

# Roland Berger

## Focus

May 2019

### Robo-advisory in Belgium Can David challenge Goliath?



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# Management summary

Robo-advisory is a currently still small but fast-growing and potentially disruptive innovation in Asset & Wealth Management. Today, 10 years after its establishment, the global market amounts to nearly EUR 500 bn assets under management (AuM). While this represents less than 1% of the worldwide AUM, the global market is expected to grow at a staggering 36% p.a. for the next 5 years.

Most Tier-1 banks in Belgium have added or are at least investigating the possibility to add robo-advice to their product offer, as they see the potential it has to disrupt part of their current business. Moreover, they realize that being an early mover in the market makes it easier to achieve significant scale, which is key to make the economics work for a robo-advisor. Furthermore, for non-traditional financial services players such as tech companies & data management specialists, robo-advisory can be a way to enter into the asset & wealth management industry.

Despite the growing market and the attention from market participants, we see that standalone robo-advisors are struggling to be profitable. They face various challenges, such as creating trust despite their online nature and lack of track record. Furthermore, they need to ensure sufficient data protection & digital security. Also, robo-advisory is a highly competitive market with a lot of pressure on fees and high customer acquisition costs. For more traditional asset & wealth managers it might be easier to create trust, still they face the risk of cannibalizing their existing business.

Therefore, it is key for robo-advisors to create scale and find the optimal client segment, level of human interaction, development model and fee structure.

**Robo-advisory is a digitalized service whereby an online platform provides automated investment advice to clients based on AI & mathematical rules linked to the client's risk profile, with little or no physical human interaction.**

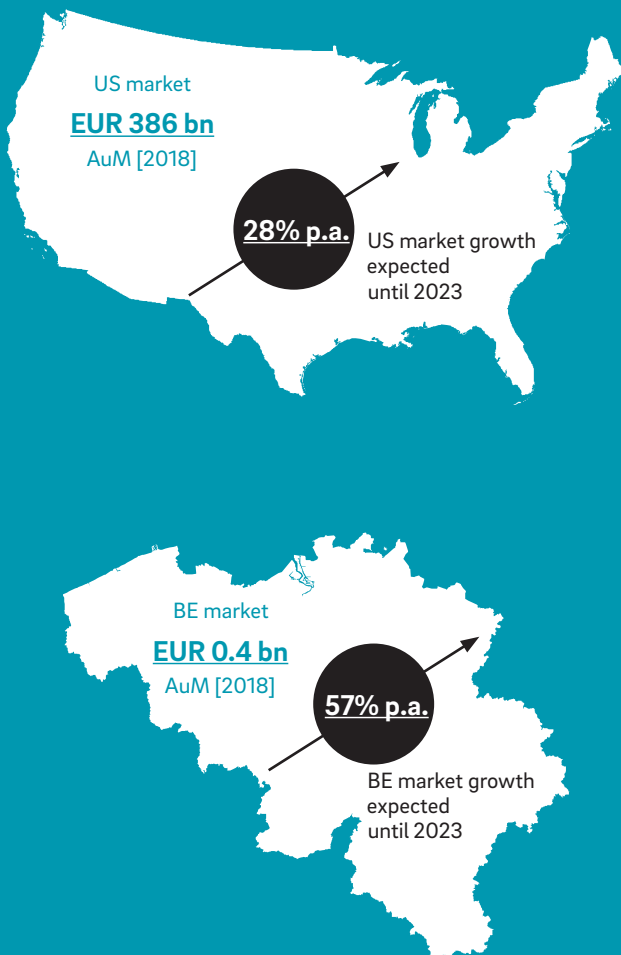
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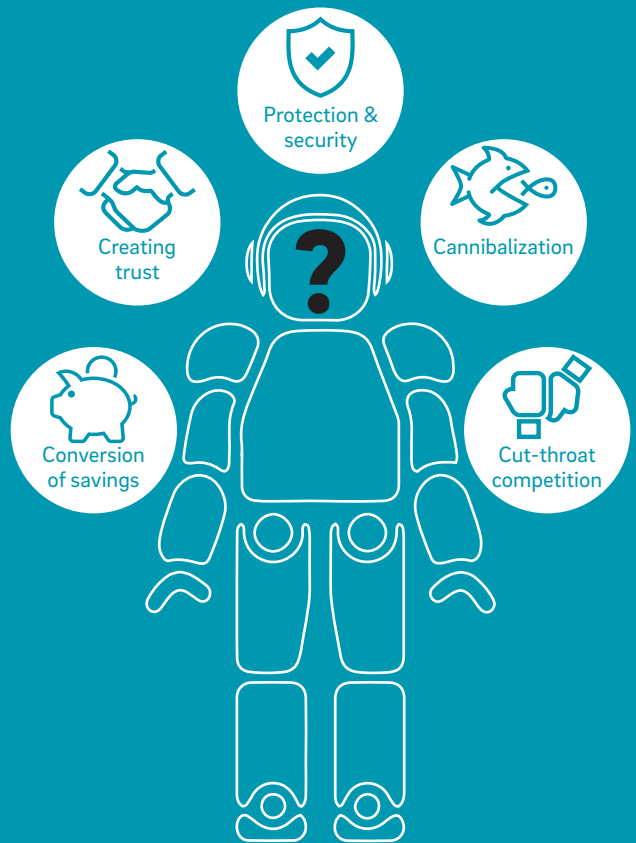
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# Key insights into robo-advisory

