

NICHE MARKETING-MANAGEMENT STRATEGIES OF RUSSIAN BANKS IN THE PRIVATE BANKING SEGMENT

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Abstract

This paper aims to highlight the necessity for banks operating in the private banking segment to utilize niche marketing-management strategy and define sub-segments within the high net worth individuals' group, which will facilitate the expansion of the banks' business portfolios to reflect changing needs and values of consumers of these sub-segments. The article carries the analysis of results of the first in-depth comprehensive research of the Russian private banking market from the standpoint of behavior of consumers of private banking services and portfolio strategies of banks on the analyzed market. The study based both on desk and field research, is characterized by its focus on qualitative research methods: in-depth interviews with the private banking market participants and consumers of private banking services. Methodology of studying consumer values transformation and expansion of business portfolios for the defined niches will enable scholars to develop methodological aspect of niche strategies in high-income consumer segments and will allow market participants to gain competitive advantage. The paper provides recommendations on development of banks' business portfolios for the niche sub-segments and offers directions for future research of strategies to be employed by banks to evolve towards occupying global niches.

Keywords: consumer of services of private banking, wealth management, niche marketing-management strategy, business portfolio of banking and non-banking services.

JEL Codes: M30, M31

Introduction

Russian private banking market is one of the most understudied and untapped for researchers due to scarcity of disclosed data on the industry. Lack of integral system of studies and analysis of the market, unified standards and approaches to its segmentation lead to conditions in which market participants make decisions in highly indeterminate environment. The issue is becoming of considerable current interest due to tightening competition on the lucrative market for consumers of the segment as the most stable and resilient to crises even in challenging economic conditions (Report of Booz and Company, 2010), (World Wealth Report, 2015).

Issues pertinent to efforts to increase and retain existing customer base are attributed largely to the lack of systematic studies of consumer behavior in the private banking segment. Poor understanding of specific needs, preferences and system of values of high-income consumers by banks' marketing managers results in the lack of existing internal segmentation and differentiated niche marketing strategies, aimed to meet specific needs and preferences of consumers of private banking services.

Prior to this research Russian private banking market has not been comprehensively studied. Separate aspects of providing service to Russian high-income consumers were examined in the Fuchsbriefer research (Russian Money in Europe, 2010) and a study undertaken by Skolkovo Wealth Transformation Center (Study of Russia's Wealth Possessors, 2015).

Within the period of October 2015 to April 2016 Frank Research Group (Moscow) research company conducted the first in-depth comprehensive study of the Russian private banking market with the following research objectives: to study and analyze Russian market of private banking services, to define issues and trends of market development and develop recommendations on adequate marketing strategies for private banking market participants based on the results of the study.

For the purposes of the study researchers developed a special purpose methodology of collection, analysis and interpretation of primary and secondary data, provided by 19 largest banks on the Russian private banking market, which account for 70-75% of the total assets under management of high net worth individuals in the sector. Banks, providing a full range of banking services to high-income consumers on the territory of Russia served as the subject of the research. Methodology of applied marketing research, developed by Frank Research Group (Private Banking in Russia, 2016), comprised desk research methods supplemented by primary data collected through field survey and observation methods with elements of multistage sampling, which included:

- 25 in-depth expert interviews with directors of private banking divisions of participating banks;
- 26 in-depth interviews with consumers of private banking services;
- 38 in-depth interviews with relationship managers of private banking divisions of banks;
- covert recorded observation in the course of 21 visits to private banking outlets by a «mystery shopper» - an actual consumer of private banking services;
- survey of 118 actual consumers of private banking services.

The list of applied research methods demonstrates the prevalence of qualitative market research methods, which increases the credibility of attained research results.

1 Research results analysis: consumers of private banking services

Private banking market is viewed by its entities as a market of sale and purchase of a customized high-end banking product. On the Russian market it is largely implied that such product is comprised of a complex of services on management of consumers' personal financial assets through transactions aimed at preservation and expansion of their financial wealth, less so a complex of services on management of the entirety of consumers' assets (wealth management).

