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Is Robo-Advisory the Next Big Thing in Wealth Management?

History of Robo-Advisory

Robo-advisors. You probably have heard of this term at least once or twice over the past few years. Touted as the next big thing, Google search queries for "Robo-Advisor" have yielded 423,000 results as of today. First launched in 2008, during the financial crisis, robo-advisors were still a relatively unknown thing back then. But everything changed when Betterment, the first robo-advisory wealth management startup, was launched in 2010.

Robo-advisors grew in popularity, with established asset managers and brokers such as Charles Schwab, Vanguard, BlackRock, Goldman Sachs, and Merrill Lynch, developing their own robo-advisors to retain clients and to develop new clienteles. By the end of 2015, there were robo-advisors in almost 100 companies in the world, managing $60 billion assets of clients. But it doesn't stop here. Experts predict that the robo-advisory industry is estimated to exceed $5 trillion by the end of 2020. It is clear that this revolutionary technology is here to stay and disrupt the financial sectors in the years to come.

So, what exactly are robo-advisors? Robo-advisors are a class of financial advisors that provide asset management and/or investment management advice on digital platforms with moderate to minimal human intervention. They use algorithms, which are executed by software, to invest in and routinely rebalance portfolios based on various investor-provided data, whilst considering the clients' risk preferences and desired target return.

How the Technology Operates

The current Robo-Advisors in the market follows a four-step evolution of features and services.[4]

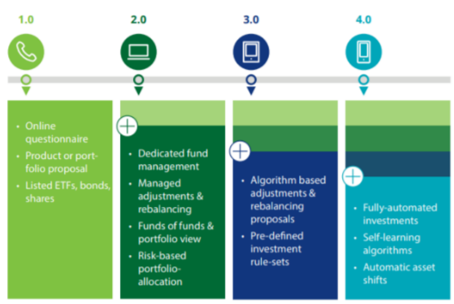
Robo-Advisor 1.0
In robo-advisor 1.0, clients would have to first answer a questionnaire regarding their investment preferences such as risk preference. According to the answers given, robo-advisors will recommend single-product proposals or portfolio allocation based on listed investment products. Most firms either operate via web-service or smartphone app. There is no bank- or broker-API (Application Programming Interface) that is managing the execution and therefore clients have to buy and manage a real product-based portfolio on their own by using their own accounts, and also manage future adjustments. Product variety ranges from stocks, bonds, ETFs (Exchange-traded funds), and other investment vehicles.

Robo-Advisor 2.0
Investment portfolios are created as a fund of funds and setting up investment accounts as well as direct order execution is part of the service. Investment managers will manually allocate these assets. Questionnaires are now not only used to filter suitable products but also to allocate clients to a handful of pre-defined risk-allocated portfolios. Real investment managers will then take care of investing and adjusting client portfolios on behalf of their clients. The realization is semi-automatic as investment managers oversee the investment algorithm and define rule sets.

Robo-Advisor 3.0
Investment decisions and portfolio rebalancing proposals are based on algorithms which monitor and satisfy pre-defined investment strategies. Final oversight is provided by professional fund managers. Some services enable their clients to follow or neglect proposed portfolio adjustment decisions in order to individualize their portfolios

Robo-Advisor 4.0
Sophisticated risk management and profiling questionnaires lead to direct investments via self-learning artificial intelligence (AI) investment algorithms. They shift between different asset classes based on changing market conditions and individual investment needs such as profit, risk appetite, and liquidity aspects, monitor and adjust single client portfolios in real time to keep on track with their selected investment strategy.

Robo-Advisory evolution: Digital Wealth Management from 1.0 to 4.0



Trends that support development of Robo-Advisory

In view of the evolution of the robo-advisors, there are 5 trends that support their development.[5]

Firstly, the emergence of a new generation of digitally savvy investors has encouraged the development of robo-advisors. These investors are accustomed to client-centric platforms, possess a global mindset and place a much greater emphasis on value propositions regardless of their service provider. Such investors are not limited to a single wealth or age group. They are also increasingly adopting digital sales channels for their banking needs.

Secondly, disruptive technology has also led to the increased popularity of robo-advisors. Technology giants are leveraging their sizable platforms and global networks to access many traditional wealth management clients, posing a threat to existing players with their breadth and knowledge in areas like AI, blockchain and robo-advisory.

Thirdly, the disintermediation of wholesale channels. Independent asset managers continue to build D2C offerings, for instance, on their own platforms with the use of robo-advisory technology. Technology giants may also become alternative distribution platforms for asset managers. With these potential shifts in the investment product distribution chain, there would be increasing disintermediation of wholesale channels.

