Group and its *Global wealth report 2009*, several measures can be implemented by private banks to stand out in the eyes of potential new clients. Those measures are summarized in exhibit 9 below.

Exhibit 9: ***Five ways to attract and retain clients***

Tailored services: *More than ever, private banks need to understand their client and provide tailored advice. […] Bank must ensure that they have the capabilities-and the capacity- to provide a meaningful level of customized service to their clients. They should consider paring down the client segments they serve rather than providing a thin level of service to multiple client segments.*

Expertise: *Private Banks have seen their image tarnished by the crisis. […]But most investors still lack the time or the knowledge to manage their assets on their own. They want (and need) to delegate this task to an expert. Banks will be able to attract clients by demonstrating their expertise and capabilities in wealth management.*

Additional services: *Private banking involves more than investment advice. A comprehensive offering includes financial planning, fiduciary services, and specialist services such as tax consulting.*

Products: *Although most investors will continue to shy away from products that seem overly complex, […] they will eventually begin searching for sophisticated products that provide capital protection along with access to different kind of market.*

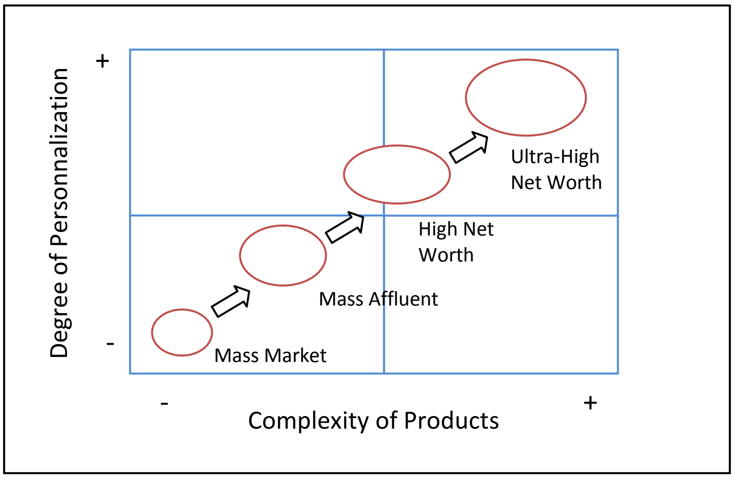
Prestige: *Clients have lost faith in some of the biggest names in wealth management […] but provided that they can deliver the products and services that are relevant to clients in the post-crisis world, these banks will regain their prestige.*

Source: extracted from The Boston Consulting Group, (2009), Global Wealth report 2009, pp.27-28

However, to implement those measures efficiently, the bank needs to know its clients. Let us recall that in private banking there is no one client but several clients with various needs and objectives. Although the behaviour of private banking clients is unpredictable (Dhar and Glazer, 2003), clients' requirements on wealth management services are well-known. Simply put, the higher the wealth of the client, the higher the degree of personalization and the complexity of products are necessary to fulfill his expectations (see exhibit 10).

While fulfilling the client expectation would go a long way towards improving the trust in the wealth management services provider, the wealth management firm should not forget that meeting clients' needs is great as long as it does not come at the expense of the survival of the firm on a long term scale. Put differently, the wealth management company should not devote more resources to the client (in terms of time, level of service, etc) than what is necessary to maintain a long term mutually beneficial relationship.

Exhibit 10: ***The complexity and personalization of services by wealth level***



Source: Cellent Communication (2001), Wealth management market: capturing the hearts and assets of mass affluent. p.9

As a consequence, each wealth management firm according to its operating business model, needs to know which client is profitable and who is not, both quantitatively and qualitatively. Prince and Grove (2007) demonstrated by surveying more than 260 wealth management companies that by knowing who can be regarded as an 'ideal client' to your firm, the wealth management company can significantly improve its performance (see exhibit 11).

