WEALTH

WILL ROBO-ADVISORY TRANSFORM THE WEALTH MANAGEMENT INDUSTRY?

Steven Seow
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The noise around the rise of “robo-advisors” and their potential to challenge established incumbents in the wealth management industry has never been louder. How will the buzz play out for the Asian wealth management industry in the near term?

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Despite all the hype, we believe human wealth managers won’t be replaced by cyborgs any time soon. In fact, the majority of high-net-worth investors continue to use traditional banks for managing their investment portfolios. Robo should be viewed as a means of enabling lower fees and better outcomes and not as an end unto itself that will replace traditional banks altogether. Here are four key reasons artificial intelligence (AI) doesn’t stand up to human intelligence — at least not yet.

ONE: THE ROBO-BUSINESS MODEL DEPENDS ON SCALE

The total assets under management for these digital disruptors represent less than 1% of all managed account assets (approximately US$10 billion of US$4 trillion). More important, most articles about robo-advisory fail to mention that the business model is dependent on scale: Earning only 15–35 basis points of the assets under management in fees, they operate at a fraction of the traditional private banking fee model of 100+ basis points. Say a robo-advisory business has US$100 million under management. Fixed operating costs would take up most of the fees earned — leaving only US$150,000–US$350,000 in gross revenue. It is difficult to imagine sustaining such a small, standalone operation in a flush market like Singapore or Hong Kong. Many firms are simply failing to scale to the size of large global firms like Wealthfront or Betterment.

TWO: PRIVATE BANKS ARE ALSO GOING ROBO

Robo-advice, by definition, promises more efficiency and transparency when compared with the discretionary management of investment offered by the traditional private banking relationship manager. However, the perceived advantage would be difficult for robo-advisors to maintain given that private banks have begun investing heavily in using algorithms similar to those in robo to provide comparable efficiency and transparency.

“TECHNOLOGY CAN BE AN ENABLER FOR CREATING MORE COMPELLING CHOICES GROUNDED IN SOLID INVESTMENTS RATIONALE AND INCREASING INVESTOR CONTROL.”

Source: SEC ADV filings, Cerulli Associates, Oliver Wyman analysis.
THREE: ROBO-ADVISORS FOCUS ON ETFs UNLIKE ACTIVE MANAGER STRATEGIES

In this era of increased macroeconomic volatility and persistently low yields, investors are looking at improving returns from investment portfolios. Robo-advisors are predominantly focused on investing in low-cost-low-yield mutual funds or in exchange-traded funds (ETFs). The returns from robo-advisory are therefore typically lower than returns from active manager strategies. In contrast, incumbent banks have responded to this market reality by creating a more diversified approach to investing and training relationship managers to look at alternative asset classes according to individual investors’ risk appetites.

FOUR: ROBO-ADVISORS DON’T PROVIDE A HUMAN TOUCH

The final reason rests on a sociocultural nuance of Asia and other growth economies. The typical wealthy Asian investor expects human interaction and personalization from an investment advisor, perhaps more so than investors in other parts of the world. Private banks in Asia have met this need by offering discrete, personalized advice based on the risk tolerance and investment preferences of individual investors. In fact, pure-play robo-advisors in Asia are now moving to a hybrid “bionic” model, with the option of either in-person or contact center support.

The ability on the part of banks to channel technology budgets into enhancing customer experience, reporting and automation means the robo-advisory model will need to adapt as quickly to continue to be relevant. Although smaller investors looking to park retirement savings in a low-cost-low-risk instrument may prefer robo, the high-net-worth segment expects a lot more than the algorithm-driven investing offered by robo. Robo-advice will have to evolve to meet its needs: flexibility and transparency; algorithms capable of generating recommendations suited to individual investment experience, preferences and risk tolerance; and more choice and control. The human interface will have to become integral as an offering, not limited to only certain tiers.

Clayton Christensen, Harvard Business School professor and author of The Innovator’s Dilemma, argues that innovation rarely comes from large incumbent players. But as with other disruptive innovations, the emergence of robo-advice has served as a wake-up call for the large incumbents of the wealth management industry. Although the portfolio approach to investing is nothing new from an academic standpoint, a number of traditional private banks have only begun to implement it in the wake of the increased threat from robo-advisors. Because of the rise of robo-advisors, banks are now investing heavily in real-time and dynamic reporting of portfolio performance by aggregating investment data from a multitude of sources using digital technologies.

Technology can be an enabler for creating more compelling choices grounded in solid investments rationale and increasing investor control. How the evolution of artificial intelligence will transform robo-advisory remains to be seen. For now, we project that incumbents will use their scale to either acquire promising robo-advisory start-ups or build robo offerings as part of their existing value chains. Robo-advisors, for all the hype, will have to work harder to build sustainable businesses.

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