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Search for growth fuels urge to merge

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With private banking contributing anything up to 20% of global bank profits, capturing market share through mergers and acquisitions is a preoccupation of wealth managers. Helen Avery asked bankers, advisers and analysts about prospects and pitfalls on this particular route to growth.

“YOU NAME THE private bank, they're out there looking for an acquisition,” says Boston Consulting Group's head of private banking and wealth management, Christian de Juniac. That might be a slight exaggeration but there will be plenty of M&A activity in the wealth management industry this year as banks strive to expand.

In a KPMG survey of 190 private banks in 2004, one-third said that their business strategy called for an acquisition to be made within the next three years – the main objectives being geographical expansion or increased market share.

There seems to be no regional bias to private banks' expansion strategies. Asia-Pacific, the Middle East, the US, Western Europe, Russia, India and China all feature as targets.

It will be supply that dictates the number of deals to close in 2005. In western Europe, in particular, targets are limited. Banks are being forced to buy small wealth managers or regional private banking operations of universal banks retreating from the sector.

Some famous names could be on the block. Last month, Swiss private bank Julius Baer announced a one share, one vote structure, significantly reducing the family's control and leading to speculation that a merger or acquisition could be in the offing. ING also entered exclusive discussions with Barclays Bank to sell its French wealth management business.

Acquisitions are not risk-free. KPMG's study showed that an average of 10% of a target's client base is lost in the first year after the transaction. Compliance issues as a result of increased regulation are also causing banks to be more discriminating in their choices of target. Due diligence was given by KPMG's survey respondents as the most important activity to undertake before deal completion, with north American private banks more attentive than their western European counterparts.

With M&A at the top of the agenda of the world's private banks, Euromoney asked seven industry participants for their perspectives on consolidation.

Ian Smith is an adviser in KPMG's strategic and commercial intelligence financial services practice, which works with management teams of private banks in the UK and European market on strategic and transaction issues.

Ian Smith, KPMG *What is going to be the biggest driver of M&A activity among private banks in 2005?*

Wealth management is big business and an increasingly important part of bank group portfolios as a revenue and profit generator. Estimates suggest that wealth management now contributes as much as 20% of global banking revenues. To put this into perspective, it's nearly double that of investment banking.

With the market forecast to continue to grow, private banking and wealth management are attractive sectors and are getting higher on the agenda in many boardrooms. M&A remains one option available to help deliver strategic and financial objectives. It can provide opportunities to more quickly enter new markets – the Far East is often quoted as a key opportunity – build market share, access new client segments or acquire specific capabilities.

What sort of deals can we expect this year?

We have seen a flurry of deals over the last couple of years, particularly in the fragmented Swiss market, and we expect consolidation to continue.

Our research indicates that larger private banks are more dependent on acquisitions for growth, and reports of potential deals are increasing. It is clear that many are considering a long list of targets. This is not to say smaller private banks will not be involved. However, high valuations and the difficulty in identifying targets have put acquisitions out of reach for many.

The focus is on organic growth underpinned by regional expansion and building their teams in an effort to get closer to existing clients and winning new ones.

There is also increasing determination across the sector to address inefficiencies created during the last upturn, which was characterized by the rush to capture assets. Understanding and making improvements in areas such as client segmentation and profitability, sales and service effectiveness and business models are front of mind and where a lot of effort is now being channelled.

How can private banks ensure that acquisitions are integrated smoothly?

The challenge is how best to protect, create and realize value. There are significant risks including the loss of the target's clients, with our research indicating this averages 10% in the first 12 months of deal completion. The research paints a very clear picture – successful mergers and acquisitions are underpinned by a clear strategy, robust plans and focused execution. Careful planning is critical.

A systematic approach is required to confirm the deal rationale and identify the synergies, benefits and risks of the deal. Detailed plans for the first 100 days are essential to ensure resource is mobilized quickly, pace and momentum are created, activity is focused on the key value drivers and progress is tracked effectively. This work should include cultural fit and what will be needed to effectively integrate.

Interestingly, our research indicates that while viewed as the most important post-deal activity, only 12% of respondents said cultural alignment was the most important pre-deal issue. And, of course, there is a need for clear and regular communication with staff and clients to win hearts and minds and gain commitment.

Justin Ong is a partner in the wealth management practice of consultants PricewaterhouseCoopers in Singapore.

Justin Ong,
PricewaterhouseCoopers

What is the outlook for M&A activity among private banks in Asia in 2005?

