

# **The new world of wealth**

Seven key trends for investing, giving and spending among the very rich

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# **Preface**

*The new world of wealth: Seven key trends for investing, giving and spending among the very rich* is a research paper written by the Economist Intelligence Unit and sponsored by Societe Generale Private Banking. The author is Rob Mitchell and the editor is Jason Sumner. The findings are based on 24 interviews with ultra high net worth individuals (defined as those with investable assets in excess of US\$30m), wealth experts, and providers of luxury goods and services. Our thanks are due to everyone who participated in the interviews for this report.

*Note about the text: the phrases “very wealthy” and “very rich” in the report refer to “ultra high net worth individuals” (those with investable assets in excess of US\$30m).*

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## Executive summary—the seven trends to watch

**B**eing wealthy was supposed to be a passport to lifelong financial stability. But after 18 months of nail-biting volatility in financial markets and wealth destruction on a massive scale, the very rich are no longer feeling quite so secure. True, the banking system and global economy are showing signs of stabilisation, but the longer-term future remains uncertain, and this is having a significant impact on the attitudes and behaviour of the wealthy.

The crisis has had a life-changing impact for many of the world's ultra high net worth individuals (those with investable assets in excess of US\$30m).<sup>1</sup> Many have lost their "ultra" tag altogether and have been downgraded to the rank of mere high net worth individual (someone with wealth in excess of US\$1m). According to the 2009 *World Wealth Report*, which is published by CapGemini, a consultancy, and Merrill Lynch, an investment company, the global population of ultra high net worth individuals fell by 24.6% during 2008 to an estimated 78,000. Overall, the wealth held by this cohort shrank by 23.9% from the previous year.

"My impression is that most of the very wealthy are feeling completely at sea right now," said one American ultra high net worth individual interviewed for this report. An acute loss of trust and a rise in uncertainty were running themes throughout the 24 in-depth interviews we conducted.

Such a seismic event was bound to have far-reaching consequences, not just on wealthy individuals themselves, but on the industries that have grown up around them. The luxury goods market, for example, has felt the full force of the crisis. According to Bain & Company, a consultancy, it will shrink by 10% in 2009 after a decade and a half of uninterrupted growth. Wealth management firms and financial advisers have also been severely affected, both by a steep decline in assets under management as a result of market falls and the attrition of funds as disaffected clients move from one institution to another. Philanthropy has also suffered at the very time when demand for donations has increased. Endowment funds have taken a substantial hit from the turmoil in financial markets, with some large universities seeing returns decline by 20% or more. Discretionary giving has also decreased, with the *Chronicle of Philanthropy* expecting a 9% drop in donations to the 400 largest US non-profits in 2009.

But the big question is whether the events of the past 18 months will lead to enduring changes in behaviour among the very wealthy. Is the era of conspicuous consumption over, or is this merely a

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<sup>1</sup>In this report, the phrase "very wealthy" refers to those in the "ultra high net worth individual" category.

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blip in spending habits before normal profligacy is resumed? What long-term changes are the wealthy likely to make to the way they invest their money, and what has been the impact on their relationships with their circle of advisers? How will the world of philanthropy change in response to greater calls for accountability and clear outcomes? Here are the seven key trends identified in this report.

**1. The financial crisis has led to a trust crisis between ultra high net worth individuals and investment experts. In the medium term, there will be more due diligence and hands-on involvement from the very wealthy.**

The very wealthy were more likely to have been exposed to asset classes that performed terribly in the downturn, such as commercial property, and complex, illiquid investments. As a result, their erosion of trust is likely to have been much greater than other investors. The very wealthy have found that trust and transparency are more important than high returns, and in the future they will be asking more questions and in some cases taking more of an active role in managing the investments themselves.

**2. When it comes to where the very wealthy are investing their money, the pendulum has swung from extreme complexity such as hedge funds and derivatives to extreme simplicity such as cash. A desire for better returns will gradually encourage them to return to more complex investments, but these will need to be fully transparent to counter entrenched conservatism.**

The very wealthy expect that returns will fall in a downturn, but in the recent crisis investments were unpredictable, and in some cases behaved exactly the opposite to the way they were intended. Wealth experts believe it is inevitable that the very wealthy will return to more complex products, but for the near future the loss of trust means it will be more difficult to tempt them, even if the stated returns are higher. From their advisers the very wealthy are asking for more streamlined reporting, clearer research and a more holistic view of their needs.

**3. The recession has caused an overall downward trend in philanthropic giving, but most very wealthy individuals intend to maintain or increase their level of donations.**

There is evidence that the downturn has led to a reduction in philanthropy across most income levels in society. At the top of the pyramid, however, those who remain very wealthy following the recession say they intend to maintain or increase giving levels. In some cases this is because they have set up foundations, whose output is not dependent on economic cycles. Most of all, the very wealthy interviewed for this report say that giving is a “state of mind” rather than a result of whether a percentage of their vast overall net worth has been gained or lost.

**4. Despite maintaining their giving levels, the very wealthy have continued to adopt a more business-like approach to philanthropy that is focused on verifying positive societal outcomes and improving accountability in the charitable sector. This trend was present before the crisis, but our research suggests it has been accelerated by the recession.**

The very wealthy want to make sure that their money is going to the people who need it most, having seen examples in the last two decades in which good intentions did not always match the actual outcome. The recession has also made them more conscious about social returns. As a group, the very wealthy often have more time to ensure accountability and give attention to chosen projects.

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### **5. Philanthropy in emerging markets such as India and China is maturing as wealth increases and as governments see the value of harnessing the expertise of wealthy entrepreneurs.**

Philanthropy among the very wealthy is in its infancy in emerging markets such as India and China. In India, the “insecurity” associated with the newly wealthy leads them to keep it within the religion, caste or immediate community. As that insecurity gradually dissipates, observers expect that giving will increase. In China, the government is encouraging philanthropy at the same time as it reduces its own role in paying to solve social problems.

