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Towards a Framework for Private Banking Services: Evidence from Chinese Bankers

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ABSTRACT

In the banking research literature, the nature and operations of commercial banks and investment banks are well covered. The understanding of private banks (i.e., banks that serve private clients rather than privately held banks) is limited. This is partly due to the "private" or secretive nature of private banks and their customers. To gain an initial understanding of the nature of private banking, this paper tracks the history of the private banking business from when it was first established in Europe. Private banks began serving traditional clients with endowment income from prior generations (hence, the concept of "old-money") expanding to serve first generation rich in the form of entrepreneurs of the "new economy" and from Asia (known as "new-money.") Based on prior literature on private banking clients' behavioral characteristics, as well as research and documented practices from the industry, this paper develops a framework to obtain behavioral characteristic data on private banking clients from bankers serving such high net worth (HNW) clients. The unique data set yields useful insights into the behavioral preferences of private banking clients and allows the examination of whether the four categories of clients identified in documented practices: the *Endowed*, the *Entertainers*, the *Executives* and the *Entrepreneurs*, do indeed display the behavior characteristics observed in prior literature. Results comparing behavioral preferences indicate a general agreement to observations from prior literature. Furthermore, a regression model that measures relationships between private client types and their behavioral characteristics yielded significant results. As such, this paper not only provides as a practical framework of client classification for banks to effectively serve private banking clients, but also a theoretical model for future research studies.

Key Words: Private Banking, Theory of Banking. JEL: G21, G29

1. Introduction

The creation of Glass-Steagall Act written a century ago has created a structure of two types of banking business, commercial (or retail) banking and investment banking (Koch et. el, 2014.) As such, the nature and operation of retail and commercial banks (retail banking, hereafter) for the general public have been well studied in monetary economics (Mishkin, 2012) as well as in the banking operations literature (Berger, 1995, Berger, et. al., 1997; Altunbas, et.. al., 2001; Howe et. al., 2012). In addition, investment and investment banks (investment banking, hereafter) have been well covered in research in the investment and corporate finance literature (Smith, 1986.)

The understanding of private banks outside and within the industry and in academe, however, is rather limited. Indeed, frequently, private banks are understood to be banks that are non-public sector banks (Reddy, 2011,) rather than banks that offer services only to selected high net worth (HNW) clients. The nature of this branch of banking should be of interest. With the already significant services offered to HNW clients in the traditional European market (Maude, et. el., 1996, Molyneux and Omarini, 2005, Maude, 2006, Rudolf, 2008, Rudolf and Baedorf, 2011,) an increasing level of private banking activities in the market place in the US has led the Federal Reserve to issue a Supervisory Letter (SR97-19) on the definition and nature of private banking (Atz, 1999.) This trend has also spread to Asia as documented in Chen (2008,) Gopalakrishnan (2010,) and Long and Tan (2010.)

The lack of research in this rather important segment of banking is, in part, due to the "private" and sometimes secretive nature of its operation, as the services are provided only to selected clients and not the masses. Another factor that may contribute to the lack of research in this area is due to the products and services offered by private banks not falling neatly into traditional categories of banking products and services, i.e., retail banking and investment banking). For example, wealth management for private banking clients with high net-worth typically is of a multigenerational orientation and is neither of a retail banking nature, i.e., helping clients with liquidity oriented transactions; nor an investment banking nature, i.e., helping corporates with funding oriented transactions.

To understand private banking, the Federal Reserve Supervisory Letter (SR97-19) suggests that, "private banking includes, among other things, personalized services such as money management, financial advice and investment services for high-net-worth clients."

Who are these high-net-worth (HNW) clients and what is the significance of their presence? While HNW is not specified in SR97-19, it generally refers to multi-millionaires. According to a 2013 report by the Spectrem Group, the number of millionaires in the US has surpassed the pre-recession high of 9.2 million in 2007 to reach 9.6 million. In fact, this represents a 7.5% growth (CAGR) over a 5-year period since 2008. Moreover, the ultra-wealthy with a net worth of $5 million and above is standing at 1.24 million households, up from 840,000 in 2008, and $25 million or more climbed to 132,000, up from 84,000 in 2008. The banking services needs of these high net worth (HNW) individuals are clearly different from those traditional products and services provided by the commercial banks and investment banks. Hence, private banks represent not only a significant, but a growing segment of financial institutions that is little known and understood.

To fill the knowledge gap in this significant segment, this paper studies the existing academic literature and documents in practice to arrive at a new framework that effectively categorizes private banking clients groups. Based on a synthesis of the above, this paper arrives at four categories of HNW clients; *Endowed*, *Executives*, *Entertainers*, and *Entrepreneurs*. We shall identify this as the 4Es HNW client classification framework, much like the 4Ps model proposed in marketing by Kotler (Kotler and Keller, 2012.)

This paper then examines how the four groups of HNW clients behave along nine behavioral dimensions, e.g., attitudes towards risk and return and others, derived from prior literature (Maude, 2006, Dufey, 2009 and Lye, 2010.) A model built by overlaying the 4Es and the nine behavioral characteristics shall serve as the focus of this paper.