M&A activity in Europe in 2003 and 2004 was largely consolidation within the industry as private banks fought for market share and to maintain margins. The Asian story is different, with many global and regional private banks on the acquisition warpath as they seek expansion opportunities, especially in promising developing markets such as India, Korea and China. We expect to see such activities continuing in 2005.

But this seems to be still very much a selective M&A focus, particularly for private banks looking to expand service offerings such as in trust and estate planning services, hedge funds, and family offices. In this regard, acquisitions appear to be the favoured method, as evidenced from recent transactions (locally and regionally) where private banks have made forays into local and cross-border transactions to acquire specialized units from other private banks to supplement their service offerings.

What issues should acquirers be aware of?

Acquisitions are always a tricky matter, and there are many aspects to consider. Key points include watching out for regulatory risks, managing people issues as well as understanding the corporate governance issues in potential targets.

As to the first point, while regulations on cross-border transactions are starting to become more liberalized, regulatory risks must still be considered. For example, what is the relationship between the acquisition target and its regulator? Does it have a good “compliance” culture? What is the quality of the compliance personnel? What is the tone driven down from the top? And how is enforcement of compliance and ethical guidelines managed?

Recent examples have shown how the lack of proper management over these issues have resulted in regulators taking a tough stance against offenders.
How do acquisitions fare against organic growth in Asia?

There is no one clear preferred growth strategy in Asian private banking – it really depends on what is being sought after. The strategy would depend on whether the growth is more of expanding into target markets, or to provide a different or wider range of service/product offerings.

In a fast-moving market like Asia, selective acquisitions appear to have taken precedence because of the preference for having a ready infrastructure available so that they can go to market in the shortest time – if the focus is to provide a new platform for services or new product offering.

Where the immediate strategy is to expand reach into target markets to acquire new clients, organic growth supplemented by concentrated recruitment has been the oft-chosen path.

Outright acquisitions have remained relatively rare in Asian private banking, most likely because of the lack of potential acquisition targets as the market is still developing. With most private banks having high expectations of growth, few are choosing to sell out now.

Nevertheless we believe that under these circumstances, private banks should perhaps consider other alternatives for growth. Alliances are still a new concept, so progress in this area is much slower. However, given the features of private banking in Asia – it is highly fragmented, has high barriers to entry in many countries, and language and cultural differences – alliances with established local players would be a good way to head towards in 2005. We believe there is much to gain from considering alliances, especially with tie-ups with complementary partners to private banks (such as financial advisers and planners, family offices and insurers).

Elizabeth Bloomer Nesvold is a managing director with M&A adviser Berkshire Capital Securities in New York, and has advised wealth management companies such as Wilmington Trust, Lydian Wealth Management, Northern Trust and more recently Mellon Financial Corporation on acquisitions.

Elizabeth Bloomer Nesvold,
Berkshire Capital Securities

What do you expect for the US private-banking industry in 2005?

It seems as if everyone is thinking about the US marketplace at the moment and we're seeing a fair amount of interest from non-US buyers, who were noticeably absent in the early 2000s. Some were caught off-guard in the late 1990s, having made acquisitions at the top of the market and then watched the market pull back, but there seems to be a clear appetite for acquisition.

Part of that may be explained by the relative weakness of the US dollar. But much of the interest is a function of the environment. The US is a marketplace that any international private bank thinking about a global name needs to be in.
How are non-US private banks approaching entering or expanding in the US market?

Their strategies run the gamut. We're seeing interest in outright acquisitions of small private banks, trust companies, and wealth managers. Another way for a non-US private bank to enter is via a liaison with a domestic business (for example a money manager) with a high-net-worth client base. It is a good way to get a foothold here and create name recognition with a particular base of clients before putting a major stake in the ground by buying a bank or opening an office de novo.

What do you foresee for domestic M&A this year?

We're seeing much more activity as a whole. Over the last few years, financial institutions have been looking at smaller players – product fills or geographic expansion – but now they are feeling a bit stronger about their balance sheet. As a result, we could see some larger players merging. I don't believe it will be a return to 2001 when everyone was looking at a bet-the-bank acquisition, but we'll certainly see some larger deals. It makes sense really, as some notable large bank deals in 2003 and 2004 have pushed other organizations down the food chain – they'll be wanting to move up a few notches.

Are any regions seeing more activity than others?

New York still remains a key area of focus. Partly this is because some of the larger private banks that for so long dominated New York have, in the last few years, faltered a bit. This perceived weakness has given other organizations the courage to hang up a shingle or move in with a smaller acquisition play. Other than that, Boston, Chicago, Los Angeles and Florida are also popular wealth management centres, although in Florida there are not many acquisition opportunities.