### **6. The so-called new austerity does not apply to the very wealthy. They will continue to spend much the same amount as they did before the downturn, but they will be less flagrant.**

Losing half of a US\$100m fortune does not mean there is necessarily less to spend on luxury, and true to that principle it seems that most of the very wealthy have not cut back. They have changed their spending habits in more subtle ways, however, partly because the recession has caused them to reassess what they really value (such as the quality of an experience versus “bling”) and partly because they are conscious not to appear insensitive to wider economic conditions.

### **7. The very wealthy want luxury goods companies to sell them a quality service and “something that feels special”, over and above the exclusive price tag. This trend began before the crisis but those we interviewed believe the recession has hastened this “flight to quality” in buying habits.**

Buying behaviour among the very wealthy is continuing to shift following the global downturn. They want better, longer-lasting and more environmentally sensitive products. They will pay for experiences and service rather than strictly for products. Opinion is divided as to how long these trends will last. Many expect the desire for visible luxury items to return with the next upturn in the business cycle.

## Investing: The trust crisis

**Trend 1: The financial crisis has led to a trust crisis between ultra high net worth individuals and investment experts. In the medium term, there will be more due diligence and hands-on involvement from the very wealthy.**

Although the turmoil in financial markets affected almost everyone, those at the upper end of the wealth scale by definition lost more. The very wealthy were also more likely to be exposed to some of the most badly affected asset classes, such as commercial property, and to have had investments locked up in illiquid products.

Even highly diversified portfolios turned out to offer little protection. Asset classes that were supposed to be uncorrelated ended up having a high degree of correlation, and many so-called absolute return strategies, which were designed to offer protection against falling markets, proved unable to offset the overall downward trend.

Problems in financial markets were compounded by the high-profile exposure of Ponzi schemes, run by Bernard Madoff and Allen Stanford. Entire fortunes were lost in these scandals and, to exacerbate matters, some wealthy individuals found that they had been exposed to the schemes without even realising it. The fact that these funds had been run for so long without suspicion caused many wealthy individuals to question the due diligence capabilities of their advisers, adding to the atmosphere of mistrust between the two parties.

### **What money can't buy**

A recurring theme pervaded our interviews with the very wealthy—the sense that something important, intangible, and perhaps ultimately irretrievable, had been lost in the last two years of financial turmoil. “I think more than anything we’re looking for someone we can trust, and the higher you go up the wealth scale the more that is the case,” says an ultra high net worth American interviewed for this report. “[Trust] is more important than the returns. Of course, we want a return, but we’re not necessarily looking for very high returns. Just a conservative rate with which we can feel comfortable.”

In our desk research for this report, we did not find survey data that apply strictly to the ultra high net worth category, probably owing to the difficulty of surveying a large enough sample, but recent opinion data from the HNWI category supports the view at the ultra level. According to the *World Wealth Report*,

“We’re looking for someone we can trust, and the higher you go up the wealth scale the more that is the case.”

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46% of HNWI's surveyed said they had lost trust in their primary adviser and an equal percentage in their wealth management firm. More than one-quarter said that they had withdrawn assets or left their wealth management firm in 2008. Trust among the very wealthy is even more likely to have declined because of the greater scale of their loss and the greater likelihood that they will have experienced problems with complex, illiquid products.

### Taking control

The very wealthy are responding to the trust crisis by seeking greater stability in their investments, more understanding of different asset classes and more transparency. They are also seeking more direct control over the investment process. "The crisis has made me more proactive in making decisions myself rather than allowing this to be done through a provider," says Vikas Shah, a UK-based entrepreneur.

James Caan, an investor, entrepreneur and CEO of Hamilton Bradshaw, a private equity firm, expresses a similar sentiment. "Where I've had investments with professional firms and they've failed to deliver, it has made me think even more so that I should do it myself," he says. "At the end of the day, they take a view, which is the same as what I do. If it is my money, and one of us has to take a view, it might as well be me."

Wealth experts we spoke to confirmed the shift. "Clients are much more inquisitive today," says Tarek Khlaf, CEO of Crossbridge Capital, an investment advisory firm that offers wealth management services. "They are better educated, they ask more questions and they want to understand the products much better than before."

Wealthy investors are also much more focused on the small detail of the investment process, and want to understand the nature of the relationship right across the value chain. "Clients are scrutinising the small print, trying to understand potential conflicts of interest because they know that, in the heat of a crisis, that becomes very important," says Andrew Rodger, executive director of Stonehage, a multi-family office.

At a time when financial markets are in turmoil, a stable, long-term relationship with a financial provider counts for a lot. Institutions suffering above-average attrition of relationship managers are likely to suffer more than those with good retention rates. "Clients want to understand what's happening and why, and they want to know that the people they have chosen to manage their assets are taking the reasons behind this turmoil into account while managing their portfolio," says William Drake, co-founder of Lord North Street, a private investment office.

But while dealings between the very wealthy and advisers remain strained, many interviewees expect a stronger, more open advisory relationship to emerge after this difficult period.

**Trend 2: When it comes to where the very wealthy are investing their money, the pendulum has swung from extreme complexity such as hedge funds and derivatives to extreme simplicity such as cash. A desire for better returns will gradually encourage them to return to more complex investments, but these will need to be fully transparent to counter entrenched conservatism.**

In the run-up to the financial crisis, appetites grew among wealthy investors for more complex asset classes and investment strategies. Between 2003 and 2007, assets under management in hedge funds

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ballooned from US\$825bn to US\$2.14trn, according to Barclay Hedge, a research firm. Structured products also increased in popularity, with global sales of retail products in 2007 estimated at more than US\$160bn, according to StructuredRetailProducts.com. “In a bull market, people want to buy things that seem to be doing well, and these are often the most exotic, structured and illiquid investments,” says Adam Wethered, co-founder of Lord North Street.

But the crisis revealed many of the strategies behind these products to be flawed. Hedge funds, which were widely employed in the portfolios of the very wealthy as a way of generating absolute returns, had a particularly bad year in 2008. According to the Credit Suisse/Tremont Hedge Fund Index, leading hedge funds globally returned a loss of 16.7%. Yet the overall losses in hedge funds compared favourably to the losses in many other asset classes—that is, there was a 43% drop in the MSCI EAFE index (non-US developed market stocks) and a 37% decline in the Russell 3000 index of US stocks. Hedge funds may have performed relatively better than many other investments, but investors who did not understand them in the first place became that much more fearful. This fear, coupled with the fact that many funds applied similar investment strategies, exacerbated the downward spiral in asset prices as a major sell-off took hold in late 2008.