Section 2 of this paper reviews the evolution of the practice of private banking, from the traditional European model to the contemporary practice that also caters to the new wealth from the new economy as well as Asia. This should serve as a foundation to the understanding of the nature of private banking. Section 3 reviews and synthesizes the limited relevant literature in private banking resulting in a collection of nine behavioral characteristics of private banking clients that forms the key variables in this paper. Section 4 examines how private banking clients are segmented in practice. Section 5 synthesizes the different practical approaches to arrive at a model to describe 4 distinct groups of clients; we identify this as the 4Es model. Section 6 provides a detailed descriptive profile of each type of the clients based on the 4Es framework from section 5 and overlays the 4Es framework to the behavioral characteristics identified from the literature and arrives at our model for analysis. Section 7 describes the data collection process and the sample, while section 8 performs statistical analyses on the data. Section 9 summarizes the findings and provides the conclusion.

2. The Evolution of Private Banking

The practice of private banking dates back at least as far as the seventeenth century with some British private banks (Maude et. el., 1996) in Europe. Traditionally, private banks are not incorporated companies, but are partnership-based organizations to provide financial and related services to high net worth individuals (HNWIs.) These services include retail banking products as well as a wide range of up-market investment and finance related services, such as intergenerational wealth management (Maude et. el., 1996).

With "a long history of authoritarian regimes, political persecutions and concomitant weak property rights, as well as confiscatory tax regimes, wealthy individuals… keep a portion of their savings in a few neighboring jurisdictions that offer a high degree of confidentiality and freedom…." (Dufey, 2009, p. 3.) Due to the desire for privacy and confidentiality by these individuals, most of the business is conducted on a private and personal basis. While private banking in Europe has primarily been driven by wealth preservation, private banking in the New World has been primarily been driven by economic growth, from industrial revolution in the early 1900s to technology revolution in recent decades.

Asia has also experienced tremendous growth in recent years as a result of liberalization, Dufey (2009) suggested "… when the colonial period had ended, local wars began to subside, and countries started to migrate from a restrictive and highly political socialist model of development to an economically-driven growth-path based on private ownership and free enterprise."

Based on the above, it is clear that private banking clients are unlike the typical risk-return driven investor portrayed in classic investment literature. They display behavioral characteristics that warrant further examination. This is consistent with the general literature in the area of behavioral finance (Kahneman and Riepe, 1998, Shefrin 2000, Montier, 2002, Tvede, 2002, Pompian and Longo, 2004, Pompian 2006, and Hens and Backmann, 2008.) For instance, while the majority of wealth is driven by inheritance in Europe, those in the US and Asia has primarily been driven by economic growth, hence, the practice of private banking in Europe, evolving over 5 centuries or so ago can be quite different from those in the US and Asian countries. In fact, private banking clients in Europe, typically known as "old-money" are generally considered to be passive and conservative in nature, while first-generation-rich private banking clients in the US and Asia, typically known as "new-money" are generally considered to be active and aggressive in nature. As such, client expectations with regard to products and services can be quite different.

3. Behavioral Characteristics of Private Banking Clients

Beyond the general bi-polar "old-money" versus "new-money," there exist limited attempts to understand private banking clients. Maude (2006) attempted to add to the understanding by hypothesizing that traditional European private banking clients tend to have characteristics beyond that of inherited income that include:

1. Preference towards confidentiality
2. Tendency to use discretionary asset management approach that rely on the banker, as oppose to active participation
3. Displays a higher degree of risk aversion

4. A focus on wealth preservation

Furthermore, Dufey (2009) observed that the HNW individuals in the East, i.e. "New-money:"

1. Are primarily still in the Wealth-building phase, and
2. Are not shy from exotic instruments such as hedge funds, private equity and commodities
3. Tend to be more home country driven (what they know) with their investment
4. Tend to look for the private banker to provide them access to credit to support growth of business operations philanthropy

Lye (2011) also observed the followings regarding Asian HNWIs.

1. They are more aggressive with the desire for wealth building
2. They also request to see their bankers more to seek information updates from them
3. They tend to retain more control and display an aversion to mandates
4. They have strong interests in loan products

He added two observations between Asian and Western HNWIs. These include,

1. Asia HNWIs' approach towards philanthropy tend to be more geared towards building intergenerational legacy rather than social legacy, and
2. Most HNWIs in the East are not used to the idea of paying fees for wealth management services.

The current study builds upon these prior observations and arrived at nine behavioral characteristics for examination.

Behavior Set 1

First, Maude (2006) indicated that traditional private banking clients prefer a private confidential relationship with the private bankers. In the meantime, Lye (2011) observed that Asian clients tend to use the banker as a platform to information. An effective information platform will mean the need to a broadened network, which, in turn, will mean the need to sacrifice confidentiality and privacy, to some extent. There is, therefore, an interest to find out how this confidentiality-information seeking dichotomy is balanced by the HNWIs. This paper shall label this as the network relationship which looks at HNWIs' preference towards privacy and confidentiality versus information seeking (behavioral characteristic set 1).

Behavior Set 2

A second behavioral characteristic again looks at the relationship between HNWIs and the outside world. In this case, however, the focus is on HNW client's interest in using private banks philanthropy in the context of legacy building; more specifically, the HNWI's preference between the building of inter-generational versus social legacy. As can be seen above, one of the new observations by Lye (2011) is that HNWIs in the east tend to have a preference for building an intergenerational legacy, i.e., a legacy among his/her "clan," rather than a social legacy, i.e., a legacy beyond the "clan" and among the society at large, e.g., the Bill and Malinda Gates Foundation (behavioral characteristic set 2).