## SIZEABLE AND FAST GROWING MARKET



## ROBO-ADVISOR HURDLES



### Key considerations before market entry

- 1. Decide which key client segments to focus on
- 2. Define the level of human interaction
- 3. Compare development options: partnership, white label or in-house
- 4. Review the fee structure

# 1. What is robo-advisory?

Traditionally, personalized investment advice has been a labor-intensive service provided only to private and wealth clients. In recent years however, Asset and Wealth Management (AWM) services have become increasingly automated and accessible to the wider public, accommodated by technological changes. One of the main changes is robo-advisory, a proven business disruption from the US which has recently entered the European and Belgian markets.

Robo-advisory is a digitalized AWM service whereby an online platform provides automated investment advice to clients, based on mathematical rules or algorithms linked to the client's risk profile, with little or no physical human interaction.

Once a client has decided to invest with a robo-advisor, their operational models are quite identical and follows 4 key steps:

## 1. Client questionnaire

An automated questionnaire is used to assess a client's age, financial goals, investment motives and risk tolerance. The questionnaire can require additional information on income, investment horizon, living expenses etc. but in many cases age and risk tolerance are most essential;

## 2. Investment risk profile

Based on the given answers in the questionnaire, an algorithm determines the investor's risk profile;

## 3. Profile-portfolio matching

The robo-advisory algorithm matches one of the firm's predefined investment portfolios with the investor's determined risk profile;

## 4. Portfolio rebalancing

The robo-advisor continuously monitors the risk profile of the investment and rebalances its composition if there would be a mismatch with the investor's risk profile.

## Customer profile



The average robo-advisory client shifted from a tech-savvy millennial to the currently a bit over 40 years old educated male with high financial literacy. Globally he invests on average EUR 19k in the platform, however there is a linear relationship between wealth and the use of robo-advice – more wealthy clients tend to invest higher amounts. The typical client most likely has other investments but would not shift his entire portfolio to robo-advised accounts. In Belgium the average currently invests EUR 9k, an amount we estimate to grow to EUR 10k by 2023.

The client's money is typically invested in a combination of stock and bond Exchange-Traded Funds (ETF). The exact split is defined by the robo-advisor's predefined investment portfolios, matched to the client's risk profile.