The retreat into more straightforward, tangible investments belies a lack of confidence and understanding among very wealthy people. “We were told to invest in hedge funds, so we invested in hedge funds, and then we were told to invest in private equity. But most of these have been failures,” says the American ultra high net worth individual who asked to remain anonymous. “We just don’t know where to go now and cash seems like the best bet because at least there’s not much inflation.”

Certain complex products turned out not to be as liquid as they first appeared. “Some banks put structured products in wrappers that allowed them to be traded, but all they were doing was wrapping something illiquid in a liquid instrument,” says Mr Wethered. “People bought products that they thought were going to behave differently. The things that really damaged trust were cash funds that turned out not to protect cash, fraud where people lost all their money, and structured products where people thought they were getting protection but ended up with Lehman Brothers as a counterparty. These are the things that really break trust whereas adverse market movements are just what you expect in these conditions.”

### **Risk averse, but for how long?**

The trust crisis has encouraged the risk pendulum to swing to the opposite extreme. Risk aversion and a fear of complexity have fostered a desire for simplicity and tangibility among the very wealthy. The retreat to more familiar assets began in 2007, as the first signs of the economic crisis emerged, according to survey data in the HNWI category. According to the *World Wealth Report*, allocation to cash and fixed-income securities among HNWIs increased by 9% to 44% of their overall holdings. In 2008 they increased their allocation to safer assets further to 51% overall. They also increased allocation to real estate, and sought refuge in more familiar, domestic investments. A 2009 survey conducted by the Economist Intelligence Unit among HNWIs encapsulates this trend, with 53% of respondents saying that they will “only invest in what they know”.

“The very wealthy think that this is a good moment to find real estate opportunities and that it is a better investment than leaving it in the bank,” says Nareg Bagdasar of Agence 107, a real estate agency

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“The recession is an interesting market if you are confident of the long-term recovery.”

– James Caan, entrepreneur and professional investor



specialising in luxury waterfront property. “When you buy a property you have a tangible piece of ground. It gives people security.”

Despite record-low interest rates and a rally in the equity and bond markets in the second half of 2009, allocations to cash have remained high among wealthy investors. A survey by Scorpio Partnership, conducted in December 2009, found that the average allocation to cash in the fourth quarter of the year was 33%, compared with 37% in the first quarter.

Allocation to real estate has also remained strong, despite sizeable falls in value across many markets. An Economist Intelligence Unit survey conducted in late 2009 of more than 2,000 high net worth investors found that 35% planned to increase the proportion of property in their portfolios over the next two years, while 48% said that they would maintain the same allocation.

This approach is unlikely to be sustainable for long, however. Several interviewees questioned for this report expect appetites among the very wealthy for more complex products and strategies to return. “In 2009, if you bought government or corporate bonds, you would have had a fantastic return so you didn’t need to stray very far to make money,” says Mr Khat of Crossbridge Capital. “But when those avenues disappear, people will have to go down the risk curve, which, by its very nature, means more complex products to get a return.”

### The psychological hurdle—buying in a bear market

Some advisers point out that the quest for simplicity can lead to the rejection of asset classes and strategies that have the potential to deliver the best returns. “Investors have been put off these asset classes at precisely the time when they should be investing more in them,” says Mr Drake of Lord North Street. “For example, the best time to invest in private equity is usually during a downturn, when people least like wrapping up money for long periods in illiquid investments. Our job is to keep that sense of longer-term perspective.”

Mr Caan has done just that. His private equity company, Hamilton Bradshaw, has invested in nine different businesses in the past 12 months, where normally it invests in about three in any one-year period. He has also bought property and invested in equities. “The recession is an interesting market if you are confident of the long-term recovery,” he says.

Given the broad spectrum of performance by alternative assets during the crisis, it is unsurprising that the very wealthy have mixed feelings about them. An additional problem is that it continues to be difficult to gain access to the best funds, despite the massive wave of redemptions that took place in 2008 and 2009. “The very best funds—hedge funds or private equity—have more demand than supply and do not often take on new or smaller investors,” says David Giampaolo, CEO of Pi Capital, a private equity investment club. “You must be in the top quartile of these asset classes or frankly you should definitely stay out. If the average wealthy person can’t get into those funds, the risk is that they may end up invested in something both poor and illiquid.”

This highlights the importance of careful due diligence in the fund selection process. “People should not back off from complex products, because this is an important way to get returns,” says Bertrand Lavayssière, managing director of Capgemini Global Financial Services. “But the point about clarity and transparency is especially important here.”

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### The whole view

The trust crisis among the very wealthy has prompted managers and advisers from across the wealth management spectrum to re-evaluate their approach to dealing with clients. The interviews conducted for this report suggest that their response breaks down into three main areas: reporting; research; and the structure of the advisory relationship itself.

Quality of reporting emerged as an important issue in our interviews and was also identified as one of four drivers of client retention in the 2009 *World Wealth Report*. "Institutions need to look at the frequency and format of reports," says Mr Lavayssière of CapGemini. "It's not uncommon that some banks will provide reporting that is 100 pages thick. What are clients expected to do with that?"

Instead, there is a recognition that reporting should be more contextualised and tailored to the individual's needs. "Clients want linkages between the objectives, asset allocation and performance," continues Mr Lavayssière. Online tools are also growing in importance, and a number of institutions are investing in web capabilities as a way of enhancing, rather than detracting from, the client-adviser relationship. These new tools can include simulation models, or the ability to combine data from multiple sources.

Also important will be more detailed client research, so that the needs and preferences of wealthy individuals are better understood. A common problem with the relationship-driven model, which relies on one-to-one dialogue, is that it can be difficult to draw broader conclusions about the customer base as a whole. "The industry must start asking clients systematically what they want to know," says Sebastian Dovey, managing partner of Scorpio Partnership, a wealth management research firm. "Only once you've got that insight will you be able to work out the information and product priority of clients."