Exhibit 11: ***The 'ideal client' for each business model***

AuM	Private Bank	Independent advisor-'brokerage model'	Multi-Family office	Total
Under $1m	0%	14.1%	0%	4.1%
$1 million to $5 million	**32%**	**42.3%**	0%	23.8%
$5 million to $10 million	**25.8%**	**17.9%**	18.1%	20.8%
$10 million to $25 million	23.7%	14.1%	**47.9%**	29.4%
Over $25 million	18.6%	11.5%	**34%**	21.9%

Source: Adapted from Prince and Grove (2007), A view from the Top, Private Wealth Magazine.

So ideally, Private Banks should target individuals with investable assets ranging from $1 million to $10 million with the possibility to extend this target to client of greater wealth according to the banks resources. Independent advisors need to focus on clients with investable assets between $1 million and $10 million while multi-family offices need to consider clients with at least $10 million. For Balmer and Stotvig (1997), segmenting clients according to their wealth is a sensible decision. However, a better fine tuning can be achieved by segmenting them according to their behaviour along with their wealth because this improved segmentation may provide the bank with the best key to understand the clients' aspirations (see Exhibit 12).

Exhibit 12: ***The 4 categories of clients in private banking***

Full Members: those who have integrated all their financial assets into the bank, and are very wealthy. Full members allow all their financial needs to be handled by the bank. The relationship between the bank and the client is very close. These clients should be encouraged to see themselves as members of a club rather than just clients of a bank.

Nominal Members: have substantial wealth, but do not use many of the services provided by the bank. Most nominal members use the bank for investment management services.

Aspirational members: use a wide range of the bank's services, but at the moment do not have a substantial amount to invest.

Pretenders: have little wealth. They use many of the services provided. In many cases, these clients had been allowed to open an account with the bank for the wrong reasons. The main motivation for remaining with the bank might be the use of the cheque book and the bank's name.

Source: Balmer and Stotvig (1997), Corporate identity and private banking: a review and a case study, p.15

Obviously, pretenders shall be discouraged from using the company services while full members had to be pampered by the bank because their financial investments are more than sufficient to justify a close-and costly- relationship (Balmer and Stotvig, 1997).

7.2 Concluding remarks

Those findings provide an enhanced foundation in our quest of the best business model in private banking. By using these findings in addition to Corporate Governance Efficiency, we are able to provide some hints to the main question of this paper which is to unveil the best business model in private banking.

Well, it is worthwhile to underline the fact that none of the business models seems to significantly emerge as the '*ultimate model'* in private banking from a Corporate Governance Efficiency standpoint. This is due to the fact that while it is important when clients are assessing the potential wealth managers' service provider, CGE may not be the first criteria they are using. This is important because it means that clients consider the alignment of interests between them and the bank to be less significant than criteria such as prestige and aspiration. For the bank, this would imply that clients may join them for reasons that are other than their intrinsic value proposition. This means that wealth management service providers need to carefully assess their potential clients before starting doing business otherwise, a fair degree of free-riding behaviour from clients with lower investable assets may be experienced.

Even though an ideal model regarding pure corporate governance consideration does not emerge from our research, some hints appears to give us a clue to know which conditions may be required for each business model to be the most efficiently used by the principal and the agent.

Independent advisors, due to their governance characteristics, may be wise not to target clients of higher wealth but rather clients with lower wealth i.e. the mass affluent category. This would allow them to exploit their brokerage model efficiently and client with lower wealth. Besides by targeting the bottom of the wealth pyramid, fierce competition with large private banks can be avoided.

Integrated banks could target entrepreneurs because by using both the retail and/or investment banking arm along with the private banking services of the bank, they may benefit from their enlarged vision of the organization. Repetitive transactions can forge clients' opinion on the objectivity of the private banking arm. If the bank manages to overcome potentially conflicting goals inherent to its organization, this relation can be highly profitable. For **pure players**, their ability to target investors that share their value may be critical. Clients with higher wealth may be favored because they would pay more attention to the service quality than the service actually provided.

Subject to minimal regulation, **family offices** have a lot to offer. From a CGE standpoint, this structure seems to constantly align its interests with those of the investors. As a consequence, this model may emerge as one of the most efficient. However, a substantial level wealth is required to set up and run this structure. That is why multi-family offices or family offices run by pure players appear to be promising solutions. If the investor is willing to deviate, to some extent, from the alignment of interest provided by single family offices to the benefit of lower services costs, those two structures can offer interesting trade-off.

