Opinion paper

MEGATREND FINANCIAL CENTRE

Five propositions for future success

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It's been several years since the financial crisis hit and the Swiss financial sector still faces major challenges. Although a number of steps have been taken to resolve historic problems, the general environment and benchmarks for success have shifted fundamentally, so not only have the goalposts been moved, the competition has also intensified. A radical rethink is therefore called for, combined with rigorous implementation, in order to ensure the continued success of the Swiss financial sector and market players. We put forward five propositions in an effort to provide a platform for further discussion.

1

Proposition 1:
Regulation as a key part of the strategy

2

Proposition 2:
Dominant design

3

Proposition 3:
Self-confidence and self-awareness – market players can learn a lot from the rebranding of the watchmaking industry.

4

Proposition 4:
Security and trust – invest in new media and other channels.

5

Proposition 5:
The future digital services field is between regulated licence holders and unregulated, agile fintech companies.

PROPOSITION

1

All financial sector players need to see regulation as a key part of their strategy

Facts

For a long time, compliance specialists or specialists performing other non-commercial internal functions have mainly been responsible for dealing with regulatory issues on behalf of financial intermediaries. However, the situation has changed in recent years, especially in regard to companies with international operations. Regulation has become a core component of strategy for which senior management is now responsible.

This has not happened by chance. In an increasingly interconnected world, non-compliance is no longer an option. As information exchange has steadily spiralled, creating higher levels of transparency, it has become easier to enforce new rules of conduct effectively both in response to regulators and clients. In general, this requires robust and holistic approaches to structuring, implementing and monitoring the relevant procedures and to documenting and reviewing these on a regular basis. This involves automating system processes and building interdisciplinary skills and capabilities. This is the only way to ensure that processes are permanently incorporated into overall structures, products and services. As a result of all this, the concept of trust between financial intermediaries and their clients will need to be redefined.

At the same time, financial services providers will need to take account of increased regulatory and tax convergence, which will make addressing the challenges posed by regulation a more complicated and resource intensive exercise. The different systems and requirements, with approaches varying widely from country to country, make the challenge facing financial intermediaries all the greater. Many financial intermediaries operate in more than one jurisdiction or provide services to clients based outside their home market. On top of this, the international regulatory agenda is steadily picking up pace.

In particular, the non-compliance of existing offshore clients is becoming more apparent and, as a consequence, there is now greater focus on law and regulation in client jurisdictions. Over a number of years, this radically changed environment has been gradually dismantling established business models, which are often based on specific national rules and regulations. Against this backdrop, financial services providers are inevitably becoming more aware of the strategic aspects of regulation, which requires a fusion of law and business.

Governments are being forced to confront the same issues as financial services companies, as competition between financial centres intensifies. The national regulatory and tax framework, for example, has a significant impact on the appeal and competitiveness of financial centres. Other factors influencing decisions on where to locate a business include geopolitical stability, the availability of an international talent pool, links to financial and trading centres, reputation and technical infrastructure.

OUR CONCLUSIONS

The specific attributes of the regulatory framework, combined with national regulatory practices, are increasingly important factors in the perception of financial centres. These can affect their prospects for competing and succeeding internationally. One of the deciding factors in seeking market access from another country is whether the standards in effect are equivalent to international standards, such as for example, the harmonised EU rules. For all financial intermediaries, expertise in dealing with regulatory rules is increasingly becoming a core discipline. Non-compliance is no longer an option these days. Clients have also changed in terms of the way they view liberal approaches to international standards or providers retreating behind special national rules. Clients are looking for certainty in legal and tax matters, and this is achieved through adherence to national and international compliance standards. In addition to this, there are now a number of routes for enforcing standards of conduct. Instead of supporting a status quo that is unsustainable, it is time to re-think, accept the new realities, and invest in resources based on holistic approaches and forward-looking strategies.

PROPOSITION

2

During any phase of transformation and upheaval, a dominant design will emerge which determines future success. This is currently shaping new requirements and standards for financial services providers to a large extent.

