## Source of Wealth based 4Es Segmentation of Private Banking Clients

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**Abstract**

The understanding of private banks (i.e., banks that serve private clients rather than privately held banks) is limited, partly due to its “private” nature. To get an initial understanding of the segmentation of clients using private banking, this paper tracks the evolution of the private banking business from when it was first established in Europe to the private banking needs of entrepreneurs of the “new economy” and from Asia. Specifically, this paper evaluates how private banking services can be effectively segmented based on client behavior.

**Key words**

Market segmentation, Bank marketing, Private banking

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***Introduction***

In the area of banking research, there exists an abundance of literature performing analyses on banks as organizations that offer products and services to customers as depositors. Indeed, with these analyses, a key concern is how the mass depositors are served and protected. However, the Glass-Steagall Act from circa a century ago clearly illustrated that “banks,” are more than just deposit taking organizations. “Banks,” as defined along the line of the Glass-Steagall Act include investment banks that focus on serving corporate clients in the “capital and investment” markets and commercial banks that focus on serving smaller corporates and individual customers in the “loans and deposits” markets. Within the commercial banking segment, retail banking serving individual consumers represents a rather broad and significant part of the banking business. As such, much research effort has been devoted not only to how this sector is served (Andrew, 1985,) but also how they are protected as depositors (Garcia, 1997.)

With deregulation and new technology impacting the retail banking sector (Keltner et al. 1998,) retail banks are challenged with increasingly intense competition. This is especially true when there are growing opportunities from a group of high net worth (HNW, hereafter) clients in the private banking space whose needs for products and services are unique and different from those of the mass depositors. To address these challenges, retail banks have expanded their traditional business of buying and selling money, deposits and loans, to include two directions; one in global banking (Kaynak, 1986, McCullough et al., 1986,) and the other in personal financial services (Wright, et al., 1986.)

Efforts in these two directions, in turn, have led a crossing-over of the two new segments to result the emergence of a new segment of clients; a group that has needs in global and personal financial services. This new breed of banking clients with a global perspective as well as specialized personal financial needs not only have wants that cannot be met by traditional products and services, but also tend to be clients that are of a more affluent nature and represents a potentially lucrative and high growth segment for financial service providers (Rose, 1982.) This group of affluent clients are identified and segmented as high net worth individuals (HNWIs,) or ultra-high net worth individuals (UHNWIs) by banks and the services and products offered to these clients are of a somewhat exclusive nature. In general, this segment of banking is identified as private banking in the industry. Service providers in this segment include not only banks in the traditional sense, e.g., UBS, HSBC Private Bank, etc., but also other financial institutions, e.g., AIG Private Bank, from the insurance sector. Capon et al. (1994) declared that “… for retail banks, the most significant development was the growth of private banking. Through private bankers, many banks aimed to provide a much broader range of financial services to affluent clients than to the mass market.” (p. 17.) While the significance of private banking is evident, the research and understanding of private banks in the industry and in academe is rather limited. Frequently, private banks are understood to be banks that are non-public sector banks (Reddy, 2011,) rather than banks that offer private services only to selected high net worth (HNW) clients.

A comprehensive review of the bank marketing literature clearly reveals that research on private banking is scarce. The dearth of research in this rather significant segment of banking is partly due to the nature of the services demanded by clients; i.e., banks want to retain the “private” and the secretive nature of its products and services as the products and services are provided only to selected clients and not the masses. Indeed, if any of the products and services provided to the private banking clients became widely known and available in the public domain, the appeal of novelty and exclusivity may be diluted, giving no reason for a private banking client to continue to be associated with the bank.

A second reason for a lack of research in the private banking sector may be academic in nature. With the core of banking research coming out from the finance literature, and research in this area traditionally being driven along the lines of capital markets, bonds and equity financing and investment, i.e., investment banking, and money markets, loans and deposits, i.e., retail banking, while the products and services offered in private banking do not fall neatly into either of these traditional categories, research in private banking naturally has not received much attention by researchers. For example, wealth management services with investment management features that are offered by private banks to HNWIs is in and of itself a service that is beyond that of the traditional retail banking products in various forms of deposit which were used to facilitate clients’ management of liquidity oriented transactions.

While there exists a clear need for general research into the private banking segment, even within the private banking segment, Surtani (1991) concluded that “the traditional view of the Hong Kong private banking market as being homogeneous needs to be abandoned,” (p.35). This reflects a need for segmentation research within the private banking segment. Chung et al. (2014) proposed, and with certain success, a 4Es model, *Endowed*, *Entertainers*, *Executives* and *Entrepreneurs*, to classify and examine behavior of private banking clients. However, it has not been investigated whether the proposed classification by Chung et al.(2014) is valid in the sense that each of the classifications represents unique and distinct groups.