8. Conclusion

The research objective of this thesis was, through a comparative study, to evaluate the Corporate Governance Efficiency (CGE) of four business models in private banking. By doing so, we intended to unveil under which condition(s) one model may emerge to be better than the others.

8.1 Summary of findings

Our results suggest that regarding corporate governance efficiency, business models currently used in the wealth management industry demonstrate varying level of efficiency. 'Pure players' and 'family offices', due to their intrinsic characteristics, appear to lead the field when it comes to Corporate Governance Efficiency.

'Pure player' business model does not suffer from any significant flaw and even performs quite well in each of the four mechanisms able to align the interests of the clients with those of the bank. Although not benefiting from strong legal protection due to the lack of regulation, 'Family offices' appear to overcome this apparent weakness by performing extremely well with the other governance mechanisms, namely long-term incentive contracts and corporate values.

Nevertheless, this result seems to be at odds with the current clients' preferences when choosing their wealth management services provider. The current largest global wealth managers -in terms of assets under management- operate under the integrated banks business model. This result suggests that when clients are looking for an organization to manage their wealth, little importance is attached to Corporate Governance Efficiency. It means that clients set aside the alignment of their own interests with those of the organization managing their wealth to focus on other criteria.

Surprisingly, this behaviour appears to be rational. By using criteria such as the minimum threshold to access each business model, word-of-mouth and apparent prestige to select their wealth manager, wealthy individuals are assessing those organizations with the only criteria they have at their disposal in an industry where secrecy and consequently objective information is scarce.

Thus, this thesis appears to be a timely contribution for clients as well as wealth management services providers.

For clients, adding Corporate Governance Efficiency to their list of criteria to make sure that their potential wealth manager will behave in compliance with their best interests is far away from being unnecessary. However, none of the four models analyzed is flawless. So, for practitioners, being conscious of the strengths and possible flaws of each business model regarding corporate governance efficiency it is important to keep in mind because efficiently handled, each model attracts the individuals that matched the organization value proposition. In a long term perspective, this implies enhanced efficiency that could be translated into higher revenues.

8.2 Future research

As mention earlier, little research has been done in the field of corporate governance in private banking. Consequently, finding strong evidence that one model is better than the others by just relying on corporate governance efficiency is currently not achievable. In the future it may be possible to collect sufficient data to draw a definite conclusion on the best business model in private banking and maybe also include more business models.

Finally, most of the data used in this research are following the post-crisis period. So, even though Corporate Governance Efficiency does not appear to be the main criteria clients are using to choose their wealth manager, it may be interesting to compare the current results with data gathered in period of economic boom to assess whether those results are robust to business cycles.

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Appendices

Appendix I: The Private banking terminology at a glance

- **Affluent:** A client with investable assets ranging from $100,000 to $500,000.

- **Asset under Management** (*AuM*): The level of wealth that a wealth management company is currently supervising. Typically, the flow and level of AuM indicates the health and the prospects of the institution.

- **Family Office**: a professional organization set up by wealthy families themselves to manage their wealth as well as family matters. A distinction is usually done to differentiate Single Family Office (SFO) from Multi-Family Office (MFO).

- **High Net Worth Individuals** (*HNWI*): clients with investable assets ranging from $500,000 to $50 million.

- **Multi-Family Office** (*MFO*): It's a family office structure set up by more than one family. The purpose is to gather the assets of several families to guarantee the access to state-of the art investment solutions that require significant upfront investment.

- **Private banking**: part of the financial industry that deals with clients of at least $100,000 of investable assets. High degree of personalization of products and services along with close relationship between the bank and the client can distinguish private banking from retail banking.

- **Private Bankers**: it's a protected designation. In Switzerland, private bankers are entrepreneurs with unlimited liability.