### Understanding the irrational

Some institutions are building up behavioural finance capabilities in order to improve their understanding of the investment decisions and risk appetites of clients. By combining elements of economics and psychology, behavioural finance examines how cognitive biases and flaws can influence the actions of investors. Armed with this information, and a better understanding of how irrational behaviour can affect investment decisions, advisers may be better able to meet their clients' underlying objectives.

The financial crisis has armed wealth advisers with a whole new set of data to assess how investors and portfolios react to volatile market conditions. Some institutions are using this data to conduct scenario analysis on behalf of clients, so that the risks and potential outcomes of different investment strategies are more thoroughly

understood. "When we take on a client relationship, we spend a lot of time explaining the potential ups and downs and pros and cons of each asset class, how different mixes of those asset classes have behaved in the past, and how they might behave in the future," says Mr Drake of Lord North Street. "We try to give a real dose of reality before embarking on the journey as a whole."

### Outside the usual circle

This may mean taking a more holistic view of the wealthy client's finances, and drawing on the resources and capabilities of other specialists, without sacrificing the personal touch of the relationship manager model. "The relationship manager understands the client's concerns, but bringing in other experts, from real estate or private equity, for example, adds credibility," confirms Mr Lavayssière. "It is pretty clear that the team-based organisation is more effective at retaining clients than single relationship managers."

More broadly, there is a recognition that clients need access to a whole range of experts outside the world of investment. These may include tax, succession planning, philanthropy and investment banking services. "It really boils down to helping families identify what are the correct strategic goals and enabling them to reach them," says Mr Khat of Crossbridge Capital. "The investment piece is just one part of a larger range of things that wealthy families have to worry about."

For individuals at the upper end of the wealth scale, there is an important international dimension to consider. The very wealthy are likely to earn money in multiple jurisdictions, spend time in several different countries each year and have complex offshore and onshore ownership structures for different assets. "You need people who are really capable of keeping your affairs in good order," says Mr Rodger. "It's not just a question of getting good advice, you need to make sure that your life is managed in a way that complies with that advice."

With governments around the world facing severe fiscal constraints, tax is becoming an increasingly important issue for the wealthy. "At some point, governments are going to come knocking on various doors to try to fill the gap in their finances," says Mr Rodger. "Wealthy international families will figure reasonably high on the list of people that they would like to talk to."

This highlights the importance of taking a bird's eye view of the wealthy individual's financial affairs. David Alexander, CEO of AAG, a wealth management boutique, uses the analogy of a general practitioner in medicine, who has enough knowledge to spot opportunities and risks, but knows when to bring in specialist expertise. "It's important to have a more holistic approach," he explains. "I don't think you can give objective advice if you don't know the whole story."

## Giving: Owning the outcome

“Just because you have more or less money, it does not mean you will give more or less. Giving has a state of mind and when you have understood that part, you will give irrespective of how much money you have.”

— Aditya Jha, entrepreneur and philanthropist



**Trend 3: The recession has caused an overall downward trend in philanthropic giving, but most very wealthy individuals intend to maintain or increase their level of donations.**

A downturn is always a difficult time for the charitable sector. As individuals from across the full spectrum of wealth feel the pinch, it is a natural response to pull back from philanthropic endeavour until better times return. The irony, of course, is that straitened economic conditions increase the need for aid and donations to protect those who have been most affected.

Research by Giving USA Foundation has investigated the impact of previous recessions on charitable giving in the US. It found that adverse economic conditions coincided with a fall in philanthropy, but that donations do not usually drop by as much as market contractions. In the most recent recessions lasting longer than eight months, which occurred in 1970, 1974, 1982 and 2001, donations fell by an average of 2.7%.

In the current downturn, there is conflicting data on the impact of recession on philanthropy. On the one hand, the growth of philanthropy and expansion of wealth worldwide has created a powerful momentum that seems relatively resistant to a turn in the economic cycle. In the UK, for example, the top 30 donors collectively pledged £2.6bn in 2009, compared with £1.2bn in 2007, according to the *Sunday Times* Giving List. On the other hand, foundations and endowments depend in part on the performance of the financial markets. This has left them brutally exposed to adverse movements in the main asset classes. According to the US Foundation Center, assets held by US foundations fell by 21.9% in 2008 from the previous year. Although this is considerably less than the decreases in many of the world's stockmarkets, it nevertheless places severe constraints on the work that the charitable sector can fund.

The poor performance of endowment-style funds could also deter further donations from the very wealthy because benefactors may fear that their money gets swallowed during adverse market swings and does not reach the intended recipient. “Many people feel let down by the big institutions even if they themselves have made the same mistakes [with investments],” says the American ultra high net worth individual who declined to be named. “With big endowments, the feeling is that all I did was give to this big pot but the pot shrank.”

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### Little effect at the top of the pyramid

Most of the very wealthy questioned for this research are adamant that they will maintain, or even increase, their level of donations in the wake of the financial crisis. Aditya Jha, a Canadian entrepreneur and philanthropist, points out that the desire to become a philanthropist is not automatically tied to the level of individual wealth. "Just because you have more or less money, it does not mean you will give more or less," he explains. "Giving has a state of mind, and when you have understood that part you will give irrespective of how much money you have."

Anant Koppar, an Indian entrepreneur and philanthropist, says that he has not changed the amount of money he donates, but admits that he has become more cautious about where it goes. He notices the same trend when trying to raise money for his own foundation. "There is more control on the money that is spent on philanthropy rather than a reduction in the money that is donated," he says.

Rohini Nilekani, one of the most prominent philanthropists in India, believes that there is no justification for a decrease in donations, despite the financial crisis. "Given that most philanthropists in India are giving away only a tiny fraction of their wealth, I see no reason for a slowdown in philanthropy," she says.

Despite their own pledges to maintain donation levels, the very wealthy questioned for this report believe that much more needs to be done to encourage private philanthropy, especially since governments around the world may be unable or unwilling to play such a large role in the future. "As a society, we need to think about what we need to do to motivate private individuals to give more," says Mr Jha. "I think this problem has been there before the crisis and now the need is much greater for people to give."