This paper examines the nature of private banking and how private bankers’ work with HNW clients and investigates effective client segmentation in the private banking sector.

***What is private banking anyway? Who are these HNWIs?***

Private banking is clearly a sector that is increasingly significant. As mentioned in the previous section, the lack of research in this rather important segment of banking is, in part, due to the “private” or “secretive” nature of its operation, as the products and services are only provided to selected clients and not the masses. In addition, another factor that may have contributed to the lack of research in this area is due to the unusual nature of the product and service offerings.

Given these circumstances, perhaps a convenient place to start is from a regulatory perspective. In this regard, the Federal Reserve Supervisory Letter (SR97-19) provides guidance and suggests that, “private banking includes, among other things, personalized services such as money management, financial advice and investment services for high-net-worth clients.” (Atz, 1999.) While HNW is not specified in SR97-19, it generally refers to multi-millionaires.

To obtain an idea of the size and nature of this client group, the Spectrum Group, a financial services industry consulting and research organization, in its 2013 report, concluded that there are 9.6 million millionaires in the US, surpassing the pre-recession high of 9.2 million in 2007. This represented a 7.5% annual growth over a 5 year period since 2008. Furthermore, the ultra-wealthy segments among this group, with a net worth of $5 million and above, includes 1.24 million households, up from 840,000 in 2008, and those with $25 million or more now include 132,000 households, up from 84,000 in 2008. Clearly, private banking represents not only a significant, but growing, segment of financial institutions that is little known and understood. The following section looks at how this group has been served traditionally.

***The Evolution and Development of Private Banking***

According to Maude et al., (1996,) the practice of private banking dates back at least as far as the seventeenth century with some British private banks providing its client services in Europe.

Maude et al. (1996,) concluded that traditional private banks are unlike their retail banks counterparts in two aspects. First, from an organization perspective, unlike retail banks, private banks are not incorporated companies. Instead, private banks are partnership-based organizations to provide financial and related services to high net worth individuals (HNWIs.) Second, from a products and services perspective, the offerings by private banks not only include retail banking products, but also a wide range of up-market investment and finance related services, such as inter-generational wealth management.

Dufey (2009, p. 3) traced the origin of private banking to “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….” Naturally, there exists a desire for privacy and confidentiality by these individuals; as such, most of the business is conducted on a private and personal basis.

Based on the above findings, traditional private banking practices, as initiated in Europe, appears to have products and services that are built to address three key characteristics displayed by HNW clients, a broadening of products and services with more investment characteristics, a more intertemporal and multi-generational perspective, and a bias towards wealth protection.

While private banking in Europe was primarily driven by multi-generational wealth, private banking in the New World has been primarily driven by the amassing of wealth from economic growth; from the industrial revolution in the early 1900s, to the technology revolution in recent decades.

This is the case as clients of traditional US private bank generally did business with the bank to “…purchase credit products, such as mortgages and other loans, and held traditional deposit accounts (Vincent, 2010, p.6.). As a result, US private banks typically have a relatively small market share among ultra high-net-worth (UHNW) individuals of the European type. US private bankers also find it difficult to win over the HNWI clients’ liquid assets from competition as wealthy individuals typically make new allocation decisions regarding their investable assets on an infrequent basis. Over time, US private banks realized that more than two thirds of UHNW individuals in the U.S. are entrepreneurs with their wealth created from economic growth. According to Vincent (2010), US private bankers found that the UHNW entrepreneurs behave differently. As a large amount of the entrepreneurs’ net worth encompasses illiquid assets in their business interests, they are often overlooked by traditional private banks that only target UHNW individuals with large pools of investable assets, such as families who have inherited wealth. Furthermore, clients from the entrepreneurial segment have to make decisions on a frequent basis regarding their businesses in the form of capital funding for growth opportunities. As such, existing relationships with these entrepreneurs on the commercial side gives private bankers access to the investable assets of these clients. This phenomenon is even more acute with the recent economic growth fueled by deregulation in industries such as telecommunications and business opportunities in technology development.

While the demand side was fueled by economic growth as a result of deregulation, deregulation and in the banking sector in the Reagan era also fueled increase competition on the supply side to retail banks giving rise to significant competition and a customer-centric environment, resulting in the need for banks to further segmentation of their clients and effectively serve their customers.

In sum, US private banks tend to serve HNW clients of a different nature from the European ones. While the Europeans are of a more multi-generation wealth preservation perspective, the Americans work toward a more wealth creation perspective. Frequently, the European type clients are referred to as “Old-money,” while the American type clients are referred to as “New-money.”