- **Single Family Office** (*SFO*): It's a family office structure set up and run by only one family. SFO are usually established by wealthy families concerned with privacy. While privacy can be guaranteed by the structure, this organization require a large upfront investment in addition the costs of running the structure.

- **Ultra High Net Worth Individuals** (*UHNWI*): clients with more than $50 million of investable assets.

- **Wealth Management**: term interchangeable with 'private banking'. The wealth management industry deals with clients of at least $100,000 of investable assets. High degree of personalization of products and services along with close relationship between the bank and the client can distinguish private banking from retail banking.

Source: Author's research.

Appendix II: Name of banks featured in this thesis

Bank's name (in alphabetic order)	Example provided	Page(s)
Barclays Wealth	- Threshold to become a client - Graduate programme	10; 22
Coutts &Co.	- Threshold to become a client	10
Credit Suisse	- One of the largest player in the market - Graduate programme - Outsourcing to third party	6; 22; 26
EFG International	- Example of pure player Business model	18
Goldman Sachs	- Example of integrated bank	16
HSBC	- Example of integrated bank	16
Julius Bär	- Training program - Example of pure player business model	28; 38
Lehman Brother	- Bank's failure	6
Lloyds	- Acquisition of private bank	12
Lombard Odier Private bankers	- Example of pure player business model	18
Pictet &Cie.	- Example of pure player business model - Training program	18; 28; 38
RBC Wealth	- Graduate program	22
UBS	- One of the largest player in the market - Example of integrated bank	6; 16
Wegelin and Co.	- Oldest Swiss private bank	8; 34

Appendix III: Range of products and services available in private banking

Investment and banking services available in most private Banks	Non-investment Management services also available
Asset protection planning	Assistance in managing and growing collections/ Art advisory
Administration and distribution of investment funds	Bill paying
Credit Services	Charitable giving
Derivative instruments	Concierge services
Estate planning	Financial educational service
Financial analysis	Luxury acquisition services
Foreign exchange operations	Managing residences, jets, helicopters and yachts
Investment advisory services	Overseeing emergency and dramatic health-care needs
Investment banking services	Personal/family security-protection services
Legal and tax advisory services	Property and casualty insurance
Life insurance	Philanthropic services
Securities trading, administration and safekeeping	Tax administration services
Trust services	

Source: Compiled by the author from the Swiss private Banker association website and Prince and Grove (2007), Blurring the lines, Private Wealth Magazine.

Appendix IV: Bank efficiency and country of origin

	Adjusted gross margin	Return on equity	Adjusted return on equity	Cost/income	Total revenue per employee	Gross profit per employee	Average AuM per employee	Stakeholder income per employee	Overall ranking
Switzerland	4	3	1	7	2	5	1	1	2
France	2	8	9	8	8	6	8	10	7
Germany	5	10	10	10	11	10	5	9	11
Italy	7	7	7	3	9	8	10	5	6
Liechtenstein	8	4	2	1	1	1	2	2	1
United Kingdom	3	2	4	6	5	7	3	7	4
USA	9	5	5	11	7	11	7	4	7
Austria	10	9	8	4	10	9	4	6	9
Benelux	6	6	6	5	4	3	6	3	5
Japan	11	11	11	9	3	4	9	11	10
Nordic countries	1	1	3	2	6	2	11	8	3

Source: Birchler et al. (2009), The International Private Banking Study 2009, p.29

Appendix V: Overview of the Swiss Private Bankers

Year	Name	Origin	Locations (In Switzerland and abroad)
1741	Wegelin & Co.	St. Gallen	11
1750	Rahn & Bodmer	Zurich	1
1780	Landolt & Cie	Lausanne	3
1786	Hottinger & Cie	Zurich	13
1787	LaRoche Banquiers & Co.	Basel	4
1796	Lombard Odier Darier Hentsch	Geneva	23
1805	Pictet & Cie	Geneva	21
1819	Mirabaud & Cie	Geneva	9
1844	Bordier & Cie	Geneva	8
1845	Gonet & Cie	Geneva	3
1886	E. Gutzwiller & Cie	Basel	3
1869	Mourge d'Algue & Cie	Geneva	1
1920	Baumann & Cie	Basel	2
1995	Reichmuth & Co.	Lucerne	2