Fourthly, the demand for superior client experience is also leading to the increase in robo-advisory services. There is now a need to provide client-centric experiences and become more agile in delivering customized experiences and solutions to their target customer segments. This encourages the emergence of robo-advisors who are able to meet that particular need, potentially better than traditional human advisors.

Lastly, the disaggregation of value chains also encourages the development of robo-advisors. The focus has shifted to building client-centric platforms similar to those offered by technology giants so that investors are able to access a wide range of products and services within a single, integrated ecosystem.

What was in the past VS now?

The rise of robo-advisors has threatened the traditional fund and wealth management industry, but how exactly have they changed the wealth management industry? Historically, complex wealth management services were only made available for the elite segment of high-net-worth clients.[1] Services provided traditionally include a wide variety of alternate investment products, complex investment strategies, actively managed individual portfolios, and discretionary specialist advice. And these are mostly performed through personal interaction, where wealth managers may either visit their clients at their homes, invite them to their branches, or arrange events. That being said, maintaining a touch of exclusivity is important to ensure high client centricity and a premium experience.

However, these have all changed. Robo-advisors have successfully transformed this once exclusive wealth management services, bringing these services to a broader audience at a much lower cost as compared to traditional human advice. Rather, they support the wealth managers by streamlining and automating certain procedures such as tax-loss harvesting and digital account opening. For example, robo-advisors have enabled traditional market analysis to be able to incorporate more real-time variables, enabling better decision-making and more efficient management of capitals. They have optimized thousands of portfolios within mere seconds, which is a feat that human advisors can never accomplish.

Pros and Cons of Robo-Advisors

So, what makes robo-advisors so attractive? One of the biggest perks is its ability to create an unbiased and highly analytical investment portfolio to help its client reach his or her financial goals. As humans, it is inevitable that we incorporate certain biases, be it emotional or cognitive biases, into our decision-making process. Cognitive biases consist of anchoring and adjustment biases, mental accounting biases, framing biases and availability biases.

Emotional biases consist of loss aversion biases, overconfidence biases, self-control biases, status quo biases, endowment biases and regret aversion biases. And robo-advisors are here to eliminate these. By strictly adhering to the algorithms that they are programmed with robo-advisors avoid those biases and make investment decisions strictly based on the data provided. Moreover, this can eliminate at least one of the double layers of biases - investor and financial advisor.[12]

As we all may know, engaging a financial advisor does not sound appealing if you only have a small net worth. This is because the fees to engage one are too high and will take up a large part of your profits. However, this is not the case with robo-advisors. Robo-advisors generally require low to no minimum account balance for you to qualify to start investing. Also, with automation and economies of scales that come about with using robo-advisors, the fees paid to engage a robo-advisor is much lower than that of a traditional financial advisor. This means that everyone and anyone can start investing, regardless of their income levels.

Furthermore, this is a digital service that is accessible and available 24/7. With just a few clicks and swipes on our smartphones, we are now able to access our finance plans and make investment decisions whenever and wherever. This enhanced service accessibility and availability is what we all need, amidst our hectic lifestyles. However, this does not mean that we no longer need wealth managers.

Robo-advising will likely never replace wealth management, because a financial advisor's job is not just about analyzing market trends and rebalancing portfolios. A professional financial advisor understands its client's concerns and provides empathy and support for his client. A robo-advisor will never be able to provide his form of personal touch.[6]

Also, since robo-advisors rely solely on the algorithms provided, they cannot go beyond their pre-programmed algorithm when creating your investment portfolio.[12] This results in a limited selection of investment choices that the robo-advisor can advise to its client. And so robo-advisors may not be a good choice, especially if you are looking for a more complex form of investment plan.

Moreover, a robo-advisor can only provide advice based on past trends and historical data. As the world continues to evolve, what's earning in the past may not be profitable in the future. Therefore, a professional financial advisor's insight would be required in order to make a sounder investment decision based on insights.[12]

Concerns of Robo-Advisory for Wealth Management Firms

First, getting the offering right. Firms need to identify the kind of experience they want to offer the prospective investor via robo-advice services and the level of support to be offered. They also need to determine the qualifications to conclude who to be directed to robo-advice services and who to have access to a financial advisor. Apart from quoting a price for investors for their offerings, they also need to clarify whether the offering should be a standalone product, a complement to other wealth management services or an entry level product.

Second, an effective distribution strategy. This means the firm needs to decide whether to use their own established brand for a robo-advice offering, or to roll out the offering under a new brand.