Asia, in the meantime, has also experienced tremendous growth in recent years as a result of both political and economic liberalization. Dufey (2009, p. 4) suggested that “… when the colonial period had ended, local wars began to die down, 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…” The Asian private banking clients appear to possess traits of both the typical European clients as well as those of the typical US clients. On the one hand, they are clients, like their European counterparts, that emerged from political instability and, hence, have a desire for wealth protection. On the other hand, they are clients, like their US counterparts, confronted with significant economic opportunities for further growth in wealth. According to a Capgemini, in 2012, the number of individuals in Asia-Pacific with at least $1 million in investable assets is reported to be at 3.37 million, outnumbering North America (3.35 million) for the first time.

Based on the above, it is clear that private banking clients are unlike the typical retail banking clients. 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 private banking practices in the US and Asian countries. In fact, from an investment perspective, 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.

In sum, while not very well understood and unique, private banking has continued to grow not only with the already significant services offered to HNWI and UHNWI clients in the traditional European private banking market (Maude, et al., 1996, Molyneux and Omarini, 2005, Maude, 2006, Rudolf, 2008, Rudolf and Baedorf, 2011,) but also in the U.S. and Asia. In the U.S., the increasing level of private banking activities in the market place has led the Federal Reserve to issue a Supervisory Letter (SR97-19) on the definition and nature of private banking. In the meantime, the practice of private banking has also spread to Asia as documented in Chen (2008,) Gopalakrishnan (2010,) and Long and Tan (2010) to cater to the new worth generated as a result of the economic growth in the region,

***Traditional Segmentation of Private Banking Clients – the “Level-of-Wealth” Approach***

To effectively serve the HNWIs, retail banks in the private banking space must not try to be all things to all people (Thomas, et al., 1976,) banks must not only treat the whole client group as one segment, but further divide the broad segment, into groups of consumers with distinct needs, Kotler and Keller (2006.)

Kotler and Armstrong (2006) suggest segmentation in four levels: segment, niche, local and one-to-one markets, where a company tailors its marketing activities to meet the needs of just one individual customer (Mawoli, 2011.)

In practice, the most commonly used segmentation by banks of its clients is the “level-of-wealth” approach, where clients are segmented based on their Asset-Under-Management (AUM hereafter.) A case in point is the segmentation of private banking clients into the high net worth individuals (HNWIs) group and the ultra high net worth individuals (UHNWIs) group. The Cerulli Edge (2010) reported that 41% of US practitioners use “Current assets with practice,” as their main criteria to segment clients, and 30% use “Total financial assets,” as their main criteria, both concepts are along the line of AUM as segmentation criteria. While the specific definition of AUM segments varies from private bank to private bank, a generic segmentation pyramid is found in figure 1.

The challenge to this “level-of-wealth” approach is that it does not provide much information to private bankers with regard to any specific behavioral characteristics by the different client types leading to *actionable* ideas to help private bankers to effectively serve their clients. The “level-of-wealth” approach does not appear to have any link to behavioral characteristics. For instance, the approach does not offer insights to the investment behavioral differences between a UHNWI and a HNWI? It cannot answer questions as to whether a UHNWI would prefer more or less aggressive investment when compared to a HNWI. This type of segmentation naturally results ineffective provision of services and reduced customer satisfaction and loyalty.

***Alternative Segmentation Systems for Private Banking Clients – the “Source-of-Wealth” Approach***

An alternative to the “Level-of-Wealth” segmentation approach is the “Source-of-Wealth” approach to segment private banking clients. The “Source-of-Wealth” approach segments private banking clients based on how wealth is achieved. Segmentation based on the “Source-of-Wealth” approach would be the “Old money” – “New money” dichotomy, i.e., traditional European inherited wealth versus American created wealth, mentioned in the above section. This “old-money” versus “new-money” approach is expected to provide a more effective way of segmenting the market.

Maude (2006) hypothesizes that, when compared to the “new-money” segment, traditional European private banking clients, the “old-money” segment, tend to have behavioral characteristics 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

Clearly, these behavioral characteristics provide more informative guideline to the bankers serving these clients.

This paper shall examine evidence of linkage between this “source-of-wealth” segmentation approach and client behaviors, hence demonstrating that the “source-of-wealth” represents a superior segmentation method to the “level-of-wealth” approach.