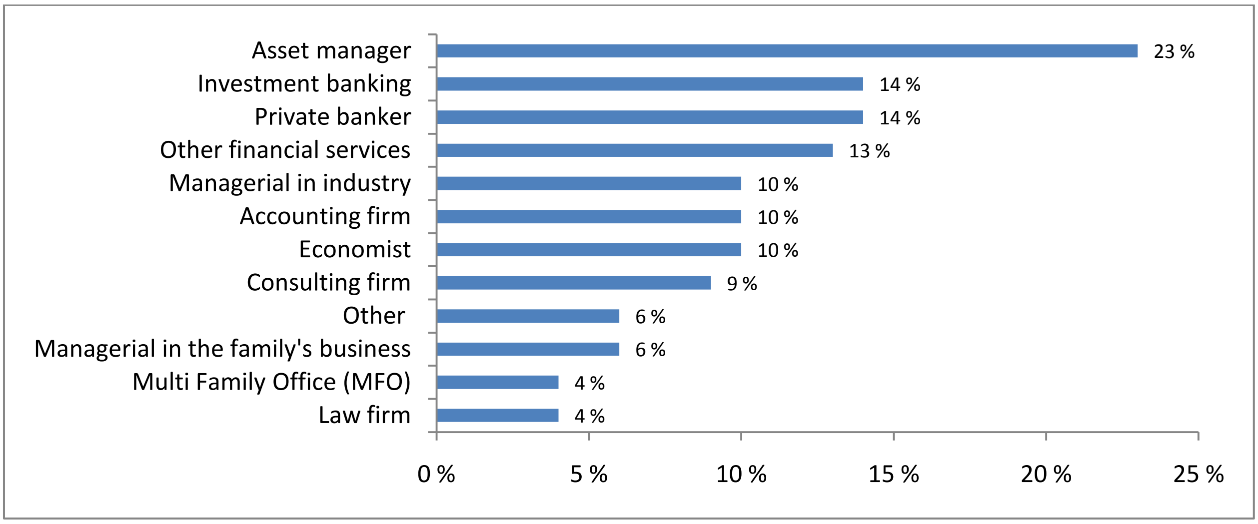
Source: adapted from Cettier and Schmitt (2009), The Rise of Switzerland's Oldest Bank, p.17

Appendix VI: Traditional financial services vs. Family Office approach

Characteristics	Traditional Financial Services Approach	Family Office Model
Wealth Management Methodology	- Product oriented; - Investment-management focused; - Advices centered on "in-house" portfolio only; - Little or no coordination/collaboration with third-party providers; - Services oriented towards individual mid-tier millionaires.	- Product neutral; - Investments are managed in the context of the family "balance sheet"; - Advice reflects a full view of client's assets; - Coordinates/collaborate with all providers to develop an integrated wealth strategy; - Service focuses on the mid-tier millionaire family "entity".
Product & Pricing	- Transaction-based pricing now moving towards asset under management or "by service" fee-based model; - Ad-hoc investment process; reacts to market conditions; - Portfolio reviews based on standard templates.	- Historically AuM-based pricing; - Investment process is often documented and standardized, according to agreed-upon investment policy; - Portfolio reviews are regularly scheduled and customized according to client's needs and preferences.
Products & Services	- **Advice & Planning** to develop personalized wealth management plan: Set objectives; Develop strategy; Implement solutions; Review progress. - **Banking services**: Direct deposit, check writing, funds transfer, etc. - **Business Financial services**: Integrated cash management, business banking, etc. - **Credit & Lending**: Home, personal, investment and business financing. - **Estate Planning**: Trust services, tax assessments, etc. - **Investment Management;** - **Retirement Planning**.	- **Chief Advisor**: Oversees relationships with all product and service providers, external counselors/advisors; provides personalized service, technical expertise and creative business leadership; - **Investment manager**: Manages, analyzes and review family's financial capital, including investment policy, manager selection/review, asset monitoring/review and due diligence; - **Financial administrator**: Ensures asset allocation mirrors client's investment philosophy, tax compliance, financial control, project management, and financial reporting; - **Trustee:** Educates and mentors: administers family trusts, ensure timely communications and oversees philanthropic management; - **Back Office Manager**: Provides investment and partnership accounting, client reporting, internal controls and technology support.