Do you have any advice for non-domestic private banks looking to acquire in the US?

It's the old M&A adage we use globally. Just make sure you spend the time figuring out the chemistry and the culture. Management needs to have the same line of thinking about firm interaction, integration (or not) and growth objectives.

Christian de Juniac is head of Boston Consulting Group's worldwide asset management and private banking practice.

Christian de Juniac,
Boston Consulting Group *Do you expect a great deal of activity among private banks in 2005?*

Almost all the private banking institutions we talk to seem to want to expand – 2002 and 2003 were devoted to cost cutting, now private banks want to grow. Profits have returned and organic growth is costly and slow. The natural answer is acquisition. It therefore raises the question – why aren't more deals taking place?

Part of the reason is that there are not many attractive candidates. Another reason is price. Multiples are very high, resulting in a lot of goodwill. Experience has shown that acquisitions are difficult to make work. Synergies are difficult to realise even in the back office, relationship managers can defect and take clients (and assets) with them, and different interpretations of compliance can lead to client losses.

What issues is compliance throwing up?

Large organizations have strict compliance requirements, and large compliance departments to enforce their rules. After an acquisition, the acquirer must ensure that its rules are applied across the new operations and this can result in a substantial loss of money and clients. The European Savings Directive imposes a new set of compliance burdens. Acquirers have to buy fully compliant firms. It's no good finding skeletons in the closet after the sale.

So the acquirers will be the large private banks?

Yes. The natural acquisition targets are the smaller and medium sized institutions. While scale is not generally a big issue in private banking, costs tend to be higher for institutions below e10 billion to e15 billion in AUM. But the issue is that there just isn't a great deal to buy. The for sale list is very short in each region. France is a difficult market to enter, the UK is fragmented but there is nothing obvious to buy, Italy is a possibility, and Spain is quite a small market. Germany is the big juicy plum that everyone will be fighting over. But that was true last year and will be true also in 2006.

So is western Europe where most deals will be?
The US is actually the largest private banking market. It's more profitable than Europe, accounting for around 60% of private-banking profits. So banks should be thinking about moving there too. The weak dollar means the opportunity is greater. In Asia, there is so much opportunity for organic growth. The region is growing at about 30% a year. Private banks need to be where new wealth is being created – not only Asia, also Russia, China and India.

Matthew Clark is an analyst at specialist US financial services investment bank Keefe, Bruyette and Woods. He covers German, Swiss and Austrian financials.

Matthew Clark,
Keefe, Bruyette and Woods *What is your view of likely M&A activity among private banks in 2005?*

Well, the most obvious trend is that small players are being squeezed. These smaller, non-quoted private banks are experiencing pressure on revenues. They can no longer rely on stock market growth to boost revenues as they did in the 1990s, and 2005 will be a particularly hard year for growing revenues because of the weak US dollar.

It's normal for European private banks to have one-third of assets invested in US securities, which feeds through to the asset base, off which services are priced. The weakening of the dollar against the Swiss franc and euro could make this a tough year. Add to this combined regulatory burden, and more demanding clients, and it is clear small players will be squeezed and large private banks will hoover them up.

But what value can such small firms add to large private banks?

The first point would be that buying small wealth management companies can involve less acquisition risk than buying medium-size companies. The biggest fear that client advisers and their clients have, in the event of acquisition, is change. If you are a small company with a couple of private-client advisers, it is easier to convince clients that things will not change. For larger firms, the advisers will be more removed from decision-making, hence less assured that ownership changes won't damage services or relationships.

The second point would be that it can be more value-creative to acquire smaller players. The larger quoted players are not obviously cheap. UBS, for example, has been acquiring its small wealth management operations for around 2% of assets under management, rather than the 3% of AUM that the medium-size companies like Julius Baer and Vontobel trade at. Furthermore, combined, acquisitions of small players over time can significantly build assets. In the case of UBS, it has bought seven small players over the past year with combined AUM of about SFr45 billion [$38 billion].

So will we see any medium-size private banking players up for grabs this year?
I think the market's obvious response to Julius Baer's recent move to have a one-share one-vote policy is that it is building a takeover premium into its stock. But it is hard to see who would be a sympathetic fit, and who would have the cash to be able to acquire Julius Baer. There may also be medium-size businesses for sale in the form of non-core private-banking business of large banks. In 2004, for example, Dresdner sold its Latin American private-banking business, Julius Baer sold its US private-banking business and Amex sold its Luxembourg wealth management operations.