Along the line of Maude (2006,) a number of practical efforts of have further segmenting the HNWIs have been in place. With the many approaches to segment the private banking clients, this paper will focus on three major approaches; one by a leading bank in Asia, Nomura (2006); another by a leading European bank, Coutts; and a final one by a leading US consulting firm, the Boston Consulting Group (BCG, 2002)

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

1. Born rich
2. Hardworkers
3. Overnight wealth

According to Nomura, the “born rich” segment mainly acquired its wealth from inheritance. With their wealth from previous generation(s), this is equivalent to the multi-generation “old money” wealth segment described above. In the Nomura framework, a second segment is the “hardworkers.” The segment acquires their wealth through accumulation over the course of their career. The HNWIs from this segment are likely to come from the professional and executives ranks such as medical doctors or lawyers. Finally, the “overnight wealth” represents a group that acquired their wealth through exit. This exit can either be the result of retirement or IPO. The HNWIs from this segment parallels to the first-generation “new money” described in the earlier paragraph.

With a model dividing the HNWIs into three segments rather than the tradition “old-money” versus “new-money,” segmentation, the Nomura segmentation approach represents a new and enriched alternative to private banking client segmentation.

Coutts is a leading private bank from the UK with private banking clients that include the Royal family for over 300 years. This bank 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

While Coutts did not offer detailed definition of each of the segment, the segment labels are rather self-explanatory. The “entrepreneurs” are self-starters and successful business-owners, with the “executives” representing senior officers in organizations. “Land owners” have their wealth derived from land and the “sports and entertainment” are recognized performers. The “international” is a group that works overseas, and “professionals” are specialists in their fields. The only segment that requires explanation is probably the “private office.” This is typical a professional office that serve not only one HNWI, but also members related to the HNWI, i.e., family members, each of which may be HNWIs in their own right.

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

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

Like the Coutts classification, this system by the Boston Consulting Group also includes “entrepreneurs.” The Boston Consulting Group approach, however, further segments “professionals” into “professional managers,” “other professionals” and “investment professionals.” In the Boston Consulting Group system, they also have “housewives” and a catch all “others.”

As can be seen, there exist a number of attempts in segmenting private banking clients, and it appears that each of the individual attempt represent inconsistent efforts in private banking client segmentation, and there exists no consensus towards an effective segmentation framework.

## A Unified “Source-of-Wealth” Segmentation System for Private Banking Clients – the 4Es Model

Chung et al. (2014) synthesized the classification attempts above by Nomura, Coutts and Boston Consulting Group and proposed the 4Es HNWIs segmentation model.

The 4Es proposed by Chung et al. (2014) includes the *Endowed* segment, the *Entertainers* segment, the *Executives* segment, and the *Entrepreneurs* segments. The following provides a summary of how the 4Es captures and unified the different segments described in the above section.

First, the classification categories proposed by Nomura (2006) which include the “born-rich,” the “hard-workers” and the “over-night wealth”. The “born-rich” group achieves their wealth from an endowment of inheritance; hence this client segment can be more conveniently re-labelled as “*Endowed*.” In the meantime, the “hard-workers” group typically achieves their wealth from progressing through their career towards an executive level. As such, this group of HNWIs can be more conveniently re-labelled as “*Executives*.” Finally, for the segment classified as “overnight wealth” includes those who achieved their wealth either from retirement, i.e., “*Executives*” or sales of business, i.e., “*Entrepreneurs*.” In sum, the Nomura classification is now re-segmented into three the “*Endowed*,” the “*Executives*,” and the “*Entrepreneurs*.”

For the classification system used by Coutts, Chung et al. (2014) retained the “*Entrepreneurs*” and “*Executives*” segments that are found in Coutts’ original classification. The “landowners” segment in the Coutts system can arguably be segmented either as “*Endowed*,” for inherited land, or “*Entrepreneurs*,” for those whose land was acquired through recent purchases. “*Sports and Entertainment*” in the Coutts system can be classified as *Entertainers* in general. “*Internationals*” are most likely “*Executives*” who are senior employees on oversees assignment. “*Professionals*” with their sources of funds employment can be classified as “*Executives*,” or those who run their own venture, e.g., a medical doctor who runs a clinic, can be classified as “*Entrepreneurs*.” Finally, “*Private Office*” is a family-oriented client-category and, most likely, of a multi-generational nature and can be classified as “*Endowed*.” Given this re-classification, the Coutts 7-category system is now consolidated into four segments, the “*Endowed*,” “*Entrepreneurs*,” “*Executives*,” and a new segment in the form of “*Entertainers*,” with three of the segments common to the Normura categories. With these new labels used in the both the framework by Coutts, based in the UK, and Nomura, a bank from Japan, the 4Es model by Chung et al. (2014) effectively synthesized the two systems from different region and culture into one.