Behavior Set 3

In addition to analyzing the relationship between HNWIs and their outside world, another key set of relationships to examine would be those between the HNWI and the bank. One aspect of the bank-client relationships would be on the degree of involvement (or participation) by clients in the investment decisions. In a discretionary relationship, the HNW client will leave investment decisions largely to the bank and the banker and have little active involvement. In this case, decisions are mainly guided by "investment mandates." On the other hand, as observed by Lye (2011) Asian clients, and the "new-money," tend to retain more control and be actively involved in investment decisions. The degree of involvement in the relationship, or more commonly known as investment (participation) style, will be examined as behavioral characteristic set 3.

Behavior Set 4

In addition to degree of involvement, it is important to look into the bank-client relationships with regard to how clients think banks should be compensated. In general, bankers are compensated either by an annual fee, typically in the form of a percentage of

Asset Under Management (AUM,) or commission, based on transactions. Behavioral characteristic set 4 should look into client's preference regarding fee structures.

Behavior Set 5

A key to traditional finance literature is to study how investors manage their wealth in the context of risk-return balance. According to Maude (2006,) traditional European private banking clients tend to manage their wealth from a wealth preservation perspective, whereas both Dufey (2009) and Lye (2011) observed that Asian private banking clients tend to manage their wealth from a wealth building outlook. We shall look into this preservation-building dichotomy in behavioral characteristic set 5.

Behavior Set 6

A nature extension of the wealth preservation versus wealth building bias would be HNWIs' attitude towards risks. While Maude (2006) indicated that European clients tend to be risk averse, Dufey (2009) detected a willingness to take risk by Asian private banking clients. This is consistent with Lye (2011)'s observation of increased aggression by Asian clients. Behavioral characteristic set 6 shall look into the degree of risk aversion of different HNW clients.

Behavior Set 7

Behavioral characteristic set 7, 8 and 9 looks at the tools used by the HNWIs in their management of wealth. Dufey (2009) observed that Asian clients are not shy from novel financial instruments, such as hedge funds, private equity and commodities. The attitude of HNWIs towards novel investment products is examined in behavioral characteristic set 7.

Behavior Set 8

Dufey (2009) also suggested that HNWIs in Asia tend to be more home country driven, i.e., more on-shore rather than offshore focused. We shall look into this in behavioral characteristic set 8.

Behavior Set 9

Finally, both Dufey (2009) and Lye (2011) observed that Asian client frequently look for the private bank to provide them access to credit to support growth of business operations, rather than simply asset management. This difference in balance sheet focus (asset v. credit) shall be examined in behavioral characteristic set 9.

Table 1 summarizes the behavioral characteristics for this study.

4. Practical Insights into Types of HNWIs

While the academic efforts above focused on two primary groups of private banking clients, the "traditional" European "old-money" clients versus the "first-generation" New World and Asian "new-money" clients, a number of key efforts have attempted to further segment the HNWIs by the practitioners. With the many approaches to effectively segment the market, this paper should focus on three key ones; one by a leading Asian bank, Nomura; another by a leading European bank, Coutts; and one by a leading consulting firm, the Boston Consulting Group (BCG.)

Nomura (2006) classified its HNW client base in Japan into three groups:

1. Born rich (inheritance)
2. Hardworkers (wealth accumulated from career)
3. Overnight wealth (exit from retirement or IPO)

Coutts, a leading private bank from the UK, who's claim to fame include serving the Royal family for over 300 years, segmented its clients into seven categories (www.coutts.com/privatebanking/ourclients):

1. Entrepreneurs
2. Executives
3. Land owners

4. Sports and Entertainment
5. International
6. Professionals
7. Private Office

In the meantime, the Boston Consulting Group in its 2002 report, classified over 1,900 private banking clients in China into the following six categories:

1. Entrepreneurs
2. Professional managers,
3. Housewives and
4. Other professionals and
5. Investment professionals
6. Others.

As can be seen, the various attempts to classify private banking clients have not reached any agreement towards a unified classification framework. However, based on the above-proposed frameworks, this paper proposes modified interpretations of the different classifications. Our goal is to come up with a unified framework for understanding and future research. While the approaches to a unified classification can be many, this paper proposes a classification approach that focuses on the start, i.e., the source of wealth approach to the classification of the HNWIs.

5. A Unified Classification System of HNWIs – the Source of Wealth Approach

With the source of wealth approach, the classification suggested by Nomura (2006) based on its Japanese practice can now be looked upon as follows. The "*born-rich*" group achieve their wealth from inheritance. This can be more specifically labelled as "*Endowed*."

In the meantime, the "*hard-workers*" group, as defined by Nomura, typicall achieves their wealth from progressing through their career towards an executive level. As such, this group can be more suitably labelled as "*Executives*." This label is used by Coutts based in the UK.

