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Robo-Advice 2.0: The Next Generation

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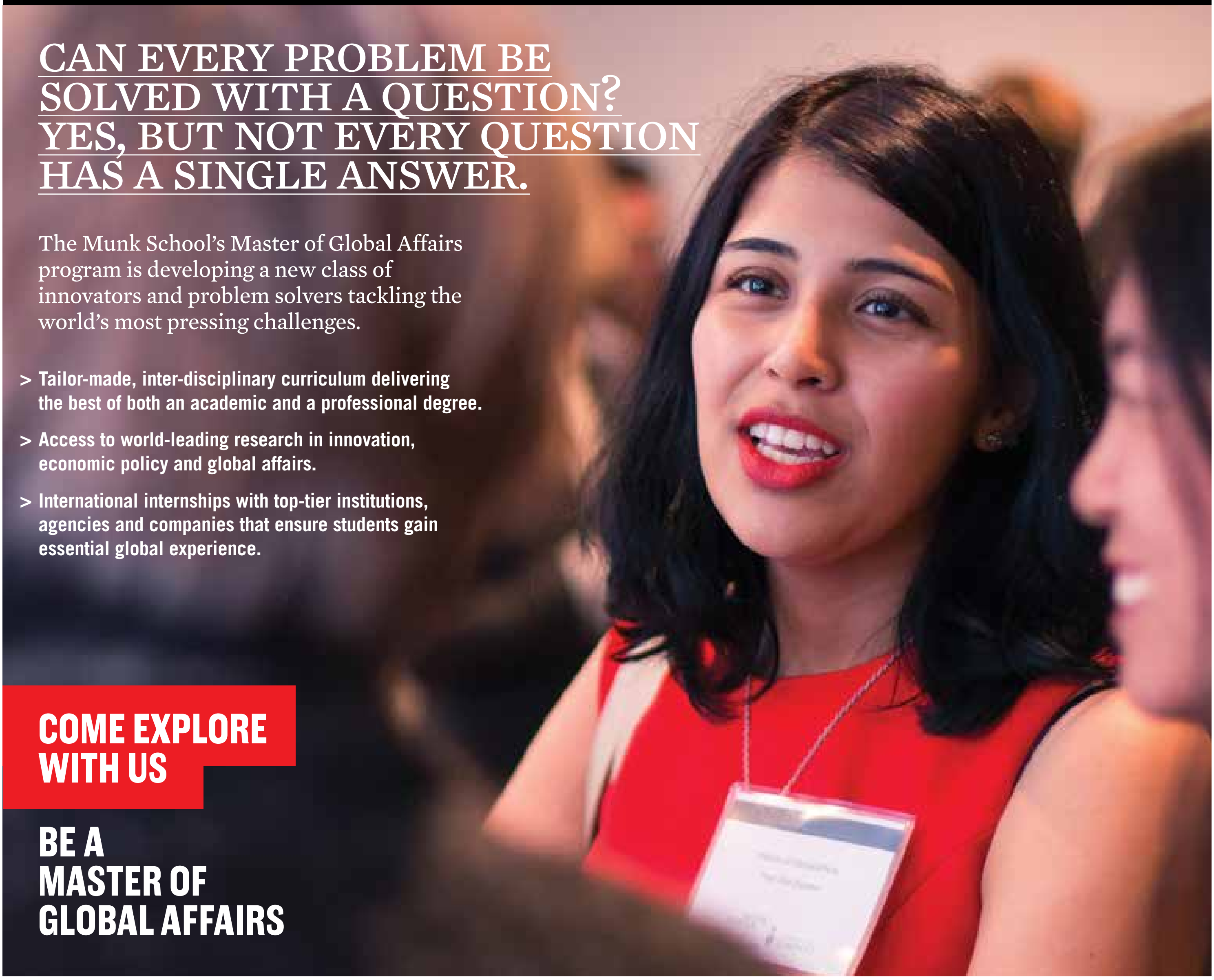

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Robo-advice 2.0: The Next Generation