Ray Soudah is founder of Millenium Associates, an independent Swiss-based M&A advisory firm that serves financial services companies worldwide. Millenium advised Barclays Bank on its recent deal with ING Feri France.

Ray Soudah,

Millenium Associates *What are private banks' strategic imperatives?*

The private banking market has now moved on from a strategy of disposal/ restructuring to one of search for growth. I would expect the trend for 2005 to reflect clearer signs of proactive M&A strategies. Banks have cleaned up their houses and now have the confidence to grow.

Where do you expect the most activity in M&A?

I would say Switzerland, although this will take place this year and over the next five years. Last year in Switzerland there were some 15 M&A transactions among Switzerland-based financial counterparties, and at least another 15 Switzerland-related international M&A transactions. In spite of that, there are still many deals that were in the pipeline last year but have yet to be announced this year, and therefore 2005 will be a similarly busy if not busier time.

There is overcapacity in the market of at least 100 banks, and I would expect a further 15 to 20 deals in Switzerland this year as the number of private banks reduces steadily. Indeed, over the next five years I predict between 15 and 20 deals in this area each year, taking out around 100 banks.

Look out too for the inevitable consolidation of independent asset management firms in Switzerland, where there are hundreds of small asset management firms facing regulatory and competitive pressures as well as succession issues.

What about the rest of the world?

For the rest of Europe I imagine there will only be selective deals due to the lack of supply. There is great demand in domestic onshore markets like the UK, but there are few targets. In the US, consolidation and proactive activity should be much faster due to the single-market nature and its relatively large size. I expect there will be some large mergers, and a lot of acquisitions of small players by national brands in a bid to expand regionally or gain access to a new market or product specialization.
What advice do you offer to private banks looking at buying or selling?

We recommend you be wary of who is advising you and why, and look for an adviser with worldwide international industry specialization and networks. Certain M&A advisers are offering their services for free with the view to their firm having first pop at future bond or rights issues, or IPOs, but people should be cautious not to be tempted by such tactics.

Proper, industry-specialized and independent advice is important and especially with a worldwide reach. This is less so in Europe than in the US, but the issue of conflicts of interest has still not been fully stamped out.

Ivan Pictet, managing partner of Pictet & Cie, is a member of the eighth generation of Pictets at the bank. In the 200 years that it has been in business, Pictet has never made an acquisition; nor does it intend to do so now.

Ivan Pictet, Pictet & Cie *Do you expect a lot of M&A activity among private banks in 2005?*

I don't think private banking is different to any other industry when it comes to M&A. M&A is just a fact of life these days as a result of globalization, and many businesses are withdrawing from some areas to focus on core competencies. Nevertheless, there is clearly some issue of profitability in private banking at the moment.

More than any other financial sector, private banking has seen changes in regulation, which have increased costs substantially and put pressure on some banks, driving consolidation. The larger private-banking institutions with international links have found it easier to cope with pressures than medium-size, more local banks.

I don't think there's any real mystery surrounding drivers of M&A. Those that sell businesses do so for internal reasons such as cashing in for purely opportunistic motives, or because they weren't really committed. There are also those who are taken over. This isn't unique to private banking. It happens in all businesses.

Why has Pictet never opted to make acquisitions?

We're one of the very few banking partnerships left in the world, so first we're not in the best position to make acquisitions as we have no shares to exchange – we would have to pay with after-tax money and cash. It's been a blessing really, and prevented us from making mistakes. Secondly, though, our philosophy is very much suited to organic growth.

You need continuity in private banking, which is much more achievable through organic growth. Acquisitions are never made in the interest of the bank's clients. Also it's not like acquiring within investment banking where hiring and firing is more the name of the game. We have been able to keep focused and keep our people. Acquisitions would not allow for that.

Being a partnership also means Pictet cannot be an acquisition target itself. Is this important?

Absolutely. As we own 100% of the bank, there is no likelihood of our being solicited. And also the bank is not reliant on just one person. It is often the case that banks have been the making of one strong personality. There have been banking groups like this in Switzerland, a few of which have disappeared as they were too centralized around that one individual. There are also cases of family-owned medium-size banks here in Switzerland that have been unable to find heirs to take on the business, and have therefore had to sell. I expect those sorts of cases to continue.

Other situations include the sale by universal banks of their private-banking operations. But this is less likely to happen here in Switzerland where private banking remains the core banking activity.