Finally, the "*overnight wealth*" in Nomura became private banking clients through either exit from retirement or IPO. The segment of this "*overnight wealth*" group that achieve wealth as a result of retirement are very likely high level employees that have been with an organization for an extended period, hence they are likely to be "*Executives*," who exit an established system. Another segment from the "*overnight wealth*" group would likely be entrepreneurs who exit by selling the entity s/he established through IPO (partial sales to the public,) or M&A (complete sales, most likely private.) In this case, "*Entrepreneurs*," a label being used by Coutts in its classification system, is a reasonable label for this "*overnight wealth*" group in Nomura. As such, two of the Normura classifications can now be integrated into the Coutts classification system.

Applying the source of wealth approach to the Coutts categories, we can yield the following categories. First, "*Entrepreneurs*" and "*Executives*" are already established categories in the above. "*Landowners*" in the Coutts classification can arguably be classified as *Endowed* if the land is inherited from prior generations, or *Entrepreneurs* if the land is acquired through recent purchases. "*Sports and Entertainment*" can be classified as *Entertainers* in general, as sport celebrities are very much in the entertainers circle themselves. "*Internationals*" are most likely "*Executives*" who are senior employees on oversees assignment by their multinational headquarters. "*Professionals*" have their sources of funds either from employment or own venture. The former can be classified as "*Executives*," if they work within a system, e.g., a medical doctor who works in a hospital, while the latter who runs their own venture, e.g., a medical doctor who runs a clinic, can be classified as *entrepreneurs*. Finally, "*Private Office*" is a family-oriented, most likely multi-generational, client, whose source of wealth is likely from endowment and, hence, can be classified as *Endowed*. The Coutts classification is now consolidated into four categories, three of which are common to the Normura categories.

Finally, in the BCG classification, they have "*entrepreneurs*," which is included in the classification category in the prior section. Their "*professional managers*" are clearly *Executives*. "*Other professionals*" in the BCG, such as medical doctors and lawyers, as argued before, depending on the nature of their source of wealth, are either *Executives* (if they are employed by an organization,) or *Entrepreneurs* (if they are self-employed.) Investment professionals in the BCG can belong to the *Entrepreneurs* category. Finally, "*Housewives*," as the BCG label suggested, probably derived their source of wealth from the husband should be in the *Endowed* category.

The Normura, Coutts and BCG categories are now integrated into four unified categories of HNWIs; *Endowed*, *Entertainers*, *Executives*, and *Entrepreneurs*. These four appear to sufficiently satisfy the MECE (mutual exclusive collectively exhaustive,) nature of classification. What's more important is that this four-category classification system allows more in-depth understanding of the HNW clients of private banks rather than just the "old-money" versus "new-money" dichotomy. In fact, other than the "*Endowed*," the other three categories are all first generation wealth. Hence, this four-category classification system basically added to our understanding of the "new-money" client. As each of the four labels under the new classification starts with an E, this paper shall refer to this classification framework of HNWIs as the 4Es classification system. The re-classification is displayed in Table 2.

6. Decoding the 4E HNWIs Classification System

With the new labeling system where classification is driven by the source of wealth; we have, potentially, a powerful tool to analyze the behavior of different groups of HNWIs. This section looks into some behavioral characteristics of the four groups of HNWIs.

Endowed refers to HNWIs whose wealth are inherited, e.g., traditional European clients. Traditionally, these represent inheritance from multi-generations (i.e., more than 2,) e.g., the Ford family whose wealth is derived from Ford Motor Company established in early 1900s. It is estimated that the minority stake owned by the family is at 2% of the company, which has a market cap of 60 Billion USD, or 1.2 Billion USD. As these are derived from multi-generations, the future outlook for the source in this category is expected to be stable and long term in nature.

Executives are professionals, whether they represent professional managers who work in corporations or professionals by trade e.g., medical doctors and lawyers. These professionals are grouped together as they typically reach their position, and achieve their wealth, through hard work and smarts, i.e., taking traditional examines, during their climb in their career. Typically, they come from middle class background, which have sufficient resources to support their striving to become professionals. The source of wealth in this group is expected to be stable and can possible be extended into the next generation, e.g., a second generation medical doctor, or lawyer. However, the wealth is not expected to last to multi-generational.

Entertainers, whether sports related or others, obtain their wealth through their talent. The *entertainers*, like the *executives* and professionals, attain their achievement through hard work and dedication. However, unlike the *executives*, they tend not to do well within the traditional structure of schools and organizational structures. Frequently, the *entertainers* come from families that are less well off. From a career perspective, the *entertainers* tend to have a short career, in comparison to the *executives* and professionals, as well as less predictable income streams.

Entrepreneurs are self-starters. They are typically from a poorer background as compared to others in the middle class. They work hard, but, frequently, unlike the *executives*, are rule breakers who do not build their career within the traditional system of schools and examinations, and eventually, the corporate structure. The *entrepreneurs*, typically, have a high appetite for risk that has led them to take chances and achieve their wealth. As such, they are more prone to taking additional risk to continue building their wealth.

Given the source of wealth framework leading to the 4Es framework and the characteristics observed by Maude (2006,) Dufey (2009) and Lye (2011) and the resulting nine behavioral hypotheses, this paper is now is in the position to not only examining the validity of the observations made by the earlier authors regarding the “old-money” (general the *Endowed*) and the "new-money" (generally *Entrepreneurs*) HNWIs, but also a richer framework with two additional categories, the *Executives* and the *Entertainers*.