## 2. The robo-advisory market

### MARKET SIZE & GROWTH: ARE ROBOTS DOING OVERTIME?

Analysis shows that the global robo-advisory market has EUR 490 bn Assets under Management (AuM) in 2018, a figure which is expected to grow by 36% p.a. until 2023. The US dominates the landscape, and is good for 79% of the total market. In recent years, popularity in the US has grown significantly with the AuM growing at a CAGR of 95% over the period 2016-2018. This growth is expected to continue, albeit at a slower pace, leading to a market of EUR 1,346 bn AuM by 2023. The differences in market size are also translated in the size of the robo-advisors: The biggest American players are more than ten times larger than the largest European robo-advisors. Despite its growth the robo-advisory market is still only marginally important, representing less than 1% of global AuM. Even in the US currently only 1-2% of the population uses robo-advise. → [A](#)

Robo-advisors in Europe manage c. EUR 14 bn assets in 2018, which makes Europe the 3rd largest market after the US and China (EUR 386 bn and EUR 80 bn AuM respectively). Within Europe, the UK has the largest national portfolio for an amount of EUR 7 bn or EUR 107 per capita. Germany's market is second biggest with EUR 4 bn invested or EUR 49 per capita, and Belgium ranks third with an amount of EUR 386 m invested with robo-advisors, equivalent to EUR 34 per capita. Belgium's robo-advisory market has an estimated 45,000 users in 2018, compared to 210,000 in Germany or 400,000 in the UK.

By 2022 the Belgian market is expected to grow significantly to EUR 3.7 bn AuM. This growth represents a CAGR of 57% over the period 2018-2023, a rate well above the average European CAGR of 50% over the same period. → [B](#)

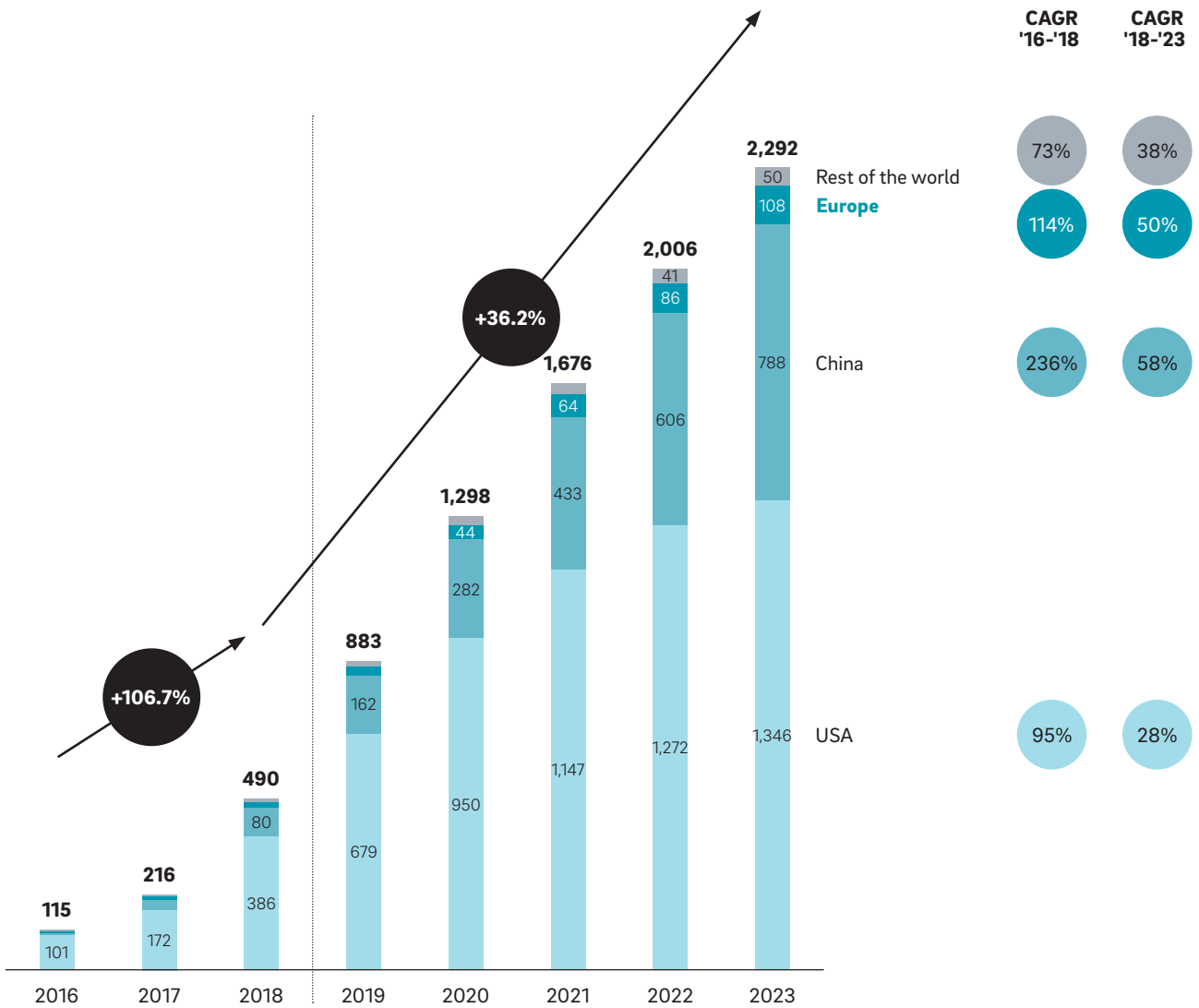
### WHAT DRIVES THE MARKET?

