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Robo-advisory: Key to the Untapped Mass Affluent Market

Over the past few years, a new wave of digital wealth management FinTech firms offering automated investment advisory services have started to gather the attention of the industry. This automated investment advisory solution has seen substantial market share growth over the past few years, and is projected to gain even more traction going forward (1 and 2)[1].These firms eliminate the need for a dedicated human advisor by leveraging client analytics, algorithmic portfolio allocation, and a simplified user experience to develop automated investment recommendations that are personalized to the needs of individual clients.

Most of the discussions on this topic have been around how such emerging FinTech firms will disrupt and challenge traditional wealth management services. Contrary to the popular view, we believe the dominant trend would be one of collaboration which will enable banks to improve their service offering and build up new revenue streams using these robo-advisory services. This article provides insights into why banks should leverage on this oncoming wave of robo-advisory to serve the various client segments, starting with Mass Affluent.

Understanding Robo-advisory

Robo-advisors refer to the digital equivalent of investment managers. The robo-advisory service leverages technology to automatically allocate client investments across different asset classes, based on clients' risk profiles and financial goals. This personalized investment advice is largely automated and can be provided with minimal or no human intervention.

The advisory process for most robo-advisors is simple. Investors are required to complete an online questionnaire comprising of questions targeted to gauge their financial goals, risk tolerance and investment horizon. Based on the risk profiling and key tenets of the Modern Portfolio Theory, the algorithm proposes an investment portfolio to the investor consisting of various asset classes such as equities, bonds, etc.

More often than not, robo-advisors predominantly offer Exchange Traded Funds (ETFs) due to their simplicity and exposure to a diversified range of underlying instruments at a lower expense ratio. Once an investment proposal is generated, the investor has discretion over the decision on whether to proceed with the execution. Rebalancing of the portfolio is then performed based on market movements or predefined schedules to ensure that portfolio remains congruent with the investor's risk profile.

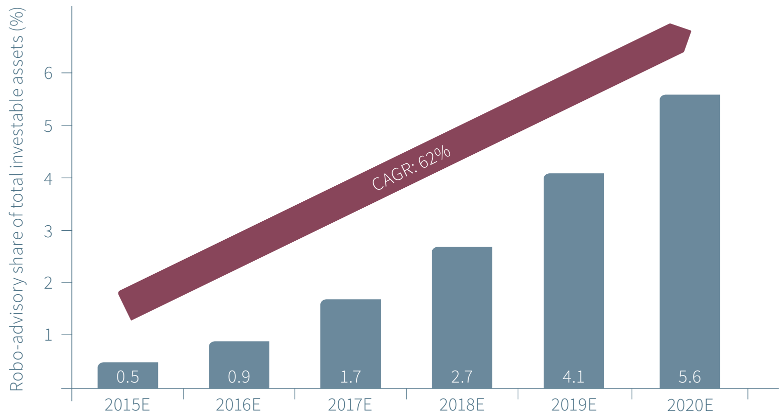

Figure 1: Global projected robo-advisory adoption rate

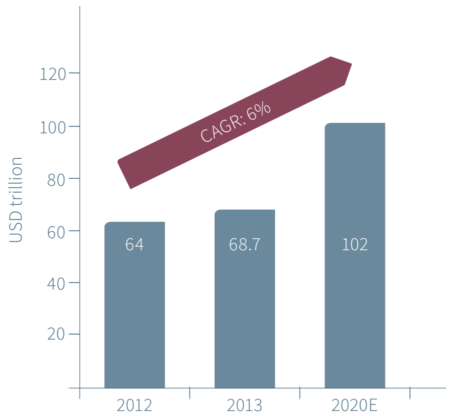

Figure 2: Global historical and projected AUM for Digital Wealth Management

[1] FTPartners, «Are the robots taking over? The emergence of Automated Digital Wealth Management Solutions»

Key Value Propositions of Robo-advisors

Robo-advisory platforms differentiate themselves by offering their investors minimal capital requirements, low management fees and a simplified investment journey.

Minimal capital requirements: Some robo-advisors provide advisory services for capital investments for as low as $50. Advanced pooling technologies make it possible for investors without a large capital to get started and build up their investment portfolio, hence addressing the needs of a new segment of investors that has previously been neglected by traditional wealth management.

Lower cost of investing: While most of the established firms are still charging a portfolio management fee of between 1-2%, if not more, on assets under management (AUM), robo-advisors are leveraging low-cost product portfolios such as ETFs that provide asset diversification. Not only are they charging lower portfolio management fees, they are also providing a more simplified fee structure as opposed to the complex fee schedules of conventional advisories.

Simplified client experience: Online portfolio management, digital investment proposals and automated rebalancing tools have been on the market for several years now. However, the crux of a robo-advisory solution is to integrate these services in a seamless manner and deliver them through an intuitive, user-centric interface that creates a scalable and cost-effective self-service model.