Given the four categories of private banking clients and nine behavioral characteristics, we can now overlay the two and form a framework that can facilitate an in-depth study of the nature of private banking. Furthermore, based on the observations by prior literature, we can form hypothesis on each behavioral preference for the *Endowed* as well as the *Entrepreneurs*.

7. Data Collection

While the conceptual framework developed in the above section has its appeal, a key to its external validity would be to test the model empirically. Obtaining of data for this type of study forms a significant challenge, as HNW clients with their preference for privacy and secrecy may not want their identity to be revealed. Furthermore, clients frequently rely on bankers to advise them and may not have the level of personal insights to able to clearly describe themselves and their behavior. As such, the ability to survey the HNWIs on their behavioral preferences is difficult.

However, the private banking relationship have two parties, the client and the banker, and that an enhanced understanding of the characteristics of their clients is of interest to the bankers, an appropriate source of information to the insight of client behavioral preferences emanates from the bankers and their assessment on clients' behavioral characteristics. The bankers are ideal candidates for the research as they represent professionals who advises clients, not only based on the long experience they have with their clients, but also a strong knowledge of the products and services being offered. Finally, the bankers also have a deep insight of the nature of the practices in the private banking industry. In this regard, the bankers are likely to be better judges of client behavior than perhaps the clients themselves.

As such, we collected client behavior data from two groups of senior bankers of a major Chinese bank who participated in a study tour of the Hong Kong financial community. Each group consists of 43 senior bankers to HNWIs. Hence, a total sample of 86 bankers was surveyed on their understanding of the wealth management preferences, based on the nine behavioral characteristics from prior studies, of the HNW clients.

These bankers are given a description of the background of each of the four-client type, i.e., *Endowed*, *Entertainers*, *Executives* and *Entrepreneurs*. A brief description of the background of each type of client was given to the bankers before they were asked to fill out a survey describing client preferences based on the nine behavioral characteristics developed above. We used a brief description of client's background in the survey rather than directly using the 4E labels to avoid the possibility of the labels biasing the bankers in their judging of client according to the 4E labels to obtain enhanced objectivity and robustness in the results. After the bankers acquired an understanding of the background of each of the client type, they were then asked to assess, based on their understanding and experience, how each of the client would behave along the areas developed above by Maude (2006,) Dufey (2009) and Lye (2011) on a 5-point Likert scale.

Given that each group has 43 senior bankers, 86 sets of survey forms were distributed to them. 61 sets of surveys were returned, representing a 71% response rate. Among the surveys collected, 10 had missing responses to certain questions and are hence discarded, leaving 51 usable surveys.

8. Data Analyses: Portrait of Private Banking Clients

Table 4 displays the descriptive statistics of all variables included in this study. Our independent variables include the four client types, i.e., *Endowed*, *Entertainers*, *Executives* and *Entrepreneurs*. These are described by the nine behavioral characteristics displayed in Table 1.

In general, the *Entrepreneurs* score the highest in all nine behavioral characteristic categories. Interestingly, the *Endowed* scored the lowest in six of the nine behavioral characteristics. These observations appear to be consistent with the traditional "old-money" versus "new-money" perspective discussed earlier.

8.1. How has the Four Groups of Private Banking Clients Behavior against Expectations?

Given the four types of clients, what type of behavior should we expect from them? By integrating the 4Es classification and the behavior characteristics, table 3 forms the basis of expectations for the *Endowed* and the *Entrepreneurs* based on early observations from Maude (2006,) Dufey (2009) and Lye (2011.) As the *Entertainers* and the *Executives* are new categories, no prior views can be offered. This paper also provides insight into the behavior and preferences of these new categories.

First, along the line of preference towards confidentiality (or privacy) versus network, the bankers indicated that the HNWIs, in general, prefer privacy to the opportunity to network, with 3 of the 4 types of HNW clients scoring below the average score of 3. Only the *Entrepreneurs* reported some preference towards networking with a score above 3.00. The *Endowed* tend to want to maintain a low profile scored the lowest with a score of 2.49. This appears consistent with the observations by Maude (2006) and Lye (2011) regarding the *Endowed* and the *Entrepreneurs*. For the two new categories, the *Entertainers,* who, having much opportunity to be in the limelight, not surprisingly, tend to treasure privacy in their personal affairs reporting a score of 2.59, follow the *Endowed*. For the *Executives*, the nature of their work tend to be very much focused on their profession, hence, opportunities to network may not perceived as high value, hence they have a rather neutral score of 2.92.

With regard to inter-generational versus social legacy, the *Executives* who work hard to achieve the current status see more of a need to extend their success to the next generation and, hence, have more of a focus on inter-generational legacy rather than societal legacy. As such, this group reported the lowest average score, 2.51. The Entertainers, who tend to have broader contact with the community and, hence, are more social legacy conscious, follow this reporting an average score of 2.65. The *Endowed*, with wealth being passed down to them from prior generations and with significant certainty of this practice continuing to later generations reported a score of 2.67, which is just higher than the *Entertainers*. Again, none of the three scores reported were remotely close to the *Entrepreneurs* group. The *Entrepreneurs*, rather surprisingly, achieved the highest score in this category with a score of 3.22. This is in contrast to the observation by Lye (2011,) who proposed that the HNWs in Asia, who tend to be *Entrepreneurs,* tend to prefer inter-generational legacy to social legacy. This contrast may be due to the fact that

Entrepreneurs, coming from a less than prestigious background, typically feel a certain degree of luck in their achieving their wealth status and feel a need to give thanks and giving back to the community.