Various factors influence the size and growth of the robo-advisor market, explaining also the difference between the US and Europe.

Firstly, date of establishment plays a role. Robo-advisors were created in 2008 in the US, about 8 years earlier than their European counterparts. In the context of the financial crisis, at the time of creation American players could take advantage of the climate of increased mistrust towards traditional financial institutions.

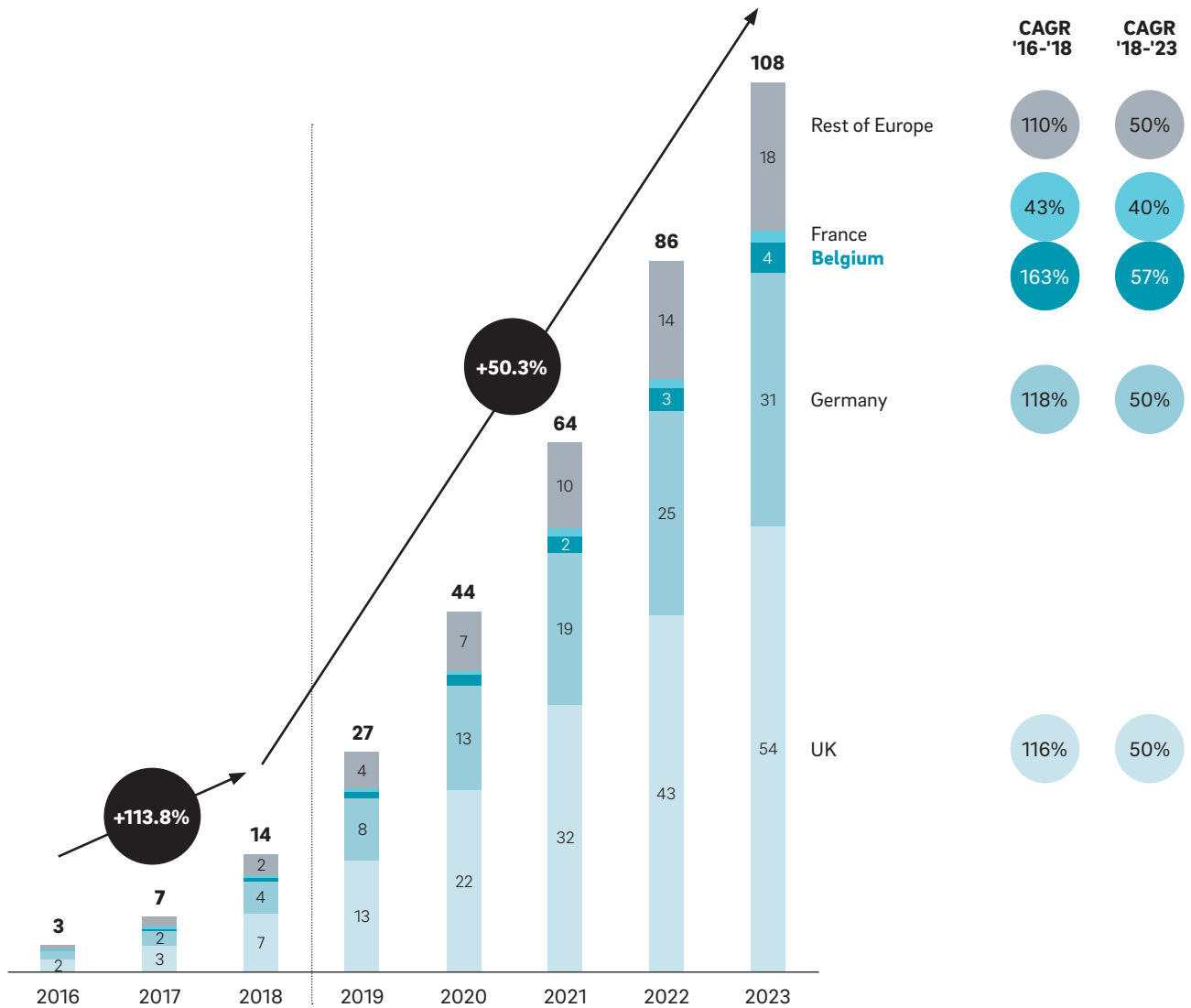
Secondly, customer preferences such as risk aversion and openness to digital vary between countries. For example, capital market participation is in general lower in Europe compared to the US due to more risk-averse behavior of the average European investor. The third key factor is the social security system of the country. The US has a different pension system than Europe: Americans are far more dependent on own investments and savings for their retirement than European and particularly Belgian citizens. Traditional American investment plans are rather inaccessible for the average American, often requiring minimum initial investments of USD 10.000 and above. Hence US robo-advisory firms offering pension saving plans saw tremendous growth thanks to a more accessible investment and more transparent, lower fees.