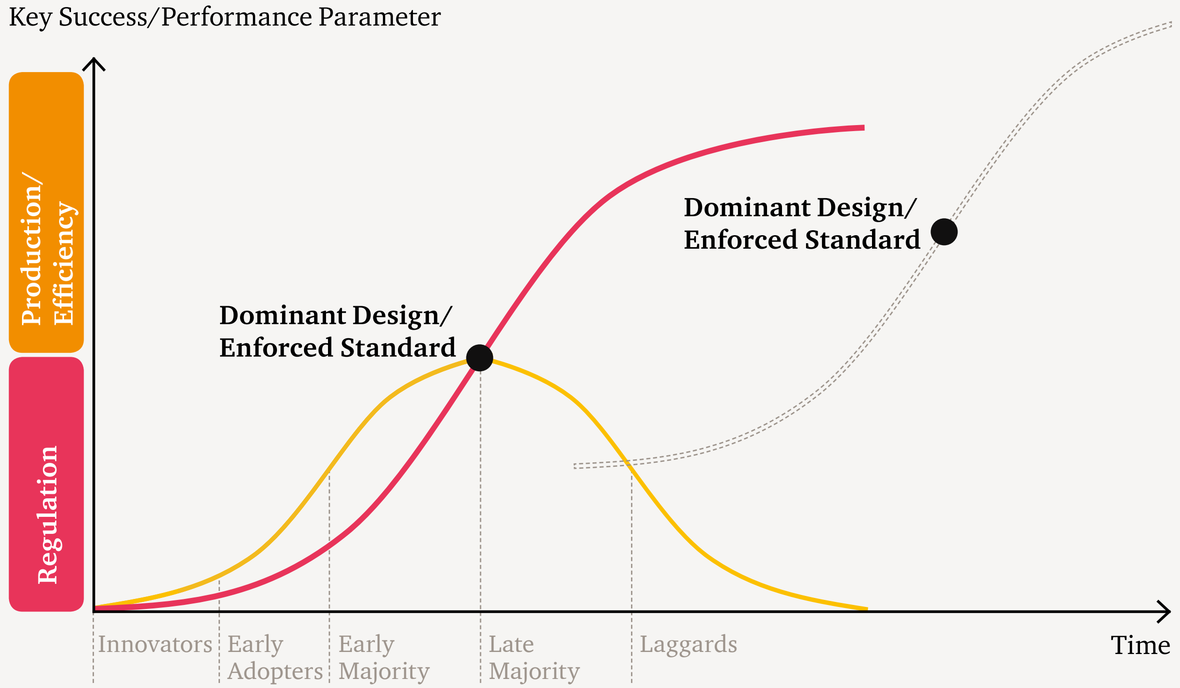
Facts

In traditional markets for technology-based products, it is crucial to identify and implement "disruptive innovations", or at least advantageous technological solutions, at an early stage. Eventually, a dominant design will emerge that can rapidly become the ultimate standard. When combined with efficient production factors, this forms the basis for building strong market positions, thus determining whether an entire business succeeds or fails (see figure).[1]

The key criteria for the new standard as well as target client groups will also change over time. Anyone who fails to respond will be out of step with the market and will not benefit from changes in it. A further complication for market players is that the market does not move in a unidirectional curve, but follows an S-curve pattern when viewed in aggregate. The biggest challenge facing all companies is therefore how to implement all the main components of the dominant design. Companies which ignore this run the risk of falling off the curve entirely, or getting left behind if they fail to switch their focus from product innovation

THE STANDARD AS DEFINED BY AN INNOVATIVE COMPANY …

Technology innovation-based dominant design



1 Cf. Utterback, J., *Mastering the Dynamics of Innovation,* 1994, p. 91, Moore, G., *Crossing the Chasm,* 1991, p. 12, and Dobrauz-Saldapenna, G., *Uptake Revisited. An Investigation into the Success & Failure Factors for Innovative Products in International Markets,* 2010, p. 12.

to product streamlining and other downstream factors at the right time. Branding and marketing are among the downstream factors that are becoming increasingly important.