From a client-bank relationship perspective, the *Entrepreneurs* tend to prefer active involvement and participation in their asset management decisions, reporting an average score of 3.90. This is not a surprising result as the *Entrepreneurs* achieve their status through active involvement in their own business. The *Entrepreneurs* are following the *Executive*s, who are almost neutral regarding their participation in their wealth management decisions, with a score of 2.98. This is consistent with an observation from the Normura (2006) study. It pointed out that, while busy, the *Executives* and Professionals are used to working hard for results and the average score probably is a reflection of the balancing between the lack of time to participate and the habit of working for results. The *Endowed*, being the gatekeeper of the family wealth, do participate somewhat in the management of their family's wealth with a score of 2.73. Finally, the *Entertainers* (2.33) are the most passive when it comes to their involving in asset management decisions. This is, again, consistent with the nature of the *Entertainers*, who tend to have backgrounds in performing arts or sports and are frequently pressured for time for practices and performance. This group also tends to be less business oriented in nature. In fact, it is true that, in most cases, their agent manages business decisions of the entertainers, such as contract negotiations for income.

When it comes to the type of compensation for services, the *Executives* are least willing to pay a fixed percent based on Asset Under Management (AUM) with a score of 3.25. This is, again, consistent with the observation by Nomura (2006), indicating that *Executives* are thorough and sophisticate in nature and, hence, are demanding user of private banking services. The *Entertainers with a score of 3.53 follow the Executives*. The Endowed are also relatively more willing to pay a fixed percent of AUM as compensation type (3.55,) as their relationship with the bank tend to be more strategic and mandate oriented. This is also consistent with Maude (2006.) Finally, a rather surprising finding is that the *Entrepreneurs* are the most willing to pay a fixed fee for services with a reported score of 3.71. While this is inconsistent with the conjecture by Lye (2011,) the result may be reasonable if the AUM is seen by the *Entrepreneurs* as an incentive for the bankers to their interest aligned with that of the clients. As poor performance that erode into the principal will cause a reduction in AUM, hence, a lower fee, while superior performance resulting an increase in principal will cause an increase in AUM, hence, a higher fee.

With regard to wealth management orientations, there exists significant contrast between the *Entrepreneurs* and the *Endowed*. The former is heavily oriented towards wealth building with an average reported score of 4.20, while the latter displayed a clear preference toward wealth preservation with an average reported score of 2.08. This strong difference is consistent with the observations by Lye (2011) and Maude (2006.) The results obtained here is consistent with the background of the HNWI, as the *Entrepreneurs* are frequently still in wealth building mode and the *Endowed* have their wealth built generations ago. With the *Executives* typically having a longer career window than the *Entertainers*, and a tendency to manage their own career and related issues, it is reasonable for us to observe a higher wealth building orientation from the *Executives* (3.75) in comparison to the *Entertainers* (3.49.) In all, all three first generation wealth "new-money" clients have significantly higher wealth building orientations, hence scores, then the "old-money" *Endowed*.

Given the respective orientation towards wealth building versus wealth preservation, it is natural to find the *Entrepreneurs* reporting the highest score (3.47) when it comes to risk taking. This makes sense as the *Entrepreneurs* typically achieve their wealth through risk taking investments. In the meantime, the *Endowed* displaying the lowest appetite towards risks (1.80.) Again, these findings are consistent with that proposed by Maude (2006) and Lye (2011.) This, again, is consistent with common sense, as the *Endowed* typically inherited their wealth because of safe keeping by prior generation; hence, prudent management represents the key to the ability to pass the wealth along to future generations. With regard to the *Executives*, they tend to be professionals who work hard within the system. Professionals, by their own nature, tend to be conservative, fact-based decision makers. In contrast, *Entertainers* tend to be performers who tend to be risk takers in their attempt to achieving performance in the next level. As such, it is natural to find the

Entertainers having a score 2.78, which is higher than the *Executives* 2.76, although the difference is rather small.

Given the understanding of clients, the following section looks at how clients want to be served by the different private banking products and services. When it comes to novel products, based on the scores reported by the different groups, the *Entrepreneurs*, with their capacity to taking risk and grabbing onto opportunities, appeared to be most receptive to new ideas with the highest reported score of 3.53 towards novel products. This is consistent with the observation by Dufey (2009.) The Entertainers, who tend to be a creative and opportunities driven group, with a score of 3.06, follow the Entrepreneurs' preference towards novel product. The *Endowed*, having a long-term perspective, appears to be the least interested in novel products with a reported score of 2.02. This makes sense as it is unlikely that many exotic and novel products would have played significant roles in the management of their family's wealth through the different generations. The fact based decisions characteristic of the *Executives* also reported a low score of 2.86 that is just higher than the *Endowed*.

When it comes to on-shore versus off-shore investments, the *Endowed* tend to have the least appetite for off-shore investments (2.25.) This makes sense as the *Endowed* has traditionally been a conservative group and the preference towards on-shore investment is simply an indication of sticking to what they are familiar with. The *Executive* also has a neutral to domestic oriented approach with a score of 2.94. This is probably due to the nature of the training received by the *Executives* as professionals, since professional trainings tend to focus on depth rather than breath. At the opposite end of the spectrum lie the *Entrepreneurs*, where they are oriented toward seeking opportunities, domestic or otherwise, reported the highest score of 3.45. The findings in this section appear to confirm the observation by Dufey (2009.) The *Entertainers*, typically, are more comfortable with the international stage, as such, they reported the second highest score 3.25.