**A. Evolution of global robo-advisory Assets under Management**  
 Assets Under Management evolution globally [2016-2023; EUR bn]



Source: Statista; Roland Berger analysis

**B. Evolution of European robo-advisory Assets under Management**  
 Assets Under Management evolution Europe [2016-2023; EUR bn]



Source: Statista; Roland Berger analysis









## COMPETITIVE LANDSCAPE IN BELGIUM: A HETEROGENOUS PICTURE

Looking at key players in the landscape, it is clear Belgian players are significantly smaller than their US and UK counterparts. Leading players in the US market manage more than EUR 10 bn assets, compared to EUR 1 bn for the UK and only c. EUR 100 m in Belgium. The Belgian robo-advisory market is therefore still quite limited and highly diverse.

Our comparison highlights the differences between market players regarding number of portfolios, minimum investment and annual fees. Medirect and Dexxi for example offer 5 investment portfolios while Birdee offers up to 20 different portfolios. Similarly, the minimum investment varies across market players, the latter

ranging from EUR 1,000 for Birdee and Dexxi, to EUR 15,000 for Keytrade Bank. Concerning the structure of the fee, most Belgian market players charge a flat rate, with only 2 out of the 6 observed market players integrating a variable component to the fee. Overall, fees charged by robo-advisors are far below fees charged by traditional banks for investments in mutual funds. This advantage will become more relevant due to regulation pushing for increasing cost transparency, which is expected to become a growth driver for robo-advisors AuM's. In addition to the existing robo-advisors, we see that multiple Tier-1 banks and asset & wealth managers in Belgium are currently investigating to enter the robo-advisory market. → [C](#) [D](#)

### C. Comparison of Belgian market players

						
<b>Date of establishment</b>	2016	2015	2016	2016	2017	2015
<b>Minimum investment [EUR]</b>	1,000	15,000	1,000	5,000	10,000	5,000
<b>Number of portfolios</b>	5	10	20	10	9	5
<b>Pricing<sup>1</sup></b>	1.02%	1.21%	1.30%	1.30%	1.48%	1.56%

Source: Company websites; Roland Berger analysis  
Research date 7/12/2018

<sup>1</sup> Estimated annual all-in cost including VAT for portfolio of EUR 15,000, 50% bond and 50% stock investments, taxes excluded.