**Trend 4: Despite maintaining their giving levels, the very wealthy have continued to adopt a more business-like approach to philanthropy that is focused on verifying positive societal outcomes and improving accountability in the charitable sector. This trend was present before the crisis, but our research suggests that it has been accelerated by the recession.**

The downward pressure on donations caused by the financial crisis, coupled with long-standing concerns about the effectiveness of some charitable institutions, is accelerating the shift towards a more business-like focus to philanthropy among the world's wealthiest individuals. This trend is best exemplified by the "philanthrocapitalism" of Bill and Melinda Gates, who run the world's largest private foundation, and Warren Buffett, who pledged most of his US\$44bn fortune to the Gates Foundation in 2006.

There was unanimous agreement among those interviewed for this research that the recession has intensified the business-like, hands-on approach being adopted in philanthropy. "I am far more directly involved in charitable projects than just writing cheques," says Mr Caan of Hamilton Bradshaw. "Five years ago, I would have given to an educational charity. Now, I will find a piece of land, buy it, build a school, buy a mini-bus, own the land and pay the teachers. It becomes my project."

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Whether they take such a direct role or not, the very wealthy are increasingly expecting to know how the money they have donated has been spent. “Rather than just writing a cheque and forgetting about it, clients want to see and understand where their money has gone,” says Mr Khlaf of Crossbridge Capital. “They view it like an investment in a company.”

“There’s more focus,” says Alec Reed, founder of Reed Recruitment and the Big Give, an online portal that aggregates more than 6,000 charities. “People are becoming more intelligent about giving and more proactive than reactive.”

This is particularly true of entrepreneurs, who want to see the same rigorous approach to investment and management that they have applied in their business transplanted to their philanthropic endeavours. “Entrepreneurs have wealth but they always remember the value of money,” says Mr Jha. “That is why active participation is very important. I have a relatively small foundation but I am much more involved and hands on because not only does this improve efficiency but my presence adds resources in numerous ways.”

### Clear outcomes

As with investments, the trend of demanding more trust, transparency and understanding applies to charities too. One way in which charities are responding to the demands of wealthy donors is to restructure their operations into projects. This makes it easier to track and measure outcomes and is more closely aligned with the approach that entrepreneurs take with their own businesses. “Charities find it easier to be transparent when people are investing in specific projects,” says Mr Shah. “As a charitable investor, you’re able to get more involved and use business logic to help these projects move forward.”

Wealthy individuals can also turn to organisations, such as New Philanthropy Capital, or the Institute of Philanthropy, for advice on giving. New Philanthropy Capital, which was founded by four former Goldman Sachs partners, evaluates the performance of charities and provides advice to donors on their effectiveness.

For charities and non-governmental organisations (NGOs) on the receiving end of this new entrepreneurial zeal, it can be a difficult learning process. “Some charities are complaining that donors are interfering with their work,” says Darwin Chen, a board member of the Asia-Pacific Philanthropy Consortium and honorary chairman of Habitat for Humanity China. But this requirement for a more cost-conscious, business-like approach is having a positive impact. “In the past, charities and NGOs have had *carte blanche* but now they have to be more accountable.”

Wealth advisers, too, are gradually responding to the changing world of philanthropy. “For many banks, philanthropy services are really just a cost base and are not fully integrated in the wealth management offering,” says Sebastian Dovey, managing partner of Scorpio Partnership, a wealth management research firm. “In reality, money that wealthy clients allocate to philanthropy is often poorly engaged, and wealth advisers could play an important role in structuring these donations.”

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### More than just moral returns

Just as wealthy entrepreneurs are imposing a more business-like focus on the causes they support, so there is a growing interest in investment that both generates a return and achieves a social or environmental goal. So-called impact investing lies somewhere between philanthropy and pure investment. It involves placing capital in businesses or funds in order to achieve a social or environmental objective but also to generate a return. In recent years, this sector has been quietly attracting funds from ultra high net worth individuals who are keen to complement existing philanthropic work with a more investment-focused activity.

Destinations for impact investment can include microfinance, green technology, community housing or healthcare. For example, the International Finance Facility for Immunisation, which was launched in 2006, has raised US\$2bn in triple-A-rated bonds for the provision of vaccines around the world.

Geoff Burnand, CEO of Investing for Good, a specialist provider of impact investment services to private banks, asset managers and foundations, confirms that interest among the very wealthy is growing. "Impact investing enables you to build a deep connection with the difference your money can make either locally in the community or globally with poverty alleviation or environmental issues," he says.

Returns from impact investing can compare favourably with traditional investment, particularly during a period of record-

low interest rates and volatility in equity markets. "Often, these are debt-yielding assets that can yield 5% plus and have fixed maturities," explains Mr Burnand. "Debt is handy because it matures and has a yield. Equity has the problem of exit and valuation."

With the exception of cash investment, maturities vary from as little as two years up to fifteen. "Most investors are coming in because they are attracted by the mission, so they're prepared to buy and hold," says Mr Burnand. "What is important to these investors is the ability to measure and rate the 'blended return' of these investments."

It is difficult to put a figure on the size of the impact investment market, because it represents quite a diffuse set of activities, but proponents argue that the potential is large. According to a recent report from the Monitor Institute, impact investing could grow to around 1% of professionally managed global assets, which currently would be equivalent to US\$500bn.

Over time, Mr Burnand hopes to see the development of funds and risk-adjusted products in the impact investing space. Also important will be the creation of secondary market liquidity, so that assets become tradeable.

Not everyone, however, is supportive of the concept. "There is a moral issue to consider," says Mr Shah. "Are we engaging in impact investing because we want to get a return or because we want something to get done? Most companies are pitching impact investment as a fund product so most investors will treat it as such. Where people are willing to pull money out of a social investment, the morality of that investment has to be questioned."

### **Trend 5: Philanthropy in emerging markets such as India and China is maturing as wealth increases and as governments see the value of harnessing the expertise of wealthy entrepreneurs.**

At a recent gathering in India designed to promote philanthropy, Sonia Gandhi, Congress party leader, pointed to her country's long, but uneven, history of philanthropy. Charitable work is embedded in the fabric of society, but is typically directed rather narrowly at the needs of an individual's religion, caste and community. There are exceptions, of course. Two-thirds of Tata Group, an Indian conglomerate, is owned by charitable trusts, while Azim Premji has pledged US\$125m worth of shares from Wipro, the business process outsourcing company that he chairs.