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Abstract
No new trend or development in the world of wealth management could have attracted more discussion, printed words, or conference speeches than Robo-advice. Hailed as the new era in providing investment advice on a large scale to the emerging, digitally savvy generation, Robo-advice has spawned new names in this most traditional of markets. Betterment, Wealthfront, Nutmeg, and others have emerged in recent years offering simple, engaging user interfaces, automated advice via algorithms and low fees. But already we are starting to consider how the next generation of such services will develop as the market matures. What is clear is that successful Robo-advice 2.0 services will focus not on the technology, but on the underlying investor and their very human needs. The key to successful proposition development continues to be a clear focus on the needs of the consumer, not on the clever technology. We believe this focus must be on three critical elements: an offer which is meaningful and relevant at all stages of the customer lifecycle, a cost structure that is transparent and low relative to traditional advice services, and genuine simplicity (in language and process) throughout. If Robo-advice is to transform into a truly mainstream and global form of digital advice, Robo-advice 2.0 must create personal, relevant, and differentiated services for real people.

As assets under management grow, robo-advice is proving more than just a flash in the pan in a bull market. How can established financial institutions successfully develop a next generation robo-advice offer? The answer lies in leveraging their long-term strengths to create personal, relevant, and differentiated services for real people. Robots may help deliver robo-advice 2.0. But it cannot be designed by them, or for them.

THE PROPOSITION

Established financial services providers have the opportunity to retain existing customers – and to acquire new ones in new market segments – by "logging on" to the latest form of digital wealth management: "Robo-advice 2.0." The term "Robo-advice" has become a catch-all term applied to investment services using online platforms to reduce – or even eliminate – the need for human advice. Yet, robo-advice is not universally impersonal. While some types of approach do include the purely formulaic, as well as forms of low cost and simple initial product selection, others also extend, in some cases, to greater depth of personal, tailored advice.

It is important to distinguish between the customer proposition and the technology when discussing robo-advice. Often, the quick, simple, and low cost investment solutions on offer are easy to buy conceptually while the technology makes the buying process accessible. But successful development of robo-advice 2.0 will **not** be based on extra technology bells and whistles. At its core will be personal, relevant, and differentiated services for real people. The technology is the medium. It is not in itself the message.

The robo-advice combination of lower fees (for an offer that typically includes rebalancing the portfolio) with engaging interfaces, appeals to people who want technology-enabled, self-directed, and affordable investing. Established players should not, however, assume the appeal is **exclusively** to the novice investor; or that it **always** culminates in simple choices, based on automated ETF selection. The offer has started to reach a wider range of age groups and levels of investment experience.[1]

OPPORTUNITY OR THREAT?

From the established brands' viewpoint, market uptake of robo-advice can be seen either as a passing fad, as a pure threat to be resisted tactically, or as a significant opportunity.

The rapid growth in the value of assets under management (AUM) suggests that, while robo-advice is a long way from cracking the market wide open, it is having a noticeable impact. This growing appeal can also be seen in the context of loyalty disintegration among millennials.[2] Its increasing uptake underlines one well-established consumer attitude: basic dissatisfaction with banks.

Robo-advice is not a threat to be countered just by putting more resources into marketing traditional investment advisory services. It cannot be resisted solely by "counter-attacks" based either on exploiting fears of smaller brands' longer term market vulnerability or by dismissing robo-advice as purely formulaic, or even inadequate. Where wealth management offerings today provide a poor client experience and/or poor value for money, the growth of robo-advice will undoubtedly present a new threat. But there is no reason to believe it will bring down the whole industry as we know it.

Few industry players today could fail to recognize both that robo-advice is a direct reflection of powerful forces across society as a whole, and that it is a major opportunity. As a result, growing numbers of established financial institutions are exploiting the opportunity to create and market the next phase of robo-advice.[3]

WHY DOES ROBO-ADVICE APPEAL?

Robo-advice grew because it is a real solution to the needs of real customers. Today, a number of key factors are helping to drive its ongoing uptake. Legislative changes to advice distribution frameworks (such as the Retail Distribution Review in the U.K.) left many potential investors unable – or unwilling – to afford up-front, conventional advice fees. Robo-advice is an accessible and affordable option for "advice gap" customers, who realize a range of life events – property purchase, education and health care funding, prolonged retirement – demand some investment for the future.