Finally, this analysis looks at how the respective client group wants the bankers to work with them on wealth management from a balance sheet perspective. A simple asset management approach would have the banker advising the client only on the asset side of the client's balance sheet, while a full balance sheet approach would have the banker advising the client from a comprehensive asset-liability management approach, i.e., advising on both the asset as well as the liability side of the client's balance sheet. In this aspect, the *Endowed* reported the lowest score among the group (1.88,) indicating that they rarely use credit when working with the banker on their family's wealth. The *Entrepreneurs*, in the other side of the spectrum, reported the highest score among the group (4.37) indicating a significant tendency of using credit and leverage to build wealth. This finding confirms the observation by Dufey (2009.) Finally credit is not as widely used by the *Entertainers* (2.10,) as it is by the *Executives* (2.47.)

8.2. Towards a Private Banking Client Behavior Model?

Given these initial findings and a better understanding of the HNWIs, we now can build a model between the client types and the client behaviors by performing a regression of the nine behavioral variables onto the four client types (E); *Endowed*, *Entertainers*, *Executives*, and *Entrepreneurs*

$$\begin{aligned} E = \alpha &+ \beta_1 \text{ Privacy} + \beta_2 \text{ Legacy} + \beta_3 \text{ Participation Style} \\ &+ \beta_4 \text{ AUM} + \beta_5 \text{ Wealth Build} + \beta_6 \text{ Risk} + \beta_7 \text{ Novel} + \beta_8 \text{ Off-shore} + \beta_9 \text{ Credit} \end{aligned}$$

The results are reported in table 5. As dependent variables reflect categories, hence, the signs reported in the table are of no significance. With a reported R-square of 0.418, and an F-statistics of 15.447, the model achieved statistical significance classifying client type based on the behavioral characteristics.

However, among the nine behavioral characteristics only three achieved statistical significance. These include compensation type (commission v. AUM) at the 5% significance level. This indicates that the different types of HNW clients do have different preference over how they are charged for services. While there may be concerns over the negative sign in front of the compensation type coefficient, it is important to reiterate that this refers how each type of client is related to the type of compensation and the sign is just the result of the associated client label with no specific economic meaning.

The two behavioral characteristics that contribute most in distinguishing HNW client type are Investment Objectives (preservation versus growth) and Banking Products and Services (balance sheet orientation.) The reported t-statistics on these two variables are 3.86 and 6.10, respectively, indicating statistical significance.

`While the other variables failed to achieve significance at the 0.05 statistical level, this does not necessarily mean that these variables are irrelevant. This is especially the case as the analysis in the previous section yielded mostly reasonable relationships that are consistent with observations from prior literature and common sense. As such, we suspect that the lack of statistical significance in some of the variables may be the result of sample size or multicollinearity. This may represent research opportunities for future studies.

9. Summary and Conclusions

This paper reviews the existing limited literature on private banking and examined the nature of a branch of banking that is less understood, as private banking caters primarily to a limited, and exclusive, group of "private" clients.

In this paper, we explored the nature of the private banking business and its evolution leading a more detailed understanding of the private banking world. While there have been attempts to understanding the clients served by private banks, there exists little systematic knowledge on the subject. Based on these prior papers, this paper identified nine behavioral characteristics to portrait the private banking clients.

This paper also synthesized the different practices in the industry and arrived at a model that effectively classified HNW individuals based on their source of wealth, the *Endowed*, *Entertainers*, *Executives*, and *Entrepreneurs*, hence the 4Es. Building from the "old-money"-"new-money" dichotomy, the new 4Es classification framework represents an enriched model of segmenting private banking clients.

While prior literature yield mostly conjectures and observations regarding client type and behavioral characteristics, this paper provided evidence on such relationships. The model in this paper was then put into test with a set of unique data collected from bankers who advises the private banking clients. The variables in the model were examined with evidence over the nine behavioral characteristics. The results indicated that the four types of clients do each display, in general, different preferences and behavior. While the differences are most, and highest, between the traditional *Endowed* ("old-money,") and the *Entrepreneurs* ("new-money,") this paper found two other categories that are distinct from the two traditional groups that should command the attentions of private bankers, i.e., the *Executives* and the *Entertainers*.

With regard to the individual behavioral characteristics, our findings confirmed most of the conjectures and observations. However, this paper did find evidence contrary to one common believe that *Entrepreneurs* tend to prefer commission rather than AUM as compensation for private banking services. Our evidence, however, points to the contrary. While the evidence appears to be inconsistent with the conjecture by prior literature, our view is that it is consistent with the view that AUM serves to align the interest of the client and the bankers.