The key criterion used by banks to segment individuals as consumers of private banking services is the minimum asset threshold. As a rule, banks consider total assets allocated by an individual in a bank, including term deposits, investment and insurance products, to determine whether a consumer meets the minimum asset requirement.

According to results of the research, high-income consumers on the Russian banking market are tentatively divided into segments/sub-segments as part of a hierarchical pyramid (Private Banking in Russia, 2016). "Affluent" segment is placed at the bottom of the hierarchy and is constituted of several sub-segments, namely: "upper affluent" – a top sub-segment of affluent consumers who allocate from 8 to 15 million rubles in a bank (approximately \$100 000 to \$200 000* as of December 31, 2015), "mass affluent" – a middle sub-segment of affluent consumers who allocate from 3 to 8 million rubles (approximately \$40 000 to \$100 000 as of December 31, 2015) in a bank, and "lower affluent" – a low sub-segment of affluent consumers who allocate from 2.5 to 3 million rubles (approximately \$35 000 to \$40 000 as of December 31, 2015) in a bank. Banks commonly target "affluent" segment consumers with their premium banking programs.

"Private banking" segment is placed at the top of the hierarchy and is tentatively divided into two sub-segments: high net worth individuals (HNWI) – a sub-segment of consumers who allocate more than 30-40 million rubles in a bank (approximately from \$400 000 - \$550 000 as of December 31, 2015), and ultra-high net worth individuals – a sub-segment of consumers who allocate more than 100-150 million rubles in a bank (approximately from \$1,5 - \$2 million as of December 31, 2015). The majority of banks' marketing managers do not account for the ultra-high net worth consumer sub-segment, which results in a unified product and services offering for the entire private banking segment. As of 2015, only two banks on the Russian market, namely Sberbank and Citibank, formally divided the two sub-segments.

In-depth interviews with private banking market experts demonstrate that consumers of private banking services on the Russian market are understudied. The research provides a detailed profile of consumers of private banking services according to a number of characteristics (Private Banking in Russia, 2016).

1. Demographic and geographical characteristics: consumers of private banking services are predominantly male, Moscow residents, business owners, who are also bank's customers as legal

entities, married, have children (Fig. 1, 2). Age categories of 30 to 40, 40 to 50 and 50+ are practically equally represented.

2. Behavioral characteristics. Consumers of the private banking segment are interested in three areas of private banking service: product and service offering for consumer's legal entity, private wealth, and family finances. Russian consumers of the segment frequently have families living abroad, while their business operations are located in Russia. In such instances the Russian bank is used for basic transactions and transferring of funds to foreign bank accounts.

Fig. 1: Gender distribution of consumers of private banking services, %

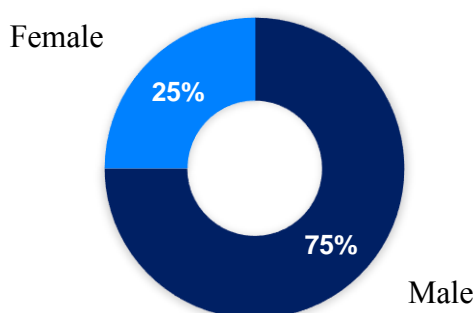
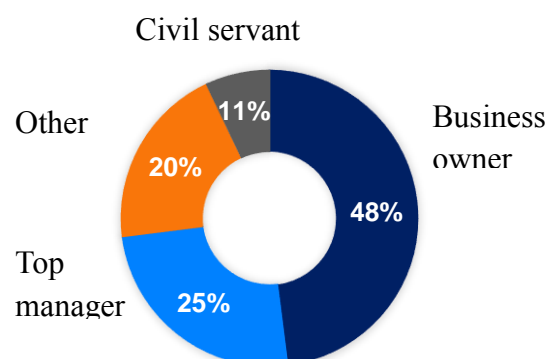


Fig. 2: Distribution of consumers of private banking services according to occupation, %



Source: Frank Research Group, survey results (based on completed 118 questionnaires), 2016