1 According to a report by Numis Securities, robo-advisors were unlikely to substantially affect the £1.1 trillion U.K. wealth management market in the next five years. However, Numis pointed out that Hargreaves Lansdown, once an upstart challenger, has risen over three decades to command significant market share in its sector; Evans, J., 2015, "Slow march of the robots," Financial Times, June 22, http://goo.gl/aKJeiZ

2 The 2015 Makovsky Wall Street Reputation Study indicates that some 49% of millennials said they would consider using financial services options from companies such as Google or Apple.

3 Many well-known brands — including Investec Wealth, Brewin Dolphin, and Barclays Stockbrokers — plan to launch robo-services in 2016, while Hargreaves Lansdown, the biggest direct-to-consumer fund shop, launched its own Portfolio+ service in July 2015 [Evans (2015)].

Proliferating device types and internet access mean that selecting financial services online is no longer restricted. Nor is it embraced exclusively by the so-called "millennials" either. Customers of all ages respond to online experiences that replace complex and expensive processes with clarity and perceived value for money.

The factors referenced above will continue to drive and shape a robo-advice market where challengers are prominent. However, they have strong potential to create opportunity for established service providers too.

Robo-advice shows that new levels of customer responsiveness – not the dominant style of many traditional offers – **are** possible, both in terms of proposition and delivery technology. The robo-advice delivery model offers older financial institutions the chance to reach existing customers with new, more personal and more responsive offers. Importantly, they can also engage with entire new market segments. And they can do all this in an operational context of very significant scalability and economies of scale.

Achieving comparable levels of scale and instant accessibility through traditional advice models – based on teams of highly qualified, but relatively scarce, advisors – would be a practical impossibility. However, cutting edge technology and efficient processes are not a proposition in themselves. Content – those real solutions for real people – has to be king.

HOW HAS ROBO-ADVICE IMPACTED TRADITIONAL SERVICE DELIVERY?

Technology-driven economies enable the transition to lower or zero fees. In addition, many current robo-advice propositions accept smaller initial investments. The minimum deposit can be just a few euros, in the case of some special offers.

The changes mean investing is no longer exclusive to high-net-worth (HNW) or ultra high-net-worth (UHNW) profiles. The robo-advice concept has "democratized" the market, appealing to younger potential investors with high incomes, and to older individuals who feel comfortable with technology and want to explore investing in a straightforward, jargon-free environment.

It is true that these developments are enabled by cost-effective delivery mechanisms, but some robo-advice service providers have gone further. They have challenged the most basic premises of financial advice, with radical **propositions** that sit above pure technology issues.