That which applies to companies in general also applies to financial services providers, where similar dynamics are at play. Here, the dominant design takes the form of regulation and standards with a virtually equivalent effect (see figure).[2]

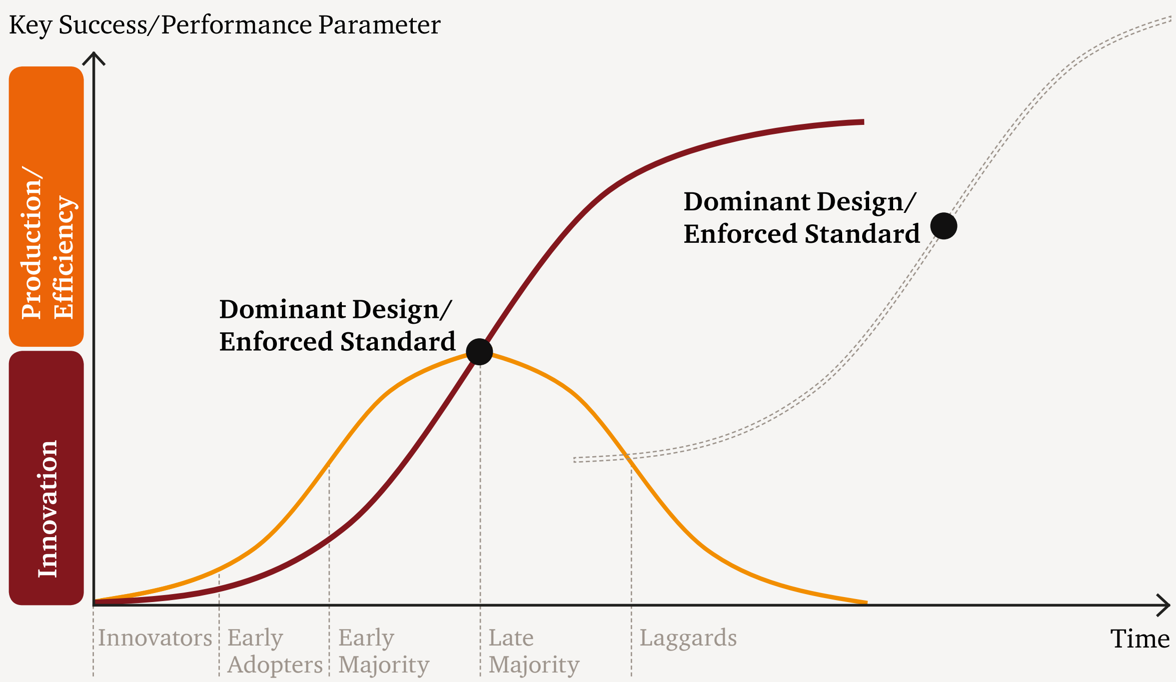
A striking example of this can be seen in the retail sector. The UCITS directives have laid down a consistent set of standards for the harmonised EU market. Although the substantive requirements laid down in the various UCITS directives have been incorporated into Swiss law, Switzerland has so far been unable to compete directly at the procedural level. As a result, Switzerland has been supplanted by other European countries as a location for retail funds. Even the Swiss home market for these products has dwindled, with EU products now making up more than 80 percent of the market.

Regulation is now creating the new dominant design for the future success of financial services providers. Regulation has become so firmly embedded it is now the "new normal". Instead of treating this as an inconvenient cost item under the heading of compliance and administrative expenses, finance companies and financial centres would be well advised to see regulation as integral to strategy and as holding the key to the future.

This is not a call for companies to implement foreign rules and regulations indiscriminately. Rather, it is a question of implementing rules to the extent necessary to secure market access. While they still have room for manoeuvre in relation to implementation, market players should adopt a pragmatic approach and make the most of this autonomy. Ideally, they should do this by offering clients optional modular systems. However, these should not be used to exploit regulatory differences between countries in a drive to the bottom. For market players whose business model does not require EU access, for example, it would make more sense to create and provide vehicles that do not incur unnecessary costs.

… OR ESTABLISHED BY THE GOVERNMENT.

Regulation-based imposed standard



2 Cf. Dobrauz-Saldapenna, G./Wirth, D., *Regulation Revisited. Switzerland's revised regulatory framework for financial intermediaries takes shape,* in: Global Banking & Financial Policy Review, 2014, p. 260 f.

OUR CONCLUSIONS

The recent regulation of financial markets should be seen as a unique opportunity rather than a constraint. In future, the market players who succeed will be those who align the dominant design, in the form of new rules and standards, with the new needs of clients at the right time. This will generate innovative, individualised client relationships characterised by transparency on both sides and a renewed awareness of price and quality in relation to advisory services and service standards generally. Given that, for the first time in history, the dominant design has not emerged by chance but is largely the result of legislative decisions, market players are in a position to identify this early on. Financial services providers therefore have the opportunity to focus on solutions that meet client needs going forward. Resistance to the new rules and standards is not just futile but a refusal to embrace the future.