**D. Spread of robo-advisory fees on the Belgian market**







Estimated annual all-in cost including VAT depending on investment size, 50% bond and 50% stock investments, taxes excluded [% p.a.]



When comparing with US players, the main differences are the lower account minimum and the lower/ flatter fees. Key driver here is the strong competition amongst the large US robo-advisors, resulting in the fact that the average fee charged by US robo-advisors is less than half of the average fee charged in Belgium. Therefore, as the

Belgian market for robo-advisors is gaining momentum fees are expected to decrease in the coming years. → [EF](#)

## E. Comparison of internationally established players

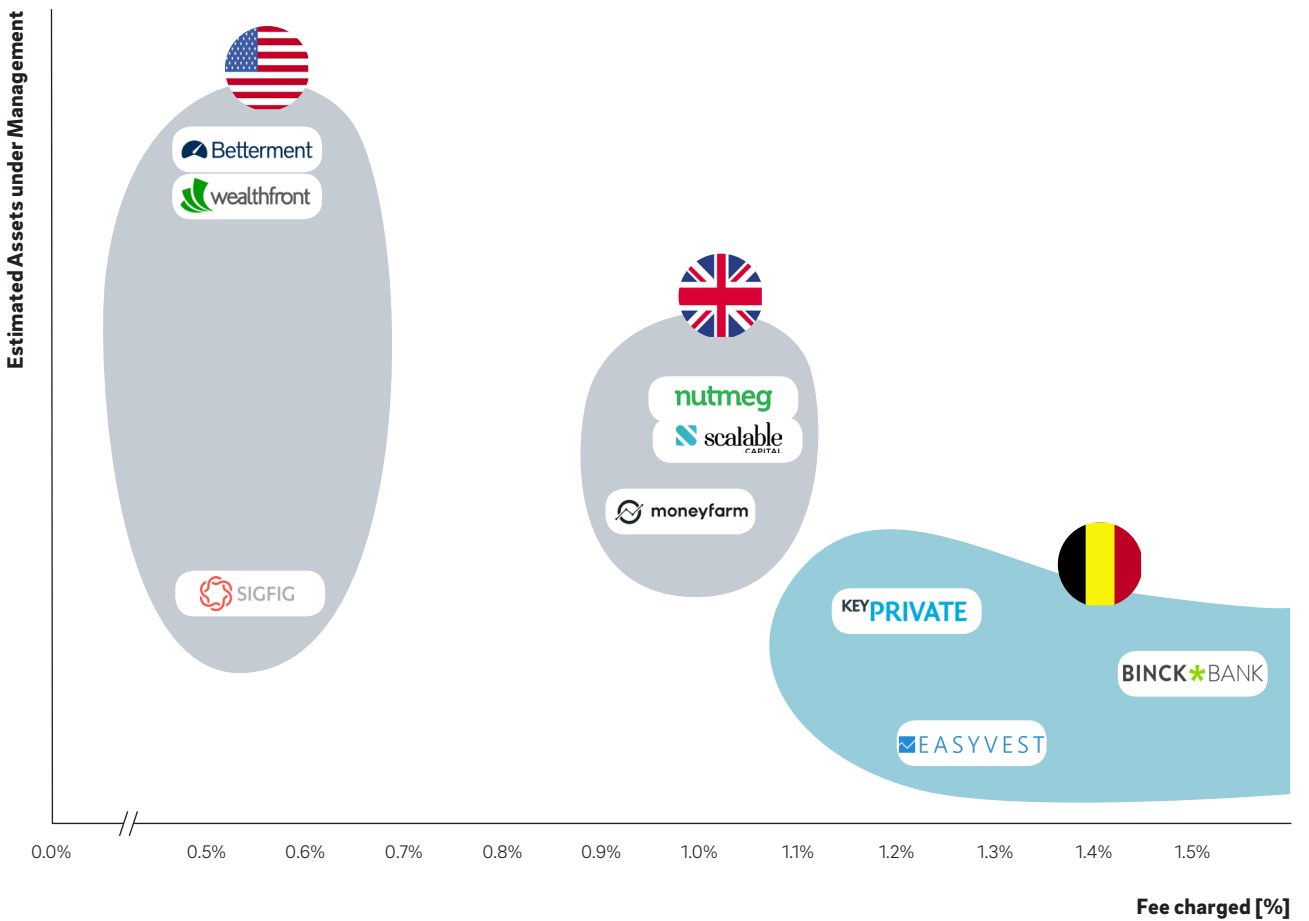
	 Betterment	 wealthfront	 SIGFIG	 moneyfarm	 nutmeg	 scalable CAPITAL
<b>Date of establishment</b>	2008	2008	2006	2016	2013	2016
<b>Country</b>	US	US	US	UK, IT	UK	DE, UK, AU, CH
<b>Assets under Management [EUR bn]<sup>1</sup></b>	11.8	8.7	0.1 (2017)	0.3 (2017)	1 (2017)	1
<b>Minimum investment</b>	USD 1	USD 500	USD 2,000	GBP 100	GBP 100	GBP 10,000
<b>Number of portfolios</b>	10	10	20	6	10	25
<b>Pricing<sup>2</sup></b>	0.55% (flat)	0.55% (flat)	0.55% (flat)	1.00%	1.05%	1.05% (flat)
<b>Standalone/partnership</b>	Standalone	Standalone	Standalone	Standalone	Standalone	Partnership