Notwithstanding these prominent examples, many wealthy individuals in India are disappointed by the slow development of philanthropy on the sub-continent. "Because of the inheritance tradition in India, large, individual philanthropy is limited and not what it should be," says Suresh Neotia, who recently retired as chairman of Gujarat Ambuja, one of the top three cement companies in India. Ms Nilekani believes that the reluctance of wealthy Indians to commit to philanthropic endeavour

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“Many newly wealthy also lack the confidence that this wealth is here to stay. It needs a little longer for that comfort to become sufficiently strong and to realise that they have a greater responsibility to give back to society.”

— Rohini Nilekani,  
philanthropist



comes down to strong family ties and a perceived lack of security. “Indian business is very family-oriented and, because the external environment for business was so uncertain until quite recently, I think a lot of money stayed within the family,” she explains. “Many newly wealthy also lack the confidence that this wealth is here to stay. It needs a little longer for that comfort to become sufficiently strong and to realise that they have a greater responsibility to give back to society.”

As India continues to liberalise, it is inevitable that the government will continue to pull back from its role of providing a social safety net. This is true not only in India, but in other emerging markets that are adopting a more free-market approach. Deteriorating public finances in those emerging markets that do not have large surpluses are compounding the problem. “The world needs more support and governments will not be in a position to provide it,” says Mr Jha. “Private individuals have more wealth than before but they are not doing enough to give it back.”

Ms Nilekani believes that stronger collaboration between NGOs and business is required to fill some of this vacuum. “The state has been talking about pulling back and handing over some of its responsibilities to either the corporate sector or to NGOs,” she says. “There needs to be more dialogue between mainstream NGOs, the state and business.”

### Chinese philanthropy—government-backed

In China, the development of philanthropy is following a different path. The liberalisations that began in 1978 have created huge wealth, but they have also widened inequality, particularly between urban and rural areas. The price of this rapid development has been growing social unrest, including ethnic rioting in the western province of Xinjiang that left 200 people dead in July 2009. A recent report by the Chinese Academy of Social Sciences, a leading think tank in China, highlighted the growing problem of social unrest, and pointed to a 15% increase in reported crime.

Mr Chen of the Asia-Pacific Philanthropy Consortium says that the Chinese government increasingly sees philanthropy as a tool to maintain social order and paper over concerns about growing wealth inequality. “President Hu Jintao has explicitly said that philanthropy is an excellent way to improve social harmony and alleviate poverty,” he says. “It has become government policy to promote and encourage philanthropy and this is now done at every level of government.”

Certainly, charitable donations are on the rise in China. A recent report by Jia Xijin and Zhao Yusi of the NGO Research Center at Tsinghua University in Beijing found that donations in 2008 reached Rmb107bn, or US\$15.7bn, three times their level the previous year. A large part of this increase, however, can be attributed to the response to the Sichuan earthquake that year.

Just as wealth is increasing rapidly in key emerging markets, so the environment for philanthropy is maturing—even if there are different drivers behind its development. “A lot of people are taking a leaf out of Western philanthropy,” says Ms Nilekani. “Much of the new wealth is being created in a more modern, business-like set-up so people from that background are bringing their expertise into the charitable sector.”

## Spending: Gone to ground, for now

“The wealthy have developed a conscience. This has been a good thing because it makes people think about how they engage with the rest of society and about what is and isn’t appropriate behaviour.”

– Vikas Shah, entrepreneur



**Trend 6: The so-called new austerity does not apply to the very wealthy. They will continue to spend much the same amount as they did before the downturn, but they will be less flagrant.**

The luxury goods market has been hit hard by the economic downturn. According to Bain & Company, a consultancy, sales of luxury goods will be down by 10% in 2009 to €154bn. This follows more than a decade of constant expansion in real terms, as the industry took advantage of the democratisation of wealth and expanded into fast-growing emerging markets.

“In general, the same consumer in 2008 bought much less in 2009,” says Claudia D’Arpizio, a partner at Bain & Company. “This had a tremendous impact on the profitability of luxury goods firms.” The only region that was an exception to this downward trend was South-east Asia, and China in particular, which posted an overall growth in sales during 2009.

High-ticket luxury items, such as private jets, have suffered a significant downturn in demand. According to an article in *The Economist* published in January 2009, the number of used private jets for sale around the world had risen by 62% compared with a year previously. Sales were also subdued in the yacht and luxury car markets.

As the crisis took hold, there was much talk of a “new austerity” among the super-wealthy, and a suggestion that conspicuous consumption may be on the wane. On a shopping trip to Hermès, a luxury retailer, Kathy Fuld, wife of Dick Fuld, a former CEO of Lehman Brothers, famously asked for her purchases to be wrapped in a plain white paper bag. Net-à-Porter, a luxury online retailer, offers its customers the option to have purchases despatched in a plain paper wrapper, rather than one displaying the logo.

“The wealthy are more conscious of conspicuous consumption,” says Rachel MacLynn, a psychologist and head of membership for Seventy Thirty, an exclusive introduction agency. “They worry more that they can’t be seen to be frivolous with money because it’s seen as distasteful.”

Several of those interviewed for this research suggest that there is greater sensitivity among the wealthy around conspicuous consumption. “I think there is more of a consciousness around

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spending and ostentation, and that people should be a bit more understated and conscious of their wealth,” says Jos White, an entrepreneur and co-founder of Notion Capital, a venture capital fund. Mr Shah agrees. “The wealthy have developed a conscience,” he says. “This has been a good thing because it makes people think about how they engage with the rest of society and about what is and isn’t appropriate behaviour.”

But this greater sensitivity does not imply that the very rich are necessarily spending less. Instead, they are just going about it in a less conspicuous way. Hugh Devlin, a consultant at Withers, a law firm, says that a distinction must be drawn between the luxury business as a whole and the market for the very wealthy. “A lot of the downturn in sales that these companies have experienced has come from the middle classes, for whom these brands were an aspirational and expensive purchase,” he explains.

