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Robo-Advisors
## Capitalizing on a growing opportunity

What is robo-advice?

Over the past few years, a new form of advice has emerged with a new breed of wealth management firm starting to gather retail assets away from incumbent players. These firms leverage client information and algorithms to develop automated portfolio allocation and investment recommendations tailored to the individual clients. They have been coined the term "robo-advisors," and include firms like Betterment, Personal Capital and Wealthfront. Clients access robo-advice through rich, digital user interfaces for very low fees (on average 20bps and sometimes free[1]).

Together the leading eleven robo-advisor firms have seen explosive growth since market entry. At the end of 2014 these firms grew to ~19 Billion AUM, a ~65% growth from the previous eight months[2]. However, these new market entrants are still nascent and represent a trivial amount relative to the $25+ trillion retail investable assets in the United States[3]. Their lack of distribution has likely contributed to difficulties in reaching a large number of potential customers. But this may be about to change with large wealth management firms now joining the fray, including Charles Schwab and Vanguard[4], bringing both investment dollars and distribution to the robo-advice space.

AUM Growth of eleven leading Robo-advisors (USD Billion)[5]
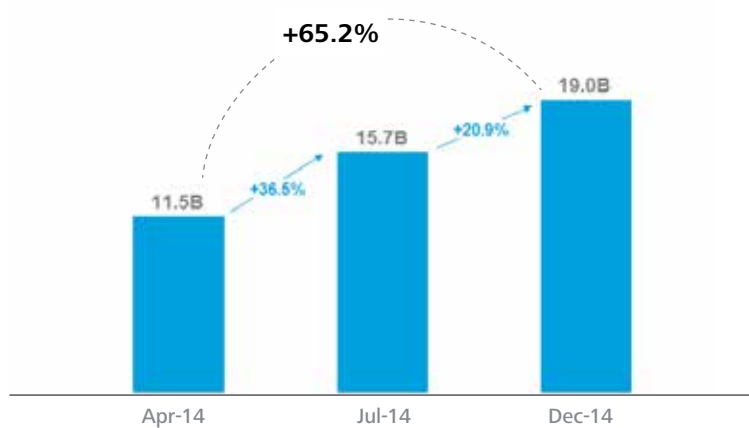
Why is robo-advice going to disrupt the market for advice?

The wealth management industry is likely entering a period of significant disruption, with robo-advice at the heart of this disruption for several reasons.

1. The significantly lower fees (and in some cases zero fees) compared to traditional fees has broadened the market for advice to include the majority chunk of untapped wealth in the United States. More mass market consumers (i.e., assets < $200K) now can afford advice that appears to be tailored to their unique needs.

2. Robo-advice plays into the common preferences of a new generation of wealth (i.e., more in control, digitally savvy, anywhere/anytime, etc.). Further, robo-advice is influencing how many baby boomers and seniors purchase and consume wealth services, thereby challenging human-based business models that typically have higher fees.

3. Some wealth management firms are investing heavily in big data and advanced analytics, potentially broadening the range of advice that can be developed through algorithms and delivered digitally (beyond portfolio allocation and plain vanilla investment products). In other words, robo-advice can become more personalized and specific over time.

4. Many leading wealth management firms are already working on incorporating robo-advice capabilities within their existing advisory offerings to create hybrid models (science and human-based) that can help increase value for clients across the wealth spectrum.

5. Technology has lowered barriers to entry for new firms to break into wealth management. Both financial and non-financial services firms can take advantage, bringing new levels of competition and innovation to the industry. For instance, we will likely see more asset management and insurance firms adding wealth advice to their distribution and effectively entering wealth management; non-financial service firms with access to large numbers of retail investors and leading edge technology firms will likely also enter wealth management through a robo-advice model.

What should incumbent firms do about robo-advice?

Some firms will choose to ignore the opportunity that robo-advice presents for now. This may be the right decision in the short-term for wealth management firms that serve a high net worth client base that can afford person-to-person advice and have more complex financial and planning needs. These firms can take the opportunity to tread slower and more cautiously, as robo-advice may not be as necessary for them in the immediate future, until their client base evolves.

However, wealth management firms that serve a mass-market and mass affluent client base are often inherently more vulnerable to this disruption and should face up to it. Firms that target these markets and do not offer a channel for digital, automated advice will likely need to embrace digital strategies and tools to help maintain competitive advantage in this new market environment.