Consumers of private banking services pursue three main objectives in the process of using banking services, namely - execution of banking transactions, saving financial wealth and gaining access to investment expertise. According to the results of in-depth interviews with consumers of private banking services, the following factors largely influence consumer decision-making on selecting a bank for private banking service:

- Reputation of a bank: governmental support (mentioned by 39% of respondents), importance of a bank for the region of operations (13% of respondents), participation of foreign banks in a bank's capital (18%);
- Product offering (30% of respondents): high deposit interest rate (60%), beneficial card products (17%);
- Convenient location of a private banking branch office, within an easy reach from place of residence/work (21%);
- Beneficial terms for corporate banking services (21%);
- Personal contacts with the bank's management (17%);

Consumers of private banking services on average use services of 2-3 banks at a time. Only 13% of consumers allocate all financial assets in one bank. According to results of the in-depth interviews, 52% of consumers have foreign bank accounts for the purposes of country diversification and making transactions connected with a range of activities abroad, including education of children, real estate maintenance, management of businesses located abroad.

3. Psychographic characteristics: lifestyle, system of values of consumers, nature of wealth and type of wealth possessors, psychological characteristics, type of personality and others. Within the group of high net worth consumers the following three subgroups are determined according to the “nature of wealth and type of wealth possessors” characteristic: wealth creators, wealth possessors/preservers and wealth heritors. It is especially essential for the consumers, who are preserving or have inherited financial wealth, to save assets and manage issues of rights of inheritance, taxation, legal issues with other heritors and development of consolidated investment concept.

Among other psychographic characteristics consumers of private banking services are distinguished by active lifestyle and mobility: these consumers regularly travel for personal reasons (4-6 times a year), frequently travel on business, attend high-profile social events, are physically active and lead lifestyle that emphasizes their elite social status.

Market experts have noted the following recent changes in the profile and preferences of consumers of private banking services:

1. Generational change. Russian private banking market sees a tendency of gradual increase of the share of young consumers, i.e. consumers in the age groups of 30 to 40 and 40 to 50 in the structure of private banking customer base. This group of consumers comes from Russia’s regions outside the capital due to the expansion of the category of wealthy consumers among top management of the largest Russian and foreign companies, mostly in the FMCG sector, that had been actively penetrating Russian regional markets in 2006-2013. This category of consumers is characterized by a different mindset and attitude to finances: they build up capital in a bank, express interest in all banking services, and tend to be less conservative and more likely to take up risks (Henrique & Augusto, 2015). They actively use remote banking channels and investment products and services (Tam & Oliveira, 2016).

2. Increasing demand of consumers for professional relationship managers, quality service, transparent fees, timeliness of service delivery and a «one stop shop» approach to service arrangement (Paul & Mittal & Srivastav, 2016).

3. Shift of consumer demand from discretionary investment management model to advisory form of investment consulting.

4. Increasing importance and prevalence of banks' reliability over profitability indicator.

5. Increasing demand of consumers for consulting services on legal, tax, real estate, asset structuring, inheritance and investor immigration issues.

6. Separation of management of consumers' legal entities' financial assets from their family/private finances. Growing number of consumers begin to seek banking service not just as corporate customers but as individuals.

2 Analysis of banks' portfolio strategies targeting consumers of private banking services

Banking, investment and non-core consulting services constitute business portfolio structure of banks providing private banking services on the Russian market.

1. Banking products and services include traditional banking products and services provided on case-by-case terms, for instance, beneficial terms on term deposit interest rates and credit card products, expanded credit limit and others.

Business portfolios of banks, participating in the study, contained a large share of term deposit products. According to Frank Research Group estimates, term deposits of consumers of private banking services account for 30% of the total term deposits on the banking market as of December 31, 2015. Share of term deposits in banks participating in the study is slightly higher than the market average and equals 40%. Market experts forecast overall decrease in deposit interest rates in the future due to lack of opportunities for banks to profitably allocate attracted funds in conditions of low demand of entities for banks' credit resources and overall low borrowing capacity and creditability. The trend is expected to result in increased demand of consumers for investment products including Eurobonds and structured notes.