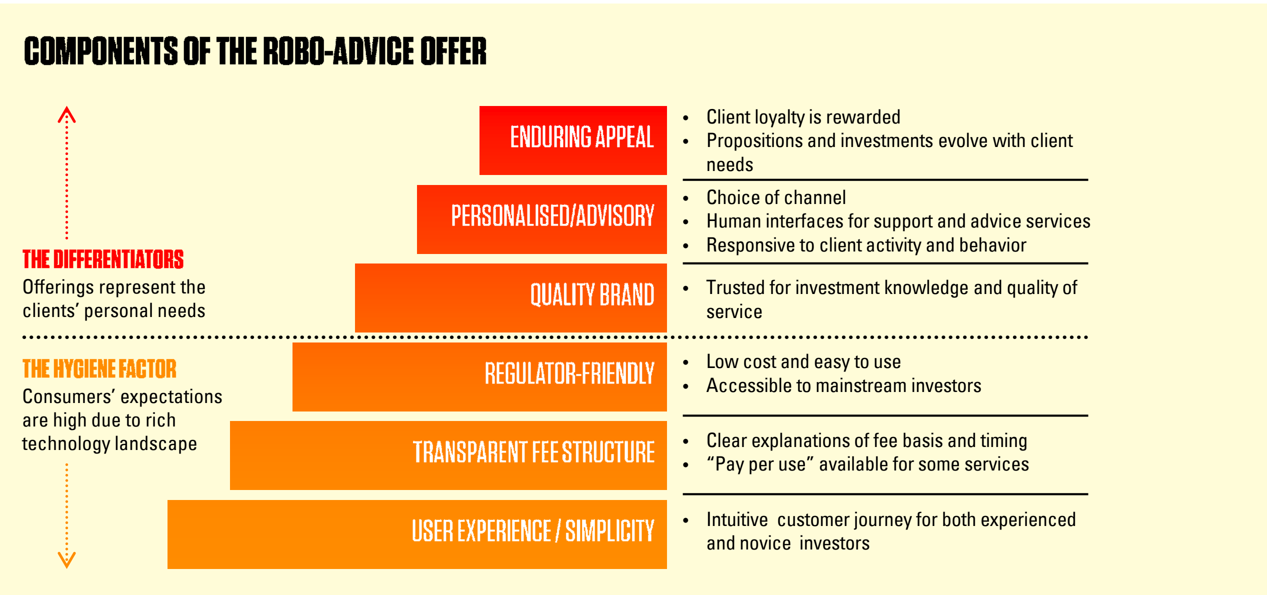

Figure 1 – Components of the robo-advice offer

For example, one is offering investment solutions on a "menu basis" where only the more complex "a la carte" services attract fees.[4] Another proposition[5] enables investors to advocate their own investment choices online. They can then earn rewards when other platform users choose their selection. In effect, an internal market is being created where individuals can become quasi investment advisors themselves.

These potentially disruptive propositions are not **intrinsic** to any core robo-advice fixed model. Their fundamental innovation value lies in their conceptual approach and their content. They are surely worth consideration from established players looking to develop robo-advice 2.0. They show that delivery technology does not have to exclude innovative and highly differentiated proposition development.

Some industry professionals have dismissed the more disruptive innovations as short-lived gimmicks. However, new thinking, stimulated by the broader possibilities of robo-advice, **has** led to real game changers for investment advice channels.

One robo-advice proposition and platform[6] has been adopted by a fund manager, who is rolling out an associated application for use by a distribution channel of 3000 financial advisors. Another is partnered with one of the biggest fund banks in Germany,[7] managing more than 600,000 customer accounts with deposits of more than €14 billion.

ROBO-ADVICE MARKET ENTRY – ADVANTAGE THE ESTABLISHED FINANCIAL INSTITUTIONS

Established financial institutions enjoy a number of powerful advantages when it comes to successful robo-advice market entry. They can leverage their greater spread of financial product offers and expertise to up-sell and cross-sell; enhancing the customer experience through a richer next generation robo-advice proposition **and** exploiting their own expertise. They can use their highly developed distribution channel networks to reach the customer base efficiently and effectively. And they have the immense leader advantage of trusted brand and market prominence already in place.

First phase competitors have done much to help the established brands. Pure-play robo-advice start-ups have done a lot of the heavy lifting – defining the initial wave of propositions, advice styles, technology platforms, target demographics, even fee structures and business models. This is an inversion of the more usual situation, where challengers cherry pick markets that long-term players have committed decades and billions to creating and developing. In fact, most of the important asymmetries between newcomers and established brands work in the latter's favor, as we highlight in four key areas below.

As far as **commercial security** is concerned, established financial institutions can resource their robo-advice offer from their own capital base. This contrasts strongly with the investment-heavy operational demands of the start-ups. Many of them have still to trade their way into profit, even if they have achieved market profile.

Trust factors provide a potentially powerful attribute. Being around for decades, or even centuries, means you do not have to commit a fortune to building a brand profile. Relationship capital is as important as the financial sort and a familiar brand commands a major potential advantage through its longevity. Banks may not always be popular with consumers, but they are acknowledged to have considerable long-term experience, when it comes to being trusted with funds. They can also justifiably claim to have survived multiple cycles in the market – downs as well as ups.

Longevity also brings deep experience of **regulatory issues** around financial advice and its compliance status. The exact regulatory position of the advice component continues to be a moving target. This will become a prominent issue in a market downturn. Some investors will inevitably challenge the appropriateness – even the fundamental status – of the advice and choices offered by their robo-advice platform.

While there are advantages to being a startup, the vast majority of new robo-advice offers are tiny in comparison to the mainstream operators. Agility is a useful attribute. However, it is more useful to be able to leverage pre-existing **operational scale** and handle large customer volumes through proven front-to-back systems.