Finally, in the Boston Consulting Group classification, they have “*entrepreneurs*,” which is in the 4Es segmentation system. Their “professional managers” are clearly “*Executives*,” who are senior managers of organizations. The “other professionals” category in the Boston Consulting Group model are professionals such as medical doctors and lawyers, as argued before, depending on the nature of their source of wealth, they can either be *Executives* (if they are employed by an organization,) or *Entrepreneurs* (if they are self-employed.) “Investment professionals” in the Boston Consulting Group model can be segmented to the *Entrepreneurs* category. Finally, “*Housewives*,” as the BCG label suggested, probably derived their source of wealth from the husband, who are in one of the prior categories mentioned before. In sum, the categories in the Boston Consulting Group framework can all be nicely classified into the 4Es segmentation system proposed.

The significance of the unified 4Es segmentation system is that it represents a powerful tool to analyze the behavior of different groups of private banking clients beyond the “old-money” versus “new-money” dichotomy. In fact, other than the “*Endowed*,” the other three categories are all first generation wealth. The 4Es model is also superior to the current “level-of-wealth” approach. The 4Es model is also superior to the current “level-of-wealth” approach. The 4Es segmentation system in relations to prior classification systems is displayed in Table 1.

While the 4Es segmentation system offers a conceptually attractive framework for analysis, it is uncertain whether each of the segments do represent unique and distinct category. This is important as overlaps represent redundancy result ineffective segmentation in practice as well as the risk of multicollinearity in statistical analysis. To address this, this paper shall look into a number of behavioral characteristics proposed by Maude (2006,) Dufey (2009) and Lye (2011) as summarized in Chung et al. (2014) and see whether each of the segments may display different behavior(s.) To test discriminate validity, we shall use ANOVA to test for significant differences between the four segments and the client behaviors.

## Behavioral Characteristics of Private Banking Clients

Chung et al. (2014) summarized a number of behavioral hypotheses proposed by Maude (2006,) Dufey (2009) and Lye (2011) and arrived at nine private banking client behavioral characteristics for examination.

### Network Relationship Behavior

While Maude (2006) suggested that traditional private banking clients prefer a private confidential relationship with the private bankers. Lye (2011) observed that Asian clients tend to use the banker as a platform to access private information. The challenge is, a relationship platform that aims at sharing information will naturally result in a certain degree of compromising of confidentiality and privacy, and, as a result, a platform that may be preferred by one segment of clients may discourage another. The decision to participate by each client segment has significant implications to private bankers offering products and services to the different segment of clients. For instance, it is expected that networking opportunities would be welcomed by the *Executives* but not the *Entertainers*. Hence, a social gathering arranged by the bank, for marketing and promotion may be welcomed by the former, but not the later. This confidentiality-information seeking dichotomy is labelled “network relationship” in Chung et al. (2014.)

### Legacy Orientation Behavior

A second behavioral characteristic again focuses on the relationship between the client and the outside world. In this case, however, at issue is the client’s preference toward an inter-generational legacy versus a social legacy. An inter-generational legacy is one which focuses on addressing the welfare of the client’s immediate family members, while a social legacy is one what addresses issues of the society at large, e.g., the Bill and Malinda Gates Foundation. Lye (2011) observed 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. Chung et al. (2014) labelled as “legacy relationship.”

### Investment Style Behavior

Investment style looks at 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 private 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, mostly “*Entrepreneurs*,” tend to retain more control and be actively involved in investment decisions. The degree of involvement in the relationship, is labelled “investment style” in Chung et al. (2014.)

### Compensation Preference Behavior

In addition to degree of involvement, another key bank-client relationship is 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. This is labelled as “compensation” in Chung et al. (2014.)

### Investment Preferences

A key behavior widely examined in traditional finance literature is to study how investors manage their wealth in the context of risk-return balance. According to Maude (2006,) and our analysis in the previous section, 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 with a wealth building outlook. This behavioral preference is labelled “Wealth building” in Chung et al. (2014.)

### Behavior towards Risk

A nature extension of the wealth preservation versus wealth building bias would be HNWIs’ behavior in the light of 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. From 4Es segmentation perspective, it is expected that “*Entrepreneurs*” will tend to be less risk averse than the other segments. This behavior is labelled “attitude towards risks” in Chung et al. (2014.)

### Use of Novel Instruments

Dufey (2009) observed that the “new-moneys” are not shy from exotic instruments. This is examined in Chung et al. (2014) under the label of “use of novel instruments.”