Source: Carrol (2001), The function of a Family Office, in McCann and Lavayssière (2008), Wealth, p.113

Appendix VII: The CIO Background in Single Family Offices



Source: Amit et al. (2008), Single family office: private wealth management in the family context, p.21

Appendix VIII: Conditions to be eligible to the "private banker" designation

To be eligible to the designation"*private banker*", Swiss private banks need to meet the following criteria:

- It is entered in the trade register as banker or bank of sole ownership, general partnership, limited partnership or limited partnership with shares, i.e. **any private bank with at least one partner who has unlimited liability** ;

- That the **partner with unlimited liability is - or that the majority of partners are – a Swiss citizen(s**). Where an institution has two partners with unlimited liability, only one need be a Swiss national ;

- That one of the partners with unlimited liability has been a **member of the Swiss Bankers Association** for at least three years.

Source: Swiss Private Banker Association website

Appendix IX: Best global private banks over the last 3 years (*Euromoney*)

Private Bank	Rank 2010	Rank 2009	Rank 2008
Credit Suisse	1	4	4
HSBC	2	2	3
UBS	3	1	1
Citi	4	3	2
JP Morgan	5	5	6
BNP Paribas	6	6	9
Julius Baer	7	13	13
Deutsche Bank	8	7	5
Bank of America Merrill Lynch	8	8	7
Pictet	10	9	11
Barclays	11	11	27
Santander	12	12	14
RBC	13	24	23
Société Générale	14	14	12
Goldman Sachs	15	10	8
ABN Amro	16	15	10
Nordea	17	18	-
BBVA	18	30	-
Danske bank	19	25	30
UniCredit	20	16	-
Lombard Odier Darier Hentsch	21	23	17
ING	22	22	19
SEB	23	32	-
Itaú Private Bank	24	29	-
China Merchants Bank	25	-	-

Source: Euromoney, Private Banking surveys 2009 and 2010

Appendix X: Best net-worth services over the past 3 years (*Euromoney*)

Super affluent ($500,000 to $1 million)

Bank	Rank 2010	Rank 2009	Rank 2008
HSBC	1	1	4
Citi	2	2	6
UBS	3	3	1
BNP Paribas	4	5	9
BofA Merrill Lynch	5	4	3
Credit Suisse	6	6	2
Deutsche Bank	7	7	7
Santander	8	10	8
Barclays	8	8	19
ABN Amro	10	9	5

High net Worth I ($1 million to $10 million)

Bank	2010	2009	2008
HSBC	1	2	3
UBS	2	1	1
Credit Suisse	3	4	2
Citi	4	3	5
Deutsche Bank	5	6	6
BofA Merrill Lynch	6	5	4
BNP Paribas	7	7	7
ABN Amro	8	13	-
Santander	8	14	-
JP Morgan	10	11	-

High Net Worth II ($10 million to $30 million)

Bank	2010	2009	2008
UBS	1	1	1
JP Morgan	2	2	4
Credit Suisse	3	5	3
HSBC	4	3	6
Citi	5	4	2
Goldman Sachs	6	6	5
Deutsche Bank	7	8	8
Pictet	8	9	9
BofA Merrill Lynch	8	7	7
BNP Paribas	10	10	10

Ultra High Net Worth (Greater than $30 million)

Bank	Rank 2010	Rank 2009	Rank 2008
JP Morgan	1	3	5
Goldman Sachs	2	2	2
UBS	3	1	1
Credit Suisse	4	6	4
HSBC	5	4	8
Citi	6	5	3
Pictet	7	8	9
Deutsche Bank	8	7	10
Rothschild	8	11	-
BNP Paribas	10	10	11

Source: Euromoney, Private Banking surveys 2009 and 2010