It would be wrong therefore to conclude that the very wealthy have cut back on spending. “When we saw the initial downturn, there were a lot of incorrect assumptions made,” says Mr Devlin. “People anticipated a cutback in spending, but in fact we have seen sales growing in some sectors of the luxury market. Among the very wealthy, they may be buying less, but they’re probably still spending the same.”

Those interviewed for this report suggest that there is a shift in buying behaviour. Conspicuous logos and mass-market luxury goods are being replaced with a more “smart” approach to shopping that favours high-quality, but lesser-known brands. “I think it’s just moved off radar,” notes Mr Shah. “There’s not any particular reduction in spending but the nature of what people buy has changed. It may be less about wearing a branded luxury suit and more about wearing a beautifully tailored suit that you know is the best quality you can buy. There’s a flight to quality just as there is in the investment markets.”

John Ueberroth, chairman of the board and CEO of Preferred Hotel Group, agrees. “What has changed is the idea of excess and paying any price for things that may not be of value,” he says. “In addition, they are more conscious of the perception that comes along with spending on luxury items and looking for more value. I don’t believe that things have changed dramatically, it is just more focused on inconspicuous consumption.”

The motivations for spending may have changed too. Previously, heavily branded luxury goods, ostentatious watches and other expensive products were, in part, a way of displaying wealth. “When wealthy people spend US\$5,000 on a handbag, it is really saying that they can do something that other people cannot,” says Isaac Mostovicz, an academic who specialises in the luxury goods industry.

Instead, the enjoyment of luxury has become more intrinsic. “There’s nothing wrong with enjoying things that you have, but the motivations have to be because you value that object rather than because you want other people to know you have wealth,” says Mr Shah.

Compared with the luxury goods market, sales of luxury services have generally held up well during the downturn. “For wealthy people, the biggest luxury is time,” says Mr Devlin, “so services that enable these individuals to spend that time in the best way possible continue to be in demand. It’s not necessarily about having the most lavish time—in some cases, the wealthy may be willing to pay a premium for simplicity, such as a simple cottage on the perfect beach.”

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### **Trend 7: The very wealthy want luxury goods companies to sell them a quality service and “something that feels special”, over and above the exclusive price tag. This trend began before the crisis but those we interviewed believe the recession has hastened this “flight to quality” in buying habits.**

Business school academics will tell you that the best way of dealing with a downturn is to cut costs, manage inventory and adjust pricing in order to boost revenue. All good advice, but for luxury goods companies the options in all three areas are relatively limited.

Although luxury goods companies have responded to the downturn by cutting costs where they can, there are limits to what they can do. “You have to remember that the bulk of their costs are fixed,” explains Ms D’Arpizio of Bain & Company. “They have a huge network of stores in expensive locations around the world, and they have to maintain their investment in marketing and branding in order to justify the premium price.”

Neither can quality be compromised. It may be expensive to source the best raw materials and craftsmanship, but this is precisely what gives luxury goods their cachet. Cutting costs in the manufacturing process would have a very negative impact on the brand. In a 2008 survey of individuals with wealth in excess of US\$3m conducted by the Economist Intelligence Unit, product quality was the most important factor influencing purchasing decisions.

The second tool that luxury goods companies can apply during a downturn is discounting. But again, the industry has traditionally been reluctant to do this, fearing that it will affect the willingness of customers to pay the full price in the future. Luxury goods companies typically keep a tight rein over their distribution channels in order to prevent discounting by third parties. But there are limits to their control; in November 2009, Saks Fifth Avenue, an upmarket US department store, cut prices on designer goods by up to 70%. Rival stores had little choice but to follow suit.

#### **Especially for you**

In the absence of the more traditional downturn-busting strategies, the luxury sector has been forced to be more creative in its approach. A good starting point for many has been to improve their understanding of customer behaviour. Early in the downturn, a lack of customer insight caused problems for many luxury goods companies in terms of their ability to forecast demand. This meant that they often got inventory levels wrong, and either had too little stock or too much. “Companies have been studying the reaction of their customers to the downturn in order to have more analysis so that they could react from a marketing standpoint,” says Ms D’Arpizio.

With limited flexibility on pricing, luxury goods companies have been forced to work harder in order to maintain their share of wallet from the wealthiest customers. For many, this has meant improving service levels or introducing new levels of exclusivity. “Luxury goods companies have to make their wealthiest customers feel special,” says Mr Devlin of Withers. “We’ve seen design conglomerates having to try harder to relate to their ultimate customer. It might be through after sales service, or it might be doing things to make people feel better about spending money.”

Luxury goods companies have long considered online channels to be anathema to this kind of

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one-to-one service, and have been slow to adopt an e-commerce model. According to a 2008 report from Forrester Research, just one-third of luxury goods companies sold their products online.

But demands from an increasingly young, tech-savvy customer base, coupled with a preference for some customers to make purchases in private, are challenging this model. According to Bain & Company, sales of luxury goods online rose by 20% year on year in 2009, despite a decline in sales for the sector overall. "Previously, luxury brands were sceptical about e-commerce but many of them now recognise that it will be an important channel in the future, particularly for sectors such as working women and younger customers," says Ms D'Arpizio.

The sector is also responding to growing consumer interest in sustainability and the environment. In this respect, luxury goods companies have an intrinsic advantage because their products are designed to be durable and long-lasting, rather than something to be discarded after one season. Some brands are making much of this in their marketing. Patek Philippe, a Swiss watchmaker, for example, advertises its watches as being something that you never actually own, but merely look after for the next generation.

Over the long term, the downturn is unlikely to affect spending levels among the wealthy on luxury goods and services. "I think people's memories are incredibly short," says Mr Caan of Hamilton Bradshaw. "Once confidence in the economy and its growth prospects returns, I am sure spending will return to pre-recession levels." But buying behaviour among the very wealthy is shifting subtly, and luxury goods companies will need to respond to these changing demands.

## Conclusion: The influence of wealth

Ten years ago, the ultra high net worth category was a niche demographic clustered around a handful of wealth centres in developed countries. Today, the very wealthy are spread around the world and are growing most quickly in markets such as India, China and Russia—countries where they barely existed just 20 years ago. Whole industries have built up to service their needs, and their influence can be felt strongly in the world of investment, consumer goods, property and philanthropy.