### International v. Domestic Orientation

In addition to investing in different types of assets and in the various asset classes, a key offering by private banks is to help clients go beyond their domestic market overseas. Dufey (2009) commented that “Another unique feature of private banking in Asia is based on the fact that almost all is ‘offshore’ i.e. of a trans-border nature.” (p. 6.)

The ability to expand the already rich investment opportunity set that include traditional as well as alternative investments to developed as well as emerging markets overseas certainly effectively expands the efficient frontier for private banking clients. However, this also significantly complicates the choice by these clients. Behavioral preference in this area is examined under “international v. domestic bias” in Chung et al. (2014.)

### Use of Credit

Finally, both Dufey (2009) and Lye (2011) observed that Asian client, mostly in the “*Executives*” segment, frequently look for the private bank to provide them access to credit (i.e., advising on the right hand side of the client’s balance sheet) to support the growth of business operations, rather than simply asset management services (i.e., advising on the left hand side of the client’s balance sheet.) This difference in balance sheet focus (asset v. credit) is examined in Chung et al. (2014) under “balance sheet focus.”

Table 2 summarizes the behavioral characteristics from that study.

## Research Methods

Obtaining of data for this type of study represents a significant challenge as private banking clients have a preference for privacy and secrecy. In many cases, they do not want their identity to be revealed. Furthermore, private banking clients frequently rely on bankers for advice and many may not have the level of personal insights to able to clearly describe their behavior.

Fortunately, from a data collection perspective, the private banking relationship has two parties, the client and the banker, and that an enhanced understanding of the behavioral characteristics of their clients is of significant interest to the bankers. As a result, an appropriate, and valuable, source of information to the insight of client behavioral preferences emanates from the bankers and their assessment on clients’ behavioral characteristics. The bankers are, therefore, ideal candidates for this research as they represent professionals who advise clients, not only based on the long experience they have with a variety of 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 even perhaps the clients themselves.

### Sample and Measurement

Therefore, we collected client behavior data with a survey from two groups of senior bankers of a major Chinese private bank who participated in a study tour of the Hong Kong financial community. Each group consists of 43 senior private bankers. 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 were given a description of the background of each of the four-client types (i.e., the segments: *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 unbiased 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 were then discarded, leaving 51 usable surveys. Table 3 provides a summary of the behavioral characteristics of each of the data set.

In general, in the area of “networking relationship behavior,” most client types display a preference towards privacy versus networking, with mean scores of below 3 on a 5 point Likert scale, the only exception being the “*Entrepreneurs*” (score = 3.47/5.00). In terms of “legacy orientation behavior,” again, the clients are mostly geared towards intergenerational legacy rather than social legacy, again the exception being the “*Entrepreneurs*.” When it comes to investment management style, again, most clients prefer a discretionary style, i.e., they are comfortable with a hands-off approach having banker making investment decisions for them. Again, the exception here is the “*Entrepreneurs*,” displaying a strong orientation towards active management of their own investment decision (score = 3.90/5.00.) The “*entrepreneurs*” continues to stand out when it comes to how the clients view private bankers should be compensated. However, all scores here indicate that asset under management (AUM) is the preferred mode of compensation by all types of clients. When it comes to investment behavior, the “*Endowed*” displays the most conservative traits, with a preference towards wealth preservation (score = 2.08/5.00) and low risk appetite (score = 1.80/5.00,) while the “*Entrepreneurs*” shows the most aggressive traits, with a strong preference towards growth (score = 4.20/5.00) and a high-risk appetite (score = 3.47/5.00.) The dichotomy between the “*Endowed*” and the “*Entrepreneurs*” are again observed with novelty of investments being used (2.02/5.00 v. 3.53/5.00,) domestic versus international orientation (2.25/5.00 v. 3.45/5.00), and finally, the use of credit (1.88/5.00 v. 4.37/5.00.)

## Analysis

In order to test the behavioral preferences of each target group and evaluate convergent validity, we factor analyzed each of four private banking segment behaviors using principle component analysis and selected the three highest behavioral preferences based on correlation from the component matrix. Using principle component analysis, the first principal component has the largest possible variance and accounts for the most variability. Of the four-factor analyses conducted each produced only one significant component. The secondary components explained only 15% of the variance or less. The behavioral criteria with the highest correlations were selected.

Table 4 reflects the results. The result in Table 4 will give private bankers the ability to determine the product and behavioral preferences for each private banking segment. In addition, the behavioral preference of the segment groups (i.e., 4 Es) lends evidence that the segments are somewhat harmonious with the behavior style of private bank clients. For example, the “*Endowed*” factor correlated most with Wealth Build (Preserve vs. Growth). This is supported by the literature. Nomura (2006) classified this group as the “born-rich” segment. A market segment that would have a strong preference toward preservation of inherited wealth.

