PARTNERING WITH ROBO-ADVISORS:

BEST MODELS FOR WEALTH MANAGEMENT INNOVATION

Growth rates in assets under management (AUM) for European robo-advisory are nothing less than impressive, in terms of both realized and projected numbers. In 2019, AUM in the segment amounts to €27 billion. It is expected to grow at a CAGR of 42 percent, reaching €108 billion by 2023[1].

However, to judge the success of robo-advisory solely on the AUM growth would be foolish. Are robo-advisors truly disrupting the wealth management industry or do the underlying market dynamics tell a different story? The reality behind the numbers shows that not all service models in the robo space are viable.

THERE ARE THREE DISTINCT MODELS USED BY THE ROBO MARKET PLAYERS:

1. **Standalone B2C (business-to-consumer)** robo-advisors target the end customer directly. These players provide automated portfolio management solutions at relatively low cost, offered through an online platform which is sometimes supplemented by human advisors.
2. **B2B (business-to-business)** players offer a digital wealth management platform to banks, insurers and corporates rather than target the end customer themselves.
3. Finally, the **B2B2C (business-to-business-to-consumer)** model involves a partnership between a robo-advisor and a financial institution, the former offering a (potentially white labeled) platform while the latter brings in customers. The difference with a pure B2B model may be subtle, but a key benefit is that the robo-advisor gains customer data which it can use to further develop its service.

Both B2B and B2B2C players tend to offer a modular solution accessible via multiple APIs. This offers banks the flexibility to choose the capabilities they want to insource.

1. https://www.statista.com/outlook/337/102/robo-advisors/europe?currency=eur

NOT ALL MODELS ARE SUSTAINABLE

Many B2C robo-advisors are currently stuck between a rock and a hard place. In the lower segment, Customer Acquisition Cost (CAC) is prohibitively high. Our experience indicates these costs can range from a few hundred to roughly one thousand euros.

Servicing customers who generate less than €100 (say 1 percent on 10,000 assets) of revenue on an annual basis is not a viable business model. Instead, robo-advisors should target higher account minimums, aiming for the mass affluent segment. Customers in this segment consider trust to be a key criterion – it can be the deciding factor in investing. To instil trust requires building a strong brand, incorporating human touch and maintaining a strong track record. B2C players who fail to meet these requirements are at an immediate disadvantage.

It's also worth highlighting the differences between the European and U.S. markets for digital advice – the former lags behind in terms of AUM. A combination of factors such as regulatory fragmentation, slower adoption of technology and a lower risk appetite, negatively impacts the potential to scale, making it difficult to build a pan-European brand. Ultimately, the B2C business model is one whose viability is greatly dependent on the successful achievement of this scale. This explains why we don't foresee many European players reaching multiple billions in AUM like Wealthfront and Betterment have done in the U.S.

ROBO – A CATALYST NOT A THREAT

The B2B and B2B2C models effectively overcome the challenge described above by partnering with financial institutions. A vital ingredient for success is a readily available distribution channel and an existing customer base, which incumbent banks can already rely on.

For the robo-advisor, there is no per-customer acquisition cost, greatly reducing the need for a marketing (advertising) budget and lowering the need for capital. Furthermore, in a B2B2C model, access to customer data facilitates further development and improvement of the platform.

From the incumbents' perspective, the pros greatly outweigh the cons. Think about the advantages of a fully digital onboarding flow - lower compliance costs and enhanced customer experience. And what about the opportunity to transition lower-segment customers to an online platform, thereby lowering the cost of servicing them without losing their future revenue potential? For those incumbents wanting to incorporate automated investment capabilities, partnering with robo firms will also allow a faster go-to-market while requiring fewer resources.

Cannibalization remains a factor reducing the willingness to convert customers to an investment platform, as potential revenue is inevitably lower than the fees currently generated (charged upfront and/or incorporated in the financial instruments used). However, MiFID II requires a new level of cost transparency and we believe it has the potential to induce many investors to

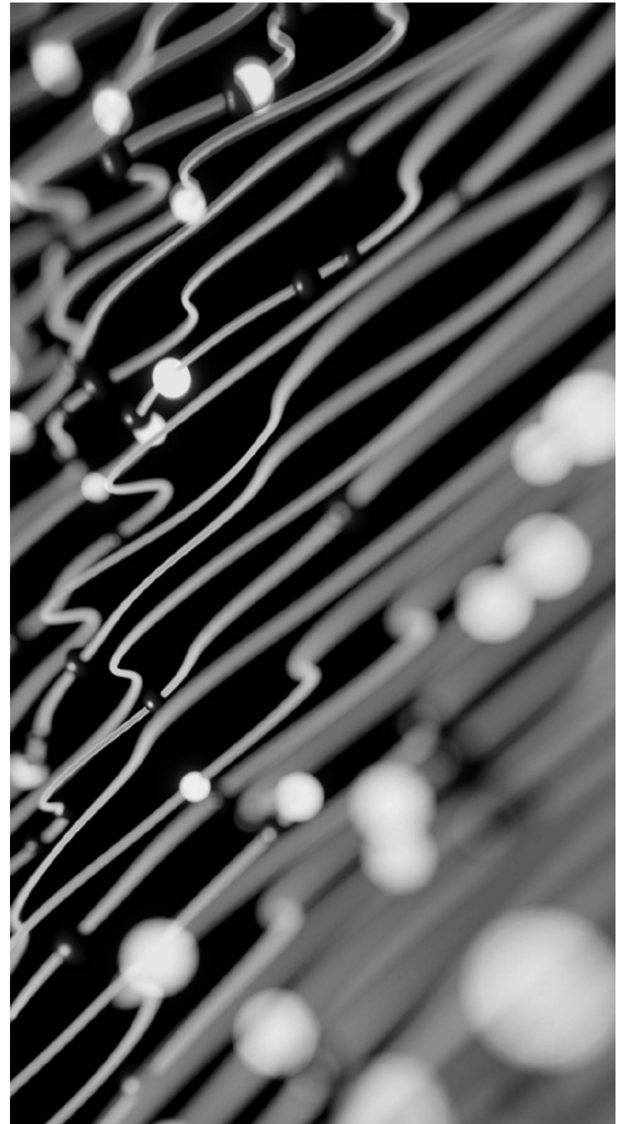
re-evaluate their choices, when Total Cost of Ownership (TCO) becomes painfully clear.

These arguments support our view that the B2B and B2B2C business models have greater potential, allowing robo-advisors to partner with incumbent banks and integrate new capabilities. In short, we see robo-advisors serving as a catalyst for innovation, rather than a threat to existing wealth managers, ultimately leading to better services and customer experience.

HOW CAPCO CAN HELP

The financial services industry is under continuous pressure to evolve and innovate. We help our clients with efficient project implementation, building or integrating capabilities necessary to compete in the wealth management space of tomorrow. Specifically, we apply an agile delivery approach based on your unique needs and business model, allowing a robo-advisory offering to be tested and scaled fast.

To discover our agile delivery approach, contact:



AUTHORS

Vincent Laureyssens, Senior Consultant
Jeroen Van Wint, Senior Consultant
Dennis Rutsaert, Consultant

CONTACT

Jeroen Dossche, Partner
E: jeroen.dossche@capco.com
T: +32 478 22 11 80

WWW.CAPCO.COM

CAPCO

© 2020 Capco – The Capital Markets Company BVBA | De Kleetlaan 6A, 1831 Diegem (Brussels) | All rights reserved