While this value proposition is compelling and allows these firms to capture an untapped segment of customers, it is not without its challenges. Most robo-advisor revenue models are based on management fees that are charged as a percentage of the AUM. Targeted at mass consumers and with a focus to disrupt the existing advisory offering by offering lower charges, most of these platforms would require a large user base to reach an AUM that can support a sustainable business model. This could be even more challenging in developing markets like APAC where the customer profile is less homogeneous as compared to mature markets like the US.

The Untapped Mass Affluent Segment

Traditionally, most of the bigger banks serve clients across different client segments covering retail, Mass Affluent and High Net Worth Individuals (HNWI). This client segmentation is typically done based on AUM and the level of sophistication of their financial needs.

Banks have typically focused on HNWI given the higher AUM that provides greater profitability to banks. HNWI also have more complex investment needs that cannot be adequately addressed without employing traditional advisory services. On the other end of the spectrum, retail investors are big in terms of volume but their average AUM is much smaller. Additionally, retail investors have less knowledge when it comes to complex investment products. Some of the banks have offered simple investment plans to buy securities in smaller lot sizes to capture more revenue from this segment. However, the cost to serve and provide individualize advisory to this segment is generally deemed to be unattractive.

Between the Retail and HNWI client segment lies the Mass Affluent segment where we believe the 'sweet spot' is with the untapped opportunity for banks to offer robo-advisory services. Despite holding the largest share of global wealth, at 43.1%[2] in 3, the Mass Affluent segment is unable to access traditional advisory services provided under private banking due to higher

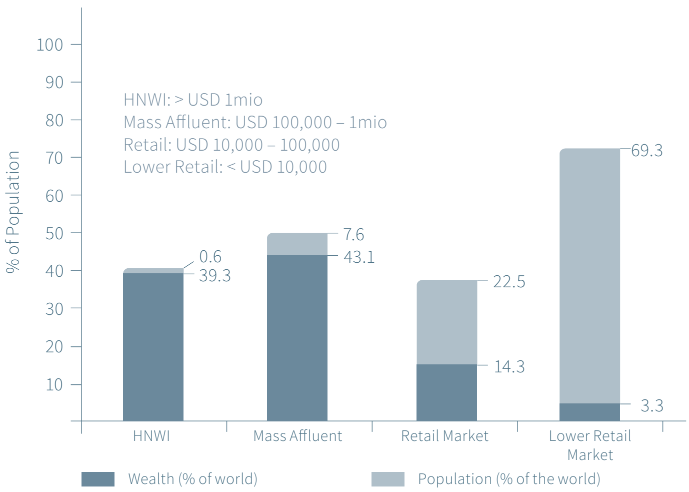

Figure 3: Global Wealth (Financial/Non-financial Assets minus Debt) Distribution

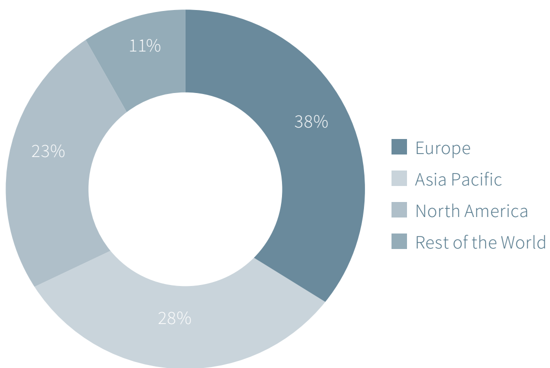

Figure 4: Mass Affluent Population Distribution by Geography

[2] Sopra Banking, «The mass affluent hold 43% of global wealth; they need better services.»

capital requirements. With only 21% of this segment currently engaging financial advisors, the Mass Affluent are well underserved. This presents a huge market opportunity for robo-advisors to provide a superior offering as compared to the current standard investment product solutions offered to them—by providing a customized advisory solution with lower management fees.

Furthermore, the Mass Affluent segment is expected to continue to grow at attain a CAGR of 9.8% in APAC, as compared to North America's 4.9% and Europe's 4.2% by 2020[3]. This would mean that APAC's share of Mass Affluent clientele is set to grow from its current distribution in 4, presenting APAC as an attractive market for robo-advisory.

Additionally, clients from the Mass Affluent segment, with their higher investable capital and better investment knowledge, would benefit from professional advisory services. This gives them greater inclination to adopt robo-advisory solutions, as supported by a 2014 study from McKinsey[4] which suggests that at least 20 to 30% of the Mass Affluent are willing to use a digital wealth management solution.

All of the above draws us to the conclusion that the Mass Affluent segment presents itself as a market with high potential and will be a sustainable business model given its large estimated potential AUM. By leveraging the technology behind robo-advisory services, banks can provide a scalable and cost effective way to address the advisory needs of this untapped segment, generating untapped revenue from this service offering.

