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Master Thesis

The Development of Value Drivers in the Swiss Private Banking Sector

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Executive Summary

I Problem Statement and Objective Target

In recent years, the Swiss private banking industry experienced large-scale changes, with significant consequences for its players. Within the last ten years, the sector faced new challenges due to regulatory decisions as well as political actions, besides facing the effects of the financial crisis. The transformation of the sector goes so far that it is even referred to as a paradigm shift (Strähle (2011)). This master thesis aims at identifying the major events that caused these changes in the market and analyzing their actual impact on the value of private banks in Switzerland, by using a specific set of value drivers. It is a goal to examine which components of value generation are affected by the different changes and how this influences the value driver framework.

Additionally, the thesis analyzes the influence of the value drivers on the prices in merger and acquisition transactions to examine the significance of these key figures in the acquisition process. Furthermore, the existence of size effects in private banking is covered, as it is analyzed whether economies of scale or size effects exist in the private banking sector and how they affect the pricing of private banking institutions.

II Approach and Methodology

At first, the thesis provides an overview of the valuation of private banks and introduces the financial value driver framework, which is the foundation for the empirical models. It explains the interactions and interpretation of value drivers and how they contribute to the value of private banks. Additionally, the thesis discusses the influence of operating costs and operating income as two of the main components of the value tree and shows inherent characteristics of the Swiss private banking industry and their possible influence on the value tree. Afterwards, major market environmental changes, as well as political and regulatory developments for the industry are presented and in addition, their possible influence on the value-tree framework is discussed.

The empirical part is based on two data sets. The first set about the value drivers consists of annual figures for Swiss private banks during the time period from 2006 to 2010. The sample

includes key figures and value drivers from the annual reports of the respective banks. By using panel regressions, where each group consists of one bank with 5 annual observations from 2005 to 2010, the empirical analysis aims at identifying the influence of the four events on various parts of the value-tree and thus, the value of the private banks. The second empirical part examines the influence of value drivers on merger and acquisition transactions. The sample consists of data about 18 merger and acquisition transactions in the Swiss private banking sector within the time period from as early as 2004 to the beginning of 2011. Through suitable multiple regression models, the analysis examines which value drivers of the tree framework have an influence on the transactions prices. The empirical blocks also test, whether the events support the formation of size effects and if acquirers are willing to pay more for larger institutes, which would indicate that practitioners believe in the existence of such size effects.

III Results

The thesis identified the financial crisis, the tax scandal because of stolen customer data, the Scudo Fiscale and the implementation of FATCA as the main changes for the industry. The empirical analysis of annual key figures from the value-tree framework showed that the examined events indeed had a negative impact on the value drivers, with the Scudo Fiscale, the tax scandal as well as the implementation of FATCA all increasing the operating costs, and the cost-income ratios and thus, decreasing the net margins. This led to a decrease in value. Additionally, it could also be shown that the Scudo Fiscale significantly reduced the volumes of net new money, which also, negatively influenced the values of affected private banking institutions. Furthermore, the empirical models showed that the financial crisis led to a significant turnover within the industry, where previously bad performing banks actually benefitted from the crisis and thus outperformed their peers during the financial crisis. Further analyses to test, whether larger banks were more able to deal with the challenges caused by the events, showed mixed results and thus, provided no convincing evidence of the existence of size effects.

The second set of empirical models, analyzing the influence of value drivers on transaction prices, revealed that major branches of the value tree framework, like the revenue

generation - represented by gross margin - and AuM - through net new money - significantly influenced transaction prices, tying the value framework to paid prices for private banks. Interestingly, the operating costs and thus operating performance as a whole measured directly or indirectly through the cost-income ratio, net margin or even return on equity has no significant impact on the transaction price. According to these results, the main negative impact of the described events, which hit the operating costs, seems to not have led to changes in transaction prices. Overall, this master thesis provided a detailed overview of the major developments of the private banking sector and its value drivers, to help to understand the thorough changes that affected the industry in the last six years.