Thirdly, getting the advisor force on board. Firms need to mesh their advisor force capabilities with those of robo-advice. Robo-advice has only a minimal ability to explain complex topics, and no ability at all to follow up with questions and make recommendations based on the answers. Thus, robo-advice can be positioned with the sales force as an effective means of serving smaller accounts and freeing up financial advisors' time to concentrate on bigger opportunities.

Figure 3. Options for introducing robo-advice capabilities

	Free standing robo advice [direct channel]	Product offering through call center based advisor channel	Product "distributed" through full-service advisors	Toolset embedded in the platform supporting a broad range of advised products
Benefits	Build a distinct brand and service offering for digital-centric millennials May mitigate pricing impact with existing client base Feeder system for new accounts	Offering is aligned with channel's target wealth tier Contains pricing impact on other channels Sandbox for developing capabilities Growth opportunity for digital-centric millennials Cost effective service model	Provides robo capabilities to advisors whose clients ask for it Provides greatest scale and leverage for the offering	Seamlessly enhances traditional advisor platform Leverage capabilities to benefit advisors and clients
Considerations	Could be viewed as competition by existing advisor force Limits synergy with existing core wealth business	Revamp of call-center advisor channel—repositioning for growth Limits near-term synergy with full service advisor channels	Large, complex deployment to distributed advisor force Broader potential impact on pricing	Large, complex deployment Change management/ cultural disruption Significant platform dependencies

Source: Accenture Research

Current Players – Who Are in The Space

Robo-advisors provide limited investment services compared to financial advisors who can offer planning, investment and insurance advice and services. As more traditional wealth management firms are adopting robo-advisory as well as an increasing number of robo-advisor startups, there are a few top players that have managed to establish themselves as a major player in the growing robo advisor market.

Major players include Betterment, well-known for its service offerings, with its management fee ranging from 0.25% to 0.4%, depending on the service level. Another top player in the industry is Wealthfront, which prides itself as offering the lowest fees on its ETFs among the other robo-advisors. Ellevest is best known for its goal-based investing model, focusing on women specifically. And Charles Schwab Intelligent Portfolios is known for its investor-friendly practices and usability.[7]

As for the robo-advisors closer to home, Stashaway and Syfe are some of the few rising startups that have managed to gain a following among Singaporeans given its simple structure and no minimum investment requirement. AutoWealth would be a good choice for those who wish to engage in more serious investment.[8]

Customers – What Customers Are We Looking at In This Space

Robo-advisors would be a great option for beginning investors, especially the younger generations like the millennials or generation Z. These are just starting out, with limited knowledge about investment and financial planning. They are people who want to be in control, are digitally savvy, and place a strong emphasis on convenience and accessibility. Hence, a robo-advisor will be useful in helping them start their financial planning journey. Aside from this new generation of wealth, investors seeking financial advice, or want a managed investment portfolio, or even high-net-worth individuals can also benefit from robo-advisors. Robo-advisors can provide a much faster and more accurate analysis of data and market trends than human advisors, making it a great supporting investment tool.

Future of The Tech

Robo-advisory is a rather new, technology-backed solution that has managed to successfully disrupt the wealth management industry. Only in its starting stage, we already see how much it has transformed the wealth management industry, and we know there is so much more potential in this new technology that has yet to be unleashed. However, it may be a bit challenging to roll robo-advisory out in Asia. This is because the main benefit of robo-advisors is that it is able to give clients selected benchmarks of investment that can meet their investment objectives.

For countries like the United States, there are over 30,000 to 50,000 investment solutions, making robo-advisors ideal to do such benchmarking. However, the current asset management market in Asia, apart from probably China and Japan, does not have that many investment products for investors to choose from[10], making it less ideal to potential clients. This is especially so in Singapore, where there is a limited variety of investment products that are offered to clients. Therefore, for robo-advisory to succeed in Singapore, there is a need for robo-advisory companies to tackle this issue first.

Robo-advice would become a norm for the mass-affluent and mass-market segments in terms of what to expect. The scope of robo-advice can be broadened extensively with big data and advanced analytics, such as incorporating financial planning into broader retirement, health and wellbeing. It can impact all investor segments apart from the mass-market and mass-affluent retail investors. As new players enter the industry, consumers would benefit from lower fees and more choices of professional asset management.

Robo-advice is likely to become more disruptive and evolve into wide-ranging forms of advice. One possible form of advice is hybrid-robo-advice, which is a popular model where investment managers use digital services, portfolio-rebalancing or asset allocation to optimize their quality of advisory services in a shorter period of time.

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