4 WiseBanyan. https://wisebanyan.com/
5 Motif enables the user to pick their own "basket" of stocks or be inspired by others. It offers ideas-based investments, and blends advocacy with social media by allowing users to earn royalties when their "motifs" are purchased.
6 Betterment has penetrated the "traditional" market, offering services to the fund manager Fidelity. Fidelity in turn offering these services to their 3,000 financial advisors, who can provide them as an app to their clients.
7 Vaamo is partnered with one of the biggest fund banks in Germany, FFB (FIL Bank Ltd), which manages more than 600,000 customer accounts with deposits of more than €14 billion.

SUCCESSFULLY DEFINING ROBO-ADVICE 2.0 – HOW WILL IT LOOK?

The true potential of this market will not be realized by **replicating** first generation offers. There are lessons to be learned and missed opportunities to be seized. A successful next generation robo-advice proposition will build on trust values and relationship capital. However, it will explicitly signal this is not the "same old, same old" dressed up in an attractive design. Customers must discern personal aspirations-based propositions not pre-conditioned by an institutional agenda.

Each customer's sense of ownership of their investment selection will prove a strong loyalty factor, even when markets become more difficult. The adept established brand will nurture the dual sense of "**my** investment journey," which is "supported by **my** financial institution." It will be very difficult for the start-ups to sustain comparable relationship strength.

Of course, one of the subtlest challenges for established brands is to pair personal, aspirations-led investment choices comfortably with a sales imperative. They should not fight the fact that a robo-advice platform is there to sell investments. Nor should they neglect up- and cross-selling opportunities – especially since their likely first target will be their existing customer base. To achieve the right balance, highly considered and creative thinking will be needed to define and develop optimum customer experiences.

Ultimately, how will the best robo-advice platforms – truly engaging customer propositions enabled by accessible delivery mechanisms – crack the challenge of excellent customer experience? By balancing perfectly understood personal aspiration with appropriate choices – including some from the provider brand's broader portfolio. This will require an expert blend, with real integrity towards the customer's financial needs and institutional business development sitting comfortably together. (Specific examples might include automated contribution links from salary increases and bonus payments to SIPP contributions.)

All the guiding theory will culminate in a "good platform environment;" defined as making customers feel they are in the driving seat, rather than being passive recipients of pre-conditioned advice. The online information gathering approach will create the sense that they are setting their own unique advice coordinates. The "robo" element will then react to those coordinates, with the algorithm-driven investing process reinforcing the fact that the user is getting exactly what they asked for. No hidden or contrary agendas. This sense of empowerment will be a key selling point over traditional advice.

AND HOW WILL ESTABLISHED INSTITUTIONS POSITION THEIR ROBO-ADVICE?

Most likely by incorporating the new approach within a portfolio of existing solutions. They will not suddenly abandon other proven customer service and product channels. Some customers will immediately see robo-advice as the best way for them to buy certain investment solutions at key life stages. So they will want a packaged solution from a robot. At other times, they will prefer a more personal and advised conversation.

Flexibility of choice is one of the great advantages the large, established players enjoy. They can offer a true **range** of advice, while the new entrants are far more restricted – or even one-dimensional – in their capability.

Any market "mass migration" to robo-advice is improbable, however. It is well understood that customers have different attitudes to risk for different investment purposes. By extension, we can expect them to also display a variety of buying preferences for a range of investment needs.

WHAT ARE THE NEXT STEPS ON THE ROBO-ADVICE 2.0 DEVELOPMENT JOURNEY?

Long term players need to take a view on their commercial horizons, establishing the scale of market share and revenue opportunity that robo-advice presents. They must capture a clear picture of those existing customers most likely to use robo-advice, as well as thinking whether it is advantageous to attract new and different customers. Then, at the operational level, key areas to clarify early on include compliance, marketing, technology, and access to expert advice.