To test discriminate validity, we used ANOVA to test for significant differences between the four segments and the investment behaviors. If there are significant differences, this reflects that segments are somewhat valid measures of differences in investment behavior. Of course, interaction effects will skew the results somewhat but there will always be some interaction variation between investment segments of this type. For example, the behavior differences between an entrepreneur and an executive at times who be more difficult to define. Table 5 displays the results.

## Results

### Endowed Segment

The highest correlation for this segment was Wealth Build (Preserve Vs. Growth) (.862). This was followed by Attitude Toward Risk (.814). The third highest correlation was Use of Novel Instruments (.783). The result are consistent with the hypothesis that the preference for building wealth has historically defined the “*Endowed*” old money segment of private banking investors. The evidence on this segment and the related behaviors are supportive of the validity of the segment.

### Entertainers Segment

For the “*Entertainer*” segment, Use of Novel Instruments (.828) rated the highest. This was followed by Attitude Toward Risk (.739). The third highest correlation was Compensation Vs. Commission (.623). “*Entertainers*” are usually relatively new to the world of investments with limited knowledge; they are also likely to be more open to creative ideas. The combination results in members of this segment being more likely to invest in the more novel investment strategies e.g., Bernie Madoff.

The attitude toward risk was also highly correlated with this segment. This tends to be more reflective of a new money segment. Coming from a less wealthy background makes one much more concerned with risk and the level of commissions.

### Executives Segment

Attitude Toward Risks had the highest correlation (.838) in the “*Executives*” segment. This was followed by Use of Novel Instruments (.758). The third highest correlation was Network Relationship (Confidentially) Vs. Information (.742). This segment tends to reflect a new money segment as well with risk being the most critical variable. However, the use of novel instruments would be reflective of a more experience attitude toward investment methods rather inexperience associated with the “*Entertainer*” segment. “*Executives*” would be much more aware of more modern investment methods and approaches e.g., derivatives and foreign money markets. Therefore, the “*Executive*” segment would have a sophisticated appreciation for the risk/return tradeoff for investment vehicles.

### Entrepreneurs Segment

“*Entrepreneurs*” preferred Use of Novel Instruments (.847). The second highest correlation for “*Entrepreneurs*” was Investment Style (Discretionary) Vs. Active (.826). Thirdly, “*Entrepreneurs*” preferred Balance Sheet Focus (.681). This segment also reflected a very different profile from the others, which also supports the segmentation profiles. “*Entrepreneurs*” would be very knowledgeable regarding a variety of investment methods based on experiences with venture capitalists and banks leveraging debt. As “*Entrepreneurs*”, they would also have a different risk/return profile which would support a more active investment style given the level of individualism displayed by this group.

### ANOVA Results

We found that of the nine investment behaviors, seven were significantly different at the 0.05 level. Results are shown in Table 5. The only two investment behaviors that were not significant were “Legacy vs. Social Relationship” and “AUM vs. Commission compensation.” These results reflect that the investment behaviors differentiate between the 4 E Segments a vast majority of the time. Regarding the lack of significance of the Legacy behavior, that is, the client’s preference toward an inter-generational legacy versus a social legacy and the AUM vs. Commission compensation variable both may be an artifact of the sample that was primarly Chinese. A lack of cultural diversity and similarity in inveestment compensation practices of the sample may have lead to a lack for variabiliy in these variables.

## Conclusions

With the private banking sector developing into an increasingly significant segment in the banking world, it is important to acquire an understanding of this form of banking practice. However, research in this area has been limited to date. This paper unveiled some of the secrecy of private banking, following its evolution to serving the “*endowed*” from Europe to the “*entrepreneurs*” in the US and Asia to the new categories of “*executives*” and “*entertainers*.”

Given these segments, we looked further into whether each segment is valid and whether each is distinct and unique. Our evidence obtained from private bankers offered support and we find that there is convergence between investor behaviors and the segments selected. However, model testing and confirmatory factor analysis in future research would lead to much more confidence in using these segments in private banking. Unfortunately, our measurement method did not allow for model testing or confirmatory factor analysis. The results do show that there is a correspondence between investor behavior and segments that will benefit bankers when segmenting their client groups. The ANOVA results lend additional evidence to the ability of the segments to discriminate between behaviors of the clients.

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Figure 1: A Generic “Level-of-Wealth” Segmentation Model of Private Banking Clients.