One of the highly demanded banking services provided to high-income consumers is currency conversion on preferential terms. Consumers pay close attention to currency conversion fees, charged by banks, transparency of fees in percentage points and possibilities to execute conversion remotely through a telephone banking channel.

2. Investment products for consumers of private banking services are comprised of a range of instruments, including mutual investment funds, structured products, unit-linked insurance plans, endowment life insurance, investments in alternative commodities (wine collections, art, jewelry), and others (Mckinsey Global Wealth Management Survey an attractive sector in transition, 2014). According to in-depth interviews with market experts, demand for investment products mainly shifts towards conservative instruments, providing guaranteed income. For instance, relationship managers have singled out Eurobonds of Russian companies, principal protected notes and notes with coupon

payouts, as well as Russian and foreign funds as top most popular investment tools among high net worth consumers. Equities are less popular with consumers of this segment. As results of the survey of relationship managers indicate, diversity of investment options is highly important for 70% of consumers of the segment; however, most banks offer practically identical investment products and services. 65% of consumers note importance of customized investment offer.

Banks, participating in the study, commonly offer three approaches to investments: discretionary investment management, advisory model and execution-only option. Experts note decreasing demand for discretionary management services as a long-term investment strategy and a shift towards advisory model and brokerage services.

Investment instruments offered by banks range from traditional instruments, including equities and bonds, to alternative investments, including commodity trading, hedge funds and derivative instruments. Such offering within the business portfolio is characteristic of banks with the high quality of investment services (32% of analyzed banks).

The majority of analyzed banks do not provide customized analytical investment reports to high net worth consumers, using available analytics from investment branches of affiliated banks and partner investment banks, which are not adapted to the needs and requests of this category of consumers. Just 20% of analyzed banks provide strategic capital markets yearly reports prepared in collaboration with colleagues from the banks' foreign units.

3. Apart from investment services banks' business portfolios for high net worth consumers usually also entail non-core services, which could be tentatively divided into non-core consulting services and other non-core services.

According to results of the in-depth interviews with consumers of private banking services, non-core consulting services are important for consumers, while in-depth interviews with the market experts indicated banks' active engagement in providing such services. Tax/legal consulting services are in demand by 75% of consumers, and 21% of analyzed banks are pro-active in providing such services; issues of inheritance are important for 58% of consumers, and no banks are pro-active in providing these services; real estate consulting services are important for 56% of consumers, and 26% of banks are pro-active in providing these services; mergers & acquisitions consulting services are demanded by 20% of consumers, and 79% of banks are able to provide these services.

Qualitative research also exposed importance of other non-core services for consumers and banks' engagement in offering these services. Endowment life insurance programs as well as unit-linked insurance plans are in demand by 47% of consumers, and 52% of banks are pro-active in offering these products; medical insurance programs are in demand by 43% of consumers, and 47% of banks are pro-active in offering these products; lifestyle services are important for 53% of

consumers, however, only a few banks offer comprehensive full-fledged lifestyle services while the majority of banks narrow lifestyle offering down to concierge services.

Overall analysis of data demonstrates broad potential for banks' marketing managers to expand business portfolio by altering its structure in accordance with consumers' needs and preferences.

3 Niche marketing strategies for target consumers of private banking services

Analysis of results of marketing research of behavior of consumers of private banking services and business portfolio of private banking market participants in Russia exposed specific unsatisfied needs and values of consumers. Tightening competition on the market will inevitably result in recognition by banks' marketing managers of the necessity to study consumer behavior and develop strategies to enhance competitiveness on the market. One of such strategies is niche strategy aimed to increase market participants' competitiveness (Ruefenacht & Schlager & Maas P & Puustinen, 2015). It is focused on acquisition and retention of consumers in relatively small market niches, in the framework of which exclusive services of high quality, which are often new and unique for the market, are offered.

Due to a generational shift and increasing share of young consumers in the general structure of the private banking segment, demand of consumers of private banking services for investment products and services is growing. Within the segment of consumers of private banking services marketing managers can define a niche of consumers, whose needs in diverse investment offering are unsatisfied. Diversity of investment products and services, for instance, structured products, can be attained through offering of structured bonds, barrier notes with conditional capital protection for high-risk consumers, tailor-made structured products offered within the framework of investment strategies employed within discretionary management, stipulated in the agreement with the managing company.