Source: Company websites; Roland Berger analysis  
Research date 7/12/2018

<sup>1</sup> Conversion based on exchange rate on December 1st 2018.

<sup>2</sup> Management fee for portfolio of EUR 15,000 (excluding taxes and including an assumed cost of underlying investments of 0.30%).

F. Global comparison of robo-advisors, Assets under Management & fee charged<sup>1</sup> [% p.a.]



Source: Company websites; Roland Berger analysis  
 Research date 7/12/2018

1 Management fee for portfolio of EUR 15,000 (excluding taxes, including an assumed cost of underlying investments).

### 3. The robo-advantages

For investors, robo-advisory can offer several advantages compared to conventional AWM. Fees are significantly lower than most investment services and the minimum investment amount is much smaller. As a result, accessibility of robo-advisors is higher, leaving investors more possibilities to diversify their investment portfolio. Furthermore, an investor's portfolio is continuously optimized based on a very objective, albeit sometimes basic, set of rules. In addition, in the US and UK these platforms often allow for basic financial planning by supporting clients in setting tangible savings targets, such as a new car. In doing so, players sometimes use gamification to make investing more fun.

Robo-advisors can also realize significant benefits. The use of an automated system providing investment advice based on the risk profile of the client leads to much lower service cost. If for example traditional banks would incorporate robo-advisory into their services offer, they could service new or existing customers at lower costs. The lower service costs of robo-advisors that are fully relying on a digital platform has however also a downside for traditional banks and asset managers, players without established branch network can enter the market relatively easily. In addition to low costs, providers can leverage the ever-improving algorithms behind robo-advisors to provide more optimal investment advice tailored to the client's risk profile compared to other, more traditional investment services.

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## 4. Where do robo-advisors struggle?

Despite the different advantages for clients of robo-advisors and the cost advantages they have, we see that mainly robo-advisors struggle to be profitable. This is mainly related to 5 hurdles they need to take.

### 1. Conversion of savings

As is the case with other investment products, market players have difficulties to penetrate markets with high regulated pension schemes or where part of the customers continues to value traditional saving accounts over financial investments (as is the case in Belgium). Although also traditional banks face this challenge, the situation is particularly difficult for robo-advisors as they often have less direct access to potential clients via e.g. bank branch employees.

### 2. Creating trust

Some client segments currently still mistrust a robotized service or algorithm-based investment advice, due to the lack of human contact. As an example, robo-advisors will have difficulties to explain and contextualize negative market movements. Furthermore, the lack of track record of these robo-advisors is for some customers an additional source of skepticism. Once a client is convinced, robo-advisors also face difficulties building up an intimate investment relationship with their customers.

### 3. Protection & security

Like any digital service using sensitive customer data such as age or net monthly household income, clear communication on how personal data will be used and stored is key. Additionally, an online platform needs to protect sufficiently against cyber-attacks which could alter advice by manipulating the algorithm.