In addition to the categorization, results in this paper also yield insights to private banks looking at how they can effectively serve their clients. In addition to the general confirmation that the *Endowed* prefers privacy, the *Entrepreneurs* prefer active participation. From a modeling perspective, this paper found three of the nine behavioral categories to be significant. The most significant categories include Investment objectives in the form of capital preservation versus capital building; and Products and Services in the form of the focusing on the Asset Management side of the balance sheet versus working with both sides of the balance sheet including the utilization of credit. A third, less significant, factor is how clients want their services received from the private bank compensated, i.e., commission versus a percent of AUM. In conclusion, this paper contributes to current literature by providing a better understanding of the private banking business, as well as the types and behavioral characteristics of private banking clients. As this is a first attempt among its kind, the sample is rather small and the data is rather crude. Future research can not only build from the current study and look into specifics of client type as well as client behavior, but also look into the possibility of expanding both, leading to a more comprehensive model.

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Table 1: Summary of Behavioral Characteristics of HNW Clients

1. **Network Relationship: Preference for Confidentiality and Privacy versus Network**
2. **Legacy Relationship: Preference for Intergenerational versus Societal Legacy Building**
3. **Investment (participation) Style: Preference towards Discretionary versus Active Management**
4. **Compensation Type: Preference towards Commission versus % of AUM**
5. **Vision for Wealth: Preference towards Wealth Protection versus Wealth Building**
6. **Attitude towards Risk: Risk averse versus Risk takers**
7. **Use of Novel Instruments: Preference towards Alternatives versus Traditional**
8. **International v. Domestic bias: Preference towards On-shore versus Off-shore**
9. **Balance sheet focus: Asset Management only versus Asset Management and Credit**

Table 2: Reclassification into the 4E Model.

Traditional Classification	4E Classification	**Nomura**	**Coutts**	**Boston Consulting Group**
Old Money	*Endowed*	• Born Rich	• Landowners (if inheritance) • Private office	
New Money	*Entertainers*		• Sports and Entertainment	
	Executives	• Hard-workers, Overnight Wealth (if wealth from retirement)	• Executives • International • Professionals (if employed by organizations)	• Professional managers • Other Professionals
	Entrepreneurs	• Overnight Wealth (if wealth from IPO)	• Entrepreneurs • Landowners (if recent acquire land) • Professionals (if run own operation)	• Entrepreneurs • Investment professionals

Table 3: Indicative Behavioral Expectations of Private Banking Client from Prior Literature

	Source of Wealth Classification			
	Endowed	*Executives*	*Entertainers*	*Entrepreneurs*
1. Network Relationship	Confidential Privacy (Maude, 2006)			Network (Lye, 2011)
2. Legacy Relationship				Inter-Generation (Lye, 2011)
3. Participation Style				Active (Lye, 2011)
4. Compensation Type	AUM based (Maude, 2006)			Commission based (Lye, 2011)
5. Vision for Wealth	Preserve (Maude, 2006)			Build Dufey (2009,) Lye (2011)
6. Attitude towards Risk	Risk averse (Maude, 2006)			Risk taking Dufey (2009,) Lye (2011)
7. Use of Novel Instruments				Novel Dufey (2009)
8. International v. Domestic bias				Home Dufey (2009)
9. Balance sheet focus				Credit Dufey (2009,) Lye (2011)

Table 4: Descriptive Statistics of Variables in the Survey.

Hypotheses sets	*Endowed*	*Entertainers*	*Executives*	*Entrepreneurs*	*Max*	*Min*	*Mean*	*s.d.*	*t*
Macro relationship									
Network relationship (confidentiality v. information)	2.49	2.59	2.92	3.47	3.47	2.49	3.11	1.60	0.50
Legacy relationship (intergenerational v. social)	2.67	2.65	2.51	3.22	3.22	2.51	2.90	1.44	(0.51)
Bank relationship									
Investment style (discretionary v. active)	2.73	2.33	2.98	3.90	3.90	2.33	3.28	1.51	1.32
Compensation (Commission v. AUM)	3.55	3.53	3.25	3.71	3.71	3.25	3.55	1.33	2.95
Wealth management									
Preserve v. growth	2.08	3.49	3.75	4.20	4.20	2.08	3.91	1.47	4.40
Attitude towards risks	1.80	2.78	2.76	3.47	3.47	1.80	3.12	1.36	0.64
Tools									
Use of novel instruments	2.02	3.06	2.86	3.53	3.53	2.02	3.25	1.38	1.27
On-shore v. Off-shore	2.25	3.25	2.94	3.45	3.45	2.25	3.27	1.34	1.46
Balance sheet focus	1.88	2.10	2.47	4.37	4.37	1.88	3.33	1.59	1.47

Table 5: Regression results on Private Banking Client type (E) and Behavioral Characteristics

	Coefficients	*Standard Error*	*t Stat*	*P-value*
Intercept	1.232	0.230	5.366	0.000
Network relationship (privacy v. inform)	-0.016	0.045	-0.347	0.729
Legacy relationship (intergenerational v. social)	-0.064	0.047	-1.371	0.172
Participation style (discretionary v. active)	0.009	0.053	0.166	0.868
Compensation (Commission v. AUM) **	-0.103	0.051	-2.008	0.046
Preserve v. Build ***	0.223	0.058	3.861	0.000
Attitude towards risks	0.110	0.073	1.506	0.134
Use of novel instruments	-0.030	0.072	-0.411	0.682
On-shore v. Off-shore	0.014	0.056	0.249	0.804
Balance sheet focus (AM v. credit)***	0.302	0.049	6.103	0.000