Although it is only the beginning, wealth managers should react, as this hybrid service model will likely become the new-norm.

Robo-advisors and some early-adopting traditional advisor firms are pursuing multiple strategies – such as marketing directly to retail clients and as a white labelled offering for financial advisors – to scale more rapidly and sustain profits. Although it is only the beginning, wealth managers should react, as this hybrid service model will likely become the new-norm.

Three ways to grow a robo-advice capability: Partner / Develop / Acquire

Partner

Develop

Acquire

1. Partner with an existing robo-advisor

Partnering with an existing robo-advisor can enable traditional firms to react quickly and typically has lower costs and limited organizational changes. It can also deliver complementary and promptly-realized advantages through process automation, cost reduction and the attraction of new customers. By partnering, traditional advisors tend to avoid many of the costs and risks inherent in implementing a customer solution into legacy systems. However, partnering can also come with potential risks, including impeded flexibility, a symbiotic reliance, and conflicting future objectives.

Industry Example: *Betterment announced a partnership with the Institutional Wealth Services division of a large, Boston-based asset management firm. Independent Registered Investment Advisors (RIAs) will have access to Betterment's online tools to help their clients set financial goals and establish ETF-based portfolios.*[6]

2. Develop in-house solution

Another way traditional advisors can effectively respond to the robo-advisor opportunity is by developing an in-house platform for both existing clients and new investors. This enables advisors to promote it as a low-cost alternative to traditional advisory services and provides the flexibility to offer varying functionality to help attract new investors. However, firms should consider how these business-to-consumer capabilities inter-play with the broader organization and the potential risks of channel cannibalization.

Industry Example: *Vanguard officially rolled out their hybrid robo-advisor service in May, with an asset requirement of $50,000. The hybrid service combines computerized asset allocation and rebalancing with access to human advisors over the phone and via videoconferencing. Their Personal Advisor Services, which charges 0.30% of assets a year, had attracted more than $7 billion in new advisory assets as of March 31. That's on top of nearly $10 billion that Vanguard moved from its older financial planning service, which required $500,000 in assets and cost 0.70% a year.*[7]

3. Acquire a robo-advisor

When acquiring a robo-advisor, firms should identify a target firm based on a growing customer base, opportunities for further growth, technology capabilities and the potential "fit" within their organization. While this could be an accelerated route-to-market for traditional investors, acquisition has its risks. How the firm is able to effectively integrate the acquired platform within its existing infrastructure will be key.

There is no industry example at this time: The market is generally well-positioned for consolidation and a recent proxy example is the acquisition of financial planning firm, LearnVest, by Northwestern Mutual. Acquisition could be a fast channel to some markets for firms lagging behind, and will likely see increased focus as the market further matures.

This is only the tip of the iceberg…

Digital, automated advice will likely become a standard expectation for the mass-affluent and mass-market segments. But we have seen only the beginning of what automated advice can become. Big data and advanced analytics have the potential to broaden the scope of robo-advice dramatically, incorporating financial planning into broader retirement, health, and wellbeing, and enabling quasi institutional research. Robo-advice could then impact all investor segments, not just the mass-market and mass-affluent retail investors.

Robo-advice is here to stay and poised to evolve into much more disruptive and wide-ranging forms of advice. All wealth management firms should take notice.

[1] Deloitte Analysis

[2] "Total AUM Increases for 11 Leading Robo-Advisors," Mark Miller, WealthManagement.com, December 22, 2014 (based on a Corporate Insights Survey)

[3] Deloitte Analysis

[4] "Investing's Old Guard Gets Its Algorithm On: Vanguard and Charles Schwab follow startups into the robo-adviser race," Margaret Collins, bloomberg.com, March 20, 2015

[5] "Total AUM Increases for 11 Leading Robo-Advisors," Mark Miller, WealthManagement.com, December 22, 2014

[6] "Betterment has teamed up with…" Jon Stein, CEO & Founder, Betterment.com, April 23, 2015

[7] "Vanguard Rolls Out New Robo-Hybrid Advisor Service With $17 Billion In Assets," Janet Novack, Forbes.com, May 5, 2015

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