PROPOSITION

3

Self-confidence and self-awareness are the best ways for Swiss financial services providers to ensure their future success. Market players can learn a lot from the rebranding of the watchmaking industry.

Facts

A new breed of global financial services provider will emerge over the next five years.[3] The Swiss financial sector is now facing similar challenges to the Swiss watchmaking industry in the 1970s and 1980s, when the goalposts shifted for the third-largest export sector, which had traded successfully over many decades. Previous business models and products failed, with competitors appearing on the market out of the blue.

Sector players did not discard their products as redundant, recognising that the symbolic and emotional aspects were far more significant. They had to revisit and reflect upon the aesthetics, their technical expertise and market profile and find a new approach.[4] This approach succeeded and the industry successfully moved ahead.

Swiss financial services providers could also stage a successful comeback along the same lines as the watchmakers. However, the sector will need to radically rethink its core strategy and value proposition. To achieve success on both counts, market players will need to optimise their resources and focus systematically on branding both in emerging markets and in their home markets, which are often overlooked. Essentially, these are the measures that Swiss watchmakers took to regain their foothold.

For a brand to leave a lasting, positive impression on consumers, it is vital that every effort be made from the outset to avoid any problems with clients and regulators. Market players can achieve this by ensuring that the highest standards of compliance are met and implemented throughout the organisation. Maximum transparency in regard to clients and regulators, continuous assessment by independent third parties and a continual drive to improve are also essential.

Switzerland's image in the world is essentially positive. Our country stands for stability, cosmopolitanism, reliability and quality. In a nutshell: Switzerland generates confidence. These are all crucial attributes for the financial sector. Yet foreign authorities, institutions and the press still have a critical or even negative view of the Swiss financial industry. To counteract this, strong location branding is required that places Switzerland's core values squarely at the heart of the financial sector. Back in the 1980s, when developing its national strategy, Switzerland still took its cue from Singapore.

The most significant growth driver for the global financial sector is the predicted rise in wealth in the SAAAME economies (South America, Africa, Asia and the Middle East). Although most analysts anticipate that wealth will mainly be concentrated in Europe and the US over the next few years, the SAAAME economies will be major contributors to the anticipated surge in assets. These pools of assets can potentially be tapped by the financial services industry.

3 Cf. *PwC Asset Management 2020.*

4 Cf. Credit Suisse.

CORE STRATEGY AND VALUE PROPOSITION

OUR CONCLUSIONS

We recommend that the Swiss financial sector and market players undertake intensive brand building based on clearly defined value propositions. We believe that branding in the financial sector will be crucial to helping financial services providers make inroads into major global markets and to funding expansion. By 2020, financial intermediaries operating internationally should therefore have a brand that is equally strong in terms of consumer recognition across all the major markets. Even specialist managers or niche providers specialising in alternative investments will need to address this challenge. This is the only way for them to stand out in a globalised, interconnected world with huge repositories of data and information, or establish strong partnerships on a level playing field. Very few Swiss financial institutions to date have successfully established their brand both in the developed markets and the SAAAME markets that are so critical to future growth. Others should go down this path.

PROPOSITION

4

Market players should invest systematically in new media and other channels. Security and trust will be gamechangers.