The current economic downturn has had a dramatic impact on the population of ultra high net worth individuals and their wealth. But while those numbers can be measured, changes in behaviour are more difficult to predict and understand, not least because there is no historical data on which to draw. Wealth has never been so democratised as it is today, so the response of this group to unprecedented economic conditions has never been observed.

Although still in uncharted waters, it is clear that the behaviour of the very wealthy is shifting. Across investment and philanthropy, there is greater scrutiny, a more questioning approach and higher expectations of transparency. In the case of spending on luxury goods and services, the key is not how much is spent, but the quality and durability of the product or experience. Consumption may no longer be conspicuous, but luxury continues to be enjoyed.

A growing proportion of the wealthy are entrepreneurs, and they are transferring their skills, expertise and desire for control onto the aspects of their lives that they see as most important. They are more hands-on with their investments, and want to play an active role in philanthropy, rather than just writing a cheque. There is a focus on achieving outcomes and a willingness to embrace innovation, so long as the process is transparent and clearly understood.

Despite the massive wealth destruction that has been seen over the past 18 months, the ultra high net worth category has suffered only a temporary setback. With wealth forecast to rise again, and economies on the mend—albeit at considerably different rates—this category will continue to grow in influence around the world. Wealth advisers, charities and luxury goods companies alike are competing more intensively than ever for this highly demanding clientele. To succeed over the long term, they need to excel in the service they offer and the outcomes they deliver.

## Appendix: Interviewee profiles

*The Economist Intelligence Unit interviewed 11 ultra high net worth individuals and 13 wealth experts.*

### Ultra High Net Worth Individuals



**James Caan** (formerly Nazim Khan) is a British entrepreneur of Pakistani origin from Lahore. He is CEO of Hamilton Bradshaw, a private equity firm, and has been building and selling businesses since 1985. In October 2007, Mr Caan joined the panel in the fifth series of BBC Two's *Dragons' Den*. Having founded the Alexander Mann Group in 1985, a recruitment company with a turnover of £130m and operations in 50 countries, he sold the company in 2002. Mr Caan also co-founded Humana International, an executive head-hunting firm, with his partner, Doug Bugie, growing the business to over 147 offices across 30 countries between 1993 and 1999.



**David Giampaolo** is CEO of Pi Capital, a private equity investment club with around 300 members who are all leading entrepreneurs or business figures. He is also a shareholder and on the board of Fitness First, the world's largest health club operator, which is majority owned by BC Partners, one of the leading buy-out firms in the world.



**Aditya Jha** is a Canadian entrepreneur and philanthropist of Indian origin who currently lives in Toronto, Canada. He is also the National Convenor for Canada India Foundation, a public policy advocacy group. After a successful career as general manager of Bell Canada, he co-founded a software company, Isopia, which was acquired by Sun Microsystems for US\$100m in July 2001. He currently owns Karma Candy Inc., a confectionery manufacturing business, and supports philanthropic causes through his private charitable foundation.



**Anant Koppa** is a serial entrepreneur and philanthropist from Karnataka, India. He was the founder president of Kshema Technologies, one of India's first venture capital-funded software services companies.



**Suresh Neotia** is the chairman emeritus of Ambuja Cements in India, a member of the central board of directors of the Reserve Bank of India, and a prominent philanthropist.



**Rohini Nilekani** is one of the most prominent philanthropists in Asia. She is founder and chairperson of Arghyam, a charitable trust she has endowed to fund initiatives in water and sanitation. She is also founder and chairperson of Pratham Books, which seeks to democratise the joy of reading for children. From 2002 to 2008, she was also chairperson of the Akshara Foundation, which works in elementary education in Karnataka. She also sits on the boards of many non-profit organisations and funds work in education, health, the environment and microfinance.



**Alec Reed** is the founder of Reed Specialist Recruitment. He is a serial social and commercial entrepreneur and the founder of the Big Give, a website that helps philanthropists find charitable projects in their area of interest.



**Vikas Shah** is an award-winning entrepreneur, with interests in sectors ranging from textiles and luxury brands, to financial recruitment, design & technology consulting, e-commerce, importing, publishing and, more recently, leisure.



**John Ueberroth** is chairman of the board and CEO of Preferred Hotel Group. He brings more than 30 years of executive-level experience to the leadership and global growth of Preferred Hotel Group and its family of brands. Prior to acquiring PHG, John was CEO of Ambassadors Group, whose educational travel programmes provide students and professionals with opportunities to meet their counterparts overseas. He continues to serve the organisation as chairman of the board.



**Jos White** is an entrepreneur and co-founder of Notion Capital, a venture capital fund and advisory business that focuses on early to mid-stage growth businesses in the Internet-based services sector. He co-founded MessageLabs in 2000, which was acquired by Symantec in late 2008 for around US\$700m, marking the second-largest transaction for a private company in the history of the IT security industry.

**Anonymous ultra high net worth individual**

A US-based fund manager.

**Wealth experts**

**David Alexander, CEO, AAG**

Wealth management boutique.

**Nareg Bagdasar, Agence 107**

Luxury property development.

**Geoff Burnand, CEO, Investing for Good**

Fund manager that specialises in ethical investment.

**Darwin Chen, APPC board member and art philanthropist**

Deeply involved in arts philanthropy in Asia. Board member of the Asia-Pacific Philanthropy Consortium and honorary chairman of Habitat for Humanity China.

**Claudia D'Arpizio, Partner, Bain & Company**

Strategy consulting firm.

**Hugh Devlin, consultant, Withers, law firm**

Law firm representing a large number of wealthy private clients.

**Sebastian Dovey, Scorpio Partnership**

Wealth management research firm.

**William Drake and Adam Wethered, co-founders of Lord North Street**

Multi-family office.

**Tarek Khat, CEO, Crossbridge Capital**

Wealth management boutique.

**Bertrand Lavayssière, managing director, Global Financial Services, CapGemini**

Management consultancy.

**Rachel MacLynn**

Psychologist and head of membership for a matchmaking service for the wealthy.

**Isaac Mostovicz, consulting academic and former CEO of a diamond company**

Wealth expert.

**Andrew Rodger, executive director, Stonehage**

Multi-family office.

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