THE IDEAL ROBO-ADVICE 2.0 DESTINATION – REAL PROPOSITIONS FOR REAL PEOPLE

Today's entry-level robo-advice formula remains primarily transactional. It enables investment **purchase** quickly, easily, and simply. But many consumers (perhaps most) do not buy investments as an end in themselves. They are motivated by specific, life-driven goals. In reality, they want to save towards a house deposit, or to fund school and college fees, or to give a grandchild a sound financial start.

ROBO-ADVICE CHECK LIST

1 BUSINESS STRATEGY

Scale of robo-advice opportunity for your business
- Is this going to grow my business significantly?
- Is not providing a robo-advice offer going to damage perceptions of my business?
- Am I going to lose significant customer numbers without this offer?

Target customer profile
- Which of my existing customers are most likely to use this offer?
- Which customer sectors am I targeting specifically?
- How do I build a robo-advice offer that engages while remaining "on brand"?

Strategy
- Where does a robo-advice offer fit within my overall strategy?

2 GOVERNANCE

- Do I have a crystal clear understanding of the current legal/compliance status of robo-advice?
- Am I aware of all potential compliance implications of offering this type of advice?
- Do I have a complete view of emerging trends, indications and likely future regulatory developments?

3 TECHNOLOGY

- Do I have the necessary technology resources in-house to design, develop, and deliver a robo-advice platform quickly and cost-effectively?
- Do I have a good understanding of the robo-advice market from a tech perspective?
- Do I have a clear picture of the tech challenges of integrating a robo-advice offer into my existing technology ecosystem?
- Do I have access to current best practice and best-of-breed technologies and solutions?

4 MARKETING

- How will I position my robo-advice offer relative to my core brand and other elements of my product and service portfolio?
- Do I have a clear idea of the most effective channels for marketing my new robo-advice offer?
- Do I understand the relationship and key intersections between the technology rollout of the robo-advice platform and marketing milestones?

Figure 2 – Robo-advice check list

For established financial institutions developing their own robo-advice 2.0, there is one absolute imperative: the advice must be truly differentiated, with personal appeal to real people. This crucial "human dimension" must be embedded in every aspect, including online packaging, promotional activity, and – above all – the individual customer journeys that begin with the core investment product offering.

Offers reflecting real personal needs will stand out in a crowd of well-designed, but ultimately impersonal, websites. Underpinning clear differentiation, there are three critical areas to get right at all stages, from planning to implementation: the offer, the cost structure, and the user experience.

- **The offer:** the entry-level portfolio(s) available to investors comprise typically of ETFs or similarly simple products. If multiple portfolio options are available, greater guidance will be required to explain the suitability of those options and to make it crystal clear which customer profiles they are intended for. While much attention focuses on the initial onboarding – the selection of a suitable investment solution for the client – as the robo-advice model matures, we will see the ongoing experience becoming a greater area of focus. This development poses a key question. How will the initial – and hopefully positive – client experience be maintained over subsequent years, thus ensuring the offer remains relevant and valuable?
- **Cost structure:** there must be a transparent fee structure, clearly explaining when fees will be charged and on what basis. With multiple services, the difference between service levels and their associated costs should be evident.
- **Simplicity:** this demands total clarity of language and terms. Many brands will need to start presenting information in a much more straightforward way.

CONCLUSION – ROBO-ADVICE IS NOT GOING AWAY

Robo-advice has the potential to change the investment advice channel choices even of experienced investors. It will shift attitudes towards fees charged, including for premium investing advice. It will scrutinize and challenge the elements of professional advice that go into active management of investments. It could even, as we have seen, empower an entirely new category of investors, who make the ultimate journey from advised to "advocate/advisor".

In short, robo-advice will not leave the investment landscape remotely in the same shape that it found it. In this context of profound change, an established financial institution's final decision might be to either fully embrace robo-advice, to wait for the time being or to leave it to one side permanently. For those that choose to adopt the robo-advice model, the over-arching priority is to focus on the **proposition** – the fulfilment of a client need – rather than the clever technology. In this sense, **ensuring customers and their needs are uppermost at all times**, it represents a challenge as old as the established banks themselves.

The next generation of providers will need to ensure that robo-advice is as personal, differentiated and, paradoxically, **un-robotic** as possible. Robo-advice 2.0 may be enabled by robots. It cannot be designed by them; still less **for** them.

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