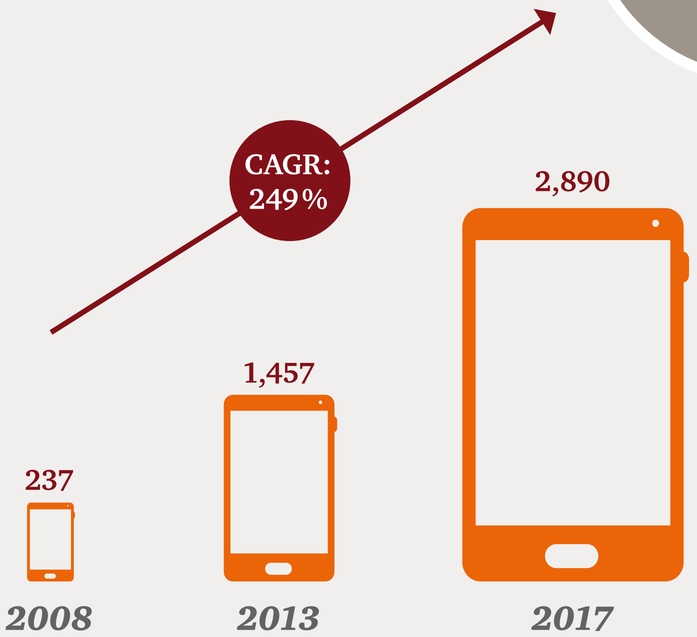
Facts

We believe that a new breed of global financial services provider will emerge by 2020, who will be reliant on a strong and trusted brand. In addition to this, they will use the most effective platforms to offer customised solutions to clients, deploy new technologies and social media channels, and capitalise on the ever-increasing volumes of data and information. Data security will be a key gamechanger that will impact the competitive environment, with data the valuable new currency in the digital economy. Who clients trust the most, especially in terms of technology, will be crucial to determining operational success. The technology will be increasingly harnessed by new providers competing for key parts of the value chain. Trust will be a key issue both at client level and for the financial sector as a whole. In the case of the financial sector, this will be measured mainly on the basis of legal certainty and predictability.

The possibilities opened up by digital technology will transform all aspects of contemporary life and have a profound and long-lasting impact on interactions between clients and banks. Digital transformation will affect all functions, products and channels for banks in particular, but also for the majority of financial services providers. This process of transformation will open up a number of new avenues, accelerated by the widespread availability of smart devices and the new opportunities these present (see figure on the next page). The interplay between increasingly sophisticated data analytics technology, useable big data and the development of digital ecosystems is clearly forcing the pace of these changes.

GLOBAL DISTRIBUTION OF SMARTPHONES

in million devices



By 2020, 80 % of the adult population will own a smartphone.

However, the most significant pressure is coming from clients. "Digital deniers" still make up the hardcore of clients receiving products and services in the financial sector. These clients tend to distrust the technology, or reject digital advances altogether. But by 2025, they will be outnumbered by digital natives or digital nomads who use and are comfortable with social media. This generation will have grown up consuming online and will be used to the immediacy and customer-centric nature of the experience. This new generation of clients already carries out virtually all financial transactions online, but this does not mean that their needs can simply be addressed by a wholesale online migration of products and services. These clients see banks primarily as a platform. It will still be essential to give them the choice of using online or offline methods, allowing them to decide when, where and how they use services.

For this category of clients, the definition of "trust" is entirely differently from that of digital deniers, who predominantly trust their own families. These clients rely on maximum privacy and non-transparency to guard against national upheavals such as war, sovereign default or government interventions into private property. By contrast, digital natives place greater emphasis on transparency, comparability and global availability. Market players who fail to respond to these general trends, which cannot ultimately be controlled, run the risk of pursuing the wrong branding strategy and ultimately losing out on future clients.

OUR CONCLUSIONS

Investment in technology and, in particular, improving the management of data is crucial to competing in the race to shape the future of wealth and asset management services. It is also essential to develop and exploit opportunities early on, including social media, with a view to enhancing services and providing a more integrated client experience. The most recent PwC Global CEO Survey already shows that the top three social media users in the asset management sector also rank among the top ten in Europe providing the largest net inflows into retail funds. It comes as no surprise that these winners are from the English-speaking world.

PROPOSITION

5

The real competition for future digital services is between regulated licence holders and unregulated, agile fintech companies.