Table 1: 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 2: 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 3: Descriptive Statistics of Variables in the Survey (n = 51.)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Hypotheses sets | *Endowed* | *Entertainers* | *Executives* | *Entrepreneurs* |
|  |  |  |  |  |
| Network relationship (confidentiality v. information) | 2.49 | 2.59 | 2.92 | 3.47 |
| Legacy relationship (intergenerational v. social) | 2.67 | 2.65 | 2.51 | 3.22 |
|  |  |  |  |  |
| Investment style (discretionary v. active) | 2.73 | 2.33 | 2.98 | 3.90 |
| Compensation (Commission v. AUM) | 3.55 | 3.53 | 3.25 | 3.71 |
|  |  |  |  |  |
| Preserve v. growth | 2.08 | 3.49 | 3.75 | 4.20 |
| Attitude towards risks | 1.80 | 2.78 | 2.76 | 3.47 |
|  |  |  |  |  |
| Use of novel instruments | 2.02 | 3.06 | 2.86 | 3.53 |
| On-shore v. Off-shore | 2.25 | 3.25 | 2.94 | 3.45 |
| Balance sheet focus | 1.88 | 2.10 | 2.47 | 4.37 |

Table 4: Component Correlation Matrix

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  |  | | --- | --- | --- | --- | --- | | Behavioral Characteristics | Endowed | Entertainers | Executives | Entrepreneurs | | Network Relationship | 0.69 | 0.45 | **0.74** | 0.31 | | Legacy Relationship | 0.5 | 0.3 | 0.54 | 0.07 | | Investment Style | 0.65 | 0.58 | 0.58 | **0.83** | | Compensation | 0.34 | 0.62 | 0.45 | 0.63 | | Wealth Build | **0.86** | 0.57 | 0.52 | 0.52 | | Attitude Toward Risks | **0.81** | **0.74** | **0.84** | 0.62 | | Use of novel instruments | **0.78** | **0.83** | **0.76** | **0.85** | | On Shore vs. Off-Shore | 0.65 | 0.44 | 0.64 | 0.64 | | Balance Sheet Focus | **0.75** | 0.43 | 0.43 | 0.68 |   Conclusion: confirm F ~ 9, if corr > 0.5 = sig., ALL, if corr > 0.6, 8F ? |

Table 5: ANOVA analysis of the behavioral relationships

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| **ANOVA** | | | | | | |
|  | | Sum of Squares | df | Mean Square | F | Sig. |
| Network Relationship (Confidentiality Vs Information) | Between Groups | 29.936 | 3 | 9.979 | 4.061 | .008 |
| Within Groups | 491.490 | 200 | 2.457 |  |  |
| Total | 521.426 | 203 |  |  |  |
| Legacy Relationship (Intergenerational Vs Social) | Between Groups | 14.877 | 3 | 4.959 | 2.429 | .067 |
| Within Groups | 408.353 | 200 | 2.042 |  |  |
| Total | 423.230 | 203 |  |  |  |
| Investment Style (Discretionarty Vs Active) | Between Groups | 67.975 | 3 | 22.658 | 11.415 | .000 |
| Within Groups | 396.980 | 200 | 1.985 |  |  |
| Total | 464.956 | 203 |  |  |  |
| Compensation (AUM Vs Commission) | Between Groups | 5.373 | 3 | 1.791 | 1.013 | .388 |
| Within Groups | 353.608 | 200 | 1.768 |  |  |
| Total | 358.980 | 203 |  |  |  |
| Wealth Build (Preserve Vs Growth) | Between Groups | 127.779 | 3 | 42.593 | 27.290 | .000 |
| Within Groups | 312.157 | 200 | 1.561 |  |  |
| Total | 439.936 | 203 |  |  |  |
| Attitude towards risks | Between Groups | 71.804 | 3 | 23.935 | 15.822 | .000 |
| Within Groups | 302.549 | 200 | 1.513 |  |  |
| Total | 374.353 | 203 |  |  |  |
| Use of novel instruments | Between Groups | 60.877 | 3 | 20.292 | 12.505 | .000 |
| Within Groups | 324.549 | 200 | 1.623 |  |  |
| Total | 385.426 | 203 |  |  |  |
| On-Shore Vs Off-Shore | Between Groups | 42.054 | 3 | 14.018 | 8.631 | .000 |
| Within Groups | 324.824 | 200 | 1.624 |  |  |
| Total | 366.877 | 203 |  |  |  |
| Balance Sheet Focus | Between Groups | 197.922 | 3 | 65.974 | 41.437 | .000 |
| Within Groups | 318.431 | 200 | 1.592 |  |  |
| Total | 516.353 | 203 |  |  |  |