Stimulation of demand for a range of investment instruments can be attained through banks' adequate information and promotion policy, including provision of consumers with targeted analytical reports and strategic reviews of capital markets.

Marketing managers can also define a niche among those high-income consumers, whose specific needs in wealth management are unsatisfied, especially among consumers preserving/inheriting assets (Wahlberg & Öhman & Strandberg, 2016). In Russian practice «private banking» and «wealth management» terms are considered equal when it comes to providing service to high-income consumers. However, wealth management services traditionally exceed the scope of

banking services (or may not include banking services at all) and incorporate management and optimization of multimillion family assets, often allocated around the world in a variety of structures (Personal Banking Service, 2015). Wealth management starts, first and foremost, with the inheritance consulting services, demand for which doubles on an annual basis in Russia.

Banks' lack of engagement in offering these services is attributed to a number of objectively reasonable circumstances of political, legal, economic and psychological nature. One of the reasons is a non-transparent procedure of forming a trust fund in the Russian legislation. Another peculiarity is existence of complex non-transparent structures of ownership of foreign assets by Russian consumers of private banking services. Such structures aimed to distance the owner from his possessions in the legal framework in the past, which complicates the inheritance processes in the present. In the course of the in-depth interviews with researchers, consumers expressed interest in a comprehensive approach of banks to resolution of inheritance issues.

In order to address needs, benefits and values of defined niches in the private banking segment we propose basic recommendations on optimization of banks' business portfolio regarding development of the following non-core services (apart from the services suggested above):

1. Tax and legal consulting services (specifically, consulting on legalization and de-offshorization of capital) as the most demanded non-core services due to tightening of Russian legislation on oversight over the flow of capital on offshore bank accounts of Russian residents and capital amnesty regulations.

2. Real estate consulting services as consumers of the defined niche express the need to acquire a broader view of real estate as an investment tool. A special division advising on investments in real estate on a global scale may engage in selecting and structuring real estate portfolios, financial analysis and profitability calculations, as well as offering services on managing certain real estate properties. Other promising areas in real estate consulting include high-level consulting on structuring real estate deals and tax optimization, investment in commercial real estate, foreign real estate inheritance, including issues of sale and inheritance of undeclared property.

3. M&A consulting services that can be of potential interest to consumers, who are owners of large businesses or actively invest in the real sector of the economy.

4. Insurance programs, specifically unit-linked insurance plans as an important part of investment offering.

5. Lifestyle services, that should encompass a broader range of consulting than just a concierge-type service, and include consulting on a more complex set of issues, such as consulting on educational programs for family members or alternative investments. In-house expertise is essential to providing this type of services.

Banks' marketing managers' pro-active position in developing relationships with the niche consumers will ensure a gradual change in consumers' conservative profile. As most of the Russian high net worth consumers start their relationship with a bank with allocating funds on term deposits, their interest in investment and non-banking services is to be shaped directly by the bank.

Conclusion

The fundamental mission of providing service to high net worth consumers is accumulation of capital funds and extension of their lifecycle. However, according to research, an average term that a high-income consumer uses private banking services of a bank for is two to seven years. By defining niches within the private banking segment and developing adequate offering of banking, investment and non-core services, satisfying needs, preferences and values of niche consumers, banks' marketing managers will ensure financial stability of consumers and their family from generation to generation. Utilization of customer retention strategies, aimed at consolidation of consumer assets in one bank, increases the bank's competitiveness on the market.

Track record of banks' marketing activity in execution of niche strategies to achieve a better quality of private banking services provided to consumers to satisfy their needs, expectations and values, will allow market participants to make strategic decisions to develop private banking market and evolve from the marketing policy of outreach to local niches towards tapping into the global niches. Future studies of the niche marketing activity of banks will require specification of methodological aspects of the outreach to global niches taking into account cross-cultural variations in consumer behavior.

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