Facts

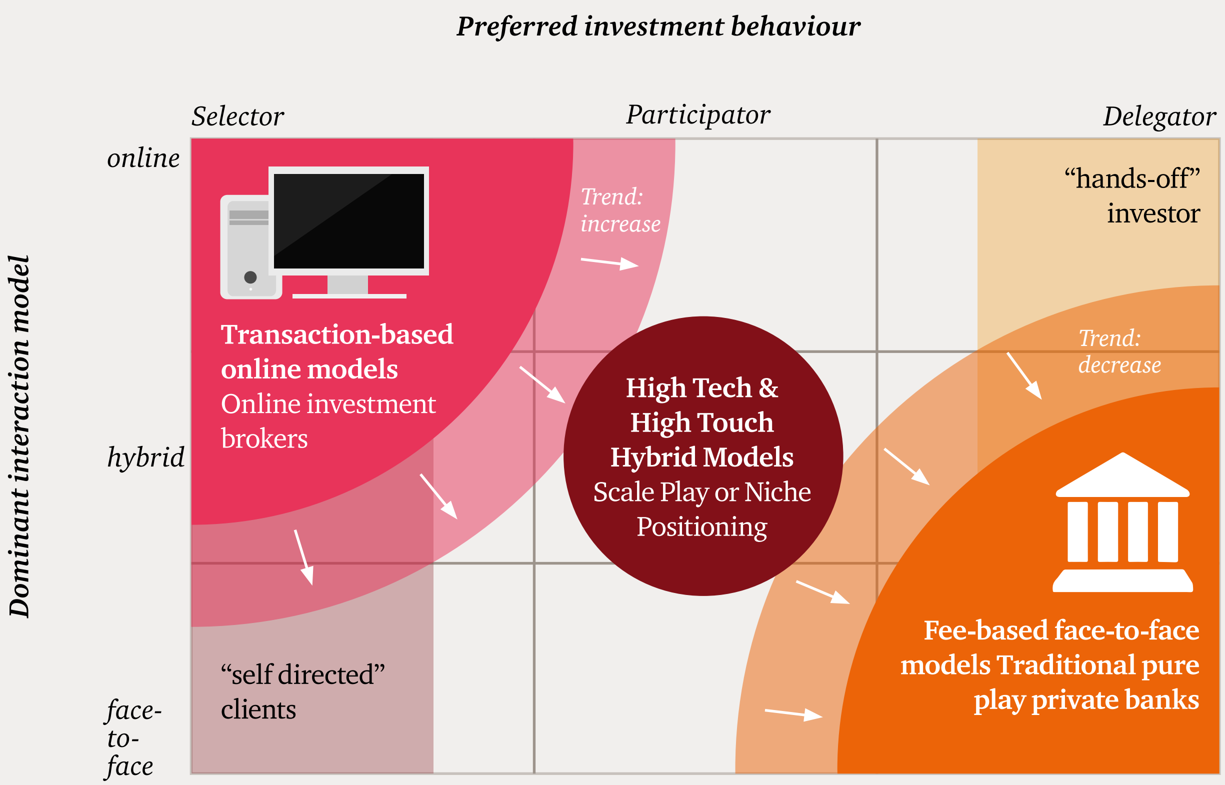
Regulated financial services companies looking to expand their services into the digital sphere are facing an ever growing burden of red tape. They are increasingly having to compete with unregulated, and therefore more agile, fintech companies for key segments of the value chain within the financial services market.

There is already evidence to suggest that in future many asset and wealth managers will not come from the ranks of traditional providers and product sectors, but from alternative sectors and currently lesser-known regions, including Asia, and on the back of the advances made by fintech and new media companies. The same applies to the credit markets, where non-banks are overturning accepted models by setting up innovative lending platforms. In future, the value chain will increasingly be occupied by independent non-banks as well as banks.

Against this backdrop, financial institutions urgently need to rethink approaches that until now were primarily designed to buy them time. Wealth management services are a concrete example of this where the following options need to be assessed on the strategic map:

The options range from the current face-to-face advisory model to fully digitised, and largely automated, online client relationships. However, it is important to bear in mind two basic trends: the steady increase in online advisory models combined with the steady decrease in fee-based face-to-face models.

In addition to adapting their processes and business models, current market players need to consider how they are going to respond to new digital competitors. There are a wide range of options, but the route that market players decide to go down will depend on their ultimate aims. If the aim is to defend their current position, it could make sense to enter into partnerships and cooperation arrangements. Players aiming to achieve steady, structured growth may need to buy in experience and market share, while companies aiming to achieve market dominance or become pioneering brands would be better advised to invest in home-grown solutions.



Source: Diemers, D./Baechi, P., PwC/Strategy&

OUR CONCLUSIONS

Traditional financial services companies and fintech/new media companies have extensive and essentially compatible expertise. The key question is the extent to which they will integrate and who will ultimately dominate in terms of combining the new opportunities with traditional financial services. Established market players have the advantage that there are significant barriers to entering the regulated financial market, with increasing rules and regulations raising the bar even higher. The crucial issue will be which banks or non-banks clients ultimately trust the most.

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