Banks' Competitive Advantages for Robo-advisory

Banks can create a compelling value proposition for their Mass Affluent clients by offering robo-advisory services as part of their digital portfolio. Furthermore, banks have several competitive advantages over other FinTechs in providing robo-advisory services.

Regulatory license: Banks can leverage their existing advisory license from the regulators that gives clients a greater sense of security and trust that their investments are managed by an entity that has met the regulators stringent requirements.

Product range: Existing distribution channel setup enables banks to offer a greater variety of products as opposed to most robo-advisory firms that mainly focus on ETFs. A diversified product portfolio will also help to satisfy investment needs of the entire spectrum of investors.

Client relationship: Banks have an existing client base which allows them to streamline the process of onboarding to their robo-advisory platform. This also enables movement of funds between various accounts with minimal transactional friction.

Online banking infrastructure: Most banks also have an existing digital offering (e.g. e-banking applications). Robo-advisory services can be easily integrated into the existing platform which will in turn provide a seamless client experience and a holistic view of the client's holdings.

Experienced portfolio managers: The in-house expertise in portfolio management and research capabilities of the bank can be integrated into the advisory algorithms allowing banks to provide value-based, unique offerings to their clients.

While most of the robo-advisors are waging a cost war to gain customer traction, the above factors can help bulge bracket investment advisors to provide a unique client offering. While it may not be the lowest in terms of cost, banks can nevertheless offer a compelling service through automated advisory tools.

Vanguard's story is a case in point. By leveraging robo-advisory, Vanguard was successful in reaping the benefits by bringing in over $12 billion to their automated advisory platform within 6 months of its launch. In comparison, Betterment or Wealthfront took several years to hit their first billion.

The competitive advantage brought forth by the above factors are however, not restricted only to the Mass Affluent segment, but are also applicable to a different target segment, such as the retail clients. This service offering would benefit retail clients by means of lower management fees charged and the small capital requirements imposed, whilst banks can seek to reduce operating costs and generate new revenue streams.

Three Headwinds for Banks

Banks can tap onto the robo-advisory trend to unlock an untapped revenue segment by providing advisory services to the Mass Affluent market. However, there are few challenges that banks should consider.

Business model: Launching a robo-advisory offering is not only a technological challenge but also a business one. Banks need

[3] Kepler Cannon, «The Growing Asian Wealth Management Market: Capturing the Mass Affluent Opportunity»

[4] McKinsey, «Robo-advisors have a cloudy future but 'virtual advice' delivered by 24-hour super-centers with experts and algorithms will win the day»

to carefully review the product range and the cost and fee structures to attract clients to the platform while ensuring that any risk of cannibalizing their existing services is kept to a minimum.

Target operating model: Banks also need to look at their internal infrastructure and competency setup to determine what would be an appropriate target operating model. Based on their strategy and vision, banks should decide whether to build the platform on their own, integrate with a solution that is available on the market or partner with other robo-advisory platforms.

Branding and marketing: Traditional banks have been deemed as less innovative when it comes to providing disruptive digital services. Branding a new offering in a targeted way is extremely important to provide a seamless integration of the existing targeted segment and to attract new users to the service.

Conclusion

The rise of FinTech firms providing robo-advisory services has challenged banks to review and rethink how technology can disrupt their current service offerings. We are certain that robo-advisory platforms are here to stay and will continue to evolve in terms of product offerings and cost and fees model (e.g. fixed cost vs performance percentage) to attract a segment of clients who currently do not have ready access to advisory services today. However, instead of a taking a back seat, banks are capable of riding on the same wave to provide an equally attractive value proposition to clients by offering robo-advisory services.

Synpulse believes that robo-advisory technologies should be adopted by traditional advisors as a collaborative solution rather than an alternative approach. It has the capability to significantly improve the productivity of conventional investment managers rather than pose a threat to their business. The HNWI and UHNW segments will always request for preferential treatment and traditional face-to-face advisory practices that are crucial to meet more sophisticated investment needs. Nevertheless, robo-advisory is well suited for investors with straightforward wealth preservation and steady growth goals given the buy-and-hold approach employed.

Offering robo-advisory can help to open up the untapped Mass Affluent investment market where the average investor does not have enough capital to open a private banking account but still needs advice and recommendations to meet his or her financial goals. Global banks and bulge bracket financial institutions are well positioned to deploy robo-advisory solutions by tapping on their existing customer base, highly diversified product portfolio, leading in-house investment experts and state-of-the-art infrastructure.

Automated advisory solutions can also be employed as a client acquisition tool to attract younger, less-affluent customers, who might potentially require private banking services in the future by offering a scaled down version of robo-advisory services as a prelude to the complete suite of private advisory service.

Synpulse can help banks navigate through the current robo-advisory trend in the market by tapping on our structured digital advisory framework and digitalization methodology. This methodology helps banks to leverage their key strengths and respond to challenges decisively, reducing time to market and sets banks en route to achieving a competitive advantage from an early entry into the robo-advisory market.

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