Additionally, because of its automated nature it is possible that investors make unsuitable decisions due to limitations, assumptions or errors within the tool. In such

scenarios unclear allocation of liability can lead to legal disputes or a bad market reputation, the effect of which can be significant in a competitive environment with no clearly differentiated service.

### 4. Cannibalization

In recent years, most Belgian banks have redesigned their service offer, no longer offering free AWM services, and are instead charging fees for investment advice on top of the fees charged for investing as such. When these banks offer now a low-cost (automated) investment platform, they risk cannibalizing their investment fees, which are significantly higher than robo-advisory fees.

### 5. Cut-throat competition

Most robo-advisors have difficulties being profitable. They rely on economies of scale but struggle to differentiate from competitors due to the technology they use. Given the limited differentiation, customer loyalty levels are also relatively low. Additionally, experience shows that customer acquisition costs increase when market maturity and competitive pressure rises. Hence, it is key to create scale and find the optimal fee structure.

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If Belgian banks offer now a low cost (automated) investment platform, they risk cannibalizing their investment fees, which are significantly higher than robo-advisory fees.

## 5. Where do we go from here?

Traditional banks, wealth management advisors and potential new entrants to this high-growth market should reflect critically on four key considerations.

### 1. Decide which key client segments to focus on

Market players should review their current client portfolio and identify on which target group they want to focus with their robo-advisory offer. On the one hand approaching one of their own client segments will save on client acquisition costs, but market players should be aware of the risk of cannibalizing their wealth management services which generates higher fees than robo-advisory. Targeting a new client segment on the other hand (e.g. tech savvy millennials) will come at a higher acquisition cost but will increase a player's aggregated AuM.

### 2. Define the level of human interaction

Based on the identified client segment(s), a market player should decide which level of human interaction is appropriate. As standalone players do not possess an extensive branch network such as a large retail bank does, most existing robo-advisors offer no physical human interaction. Hence, generally only online contact (e-mail, phone & videocall) is possible.

However, client preferences vary by country and region, and Belgian customers often still value human interaction in financial advice, even if fully automated advice allows for lower costs and fees. Therefore, a hybrid model could be successful. In this model, the investment advice could for example originate from a robo-advisor through a chatbot, supported by an experienced banker who does the intake and who is available for follow-up. Furthermore, marketing the service as a "Digital advisor" or "Discount advisor" could bring more trust.

### 3. Compare the development options: partnership, white label or in-house

In-house development of a robo-advisor has the advantage of creating a fully tailor-made solution for a specific company or client segment. It however requires particular expertise and could lead to a long, uncertain process. Alternatively a market player could reduce the development cost by cooperating with a white label platform provider. Such platforms often have a proven track record but are less customizable, making it more difficult to differentiate from competing robo-advisors.

Finally partnerships between market players can further share risks and decrease investment costs, but here again customization could become an issue as well as information sharing between different players.

### 4. Review the fee structure to create a profitable and sustainable business model.

For robo-advisory four main fee categories can be used: **Flat fees** take a fixed percentage on an investor's AuM. They are most common in today's robo-advisory market. A flat fee is more likely to be cheaper than a variable fee for a smaller sum investment and hence should attract a large number of small investments. With flat fees however, incentivizing investors to increase AuM will be a major challenge, which makes harvesting economies of scale more complex.

**Variable fees** charge a percentage on an investor's AuM, the percentage decreasing as the client's investment becomes larger. This allows an investor to benefit from economies of scale when transferring more funds to the robo-advisor's management but is often relatively more expensive for smaller investments. The advisor can however more easily target wealthier clients such as High Net Worth Individuals and grow its profitability faster.



**Performance-based fees** take a percentage of the investors return. These fees reduce costs for investors, in situations where market circumstances limit profit. From the advisory firm's viewpoint however, a performance-based fee introduces market risk to the business model.

A fixed amount fee is charged, disregarding the invested amount. For the investor this could lead to relatively high costs when investing small amounts, whereas for the robo-advisor a fixed amount fee mirrors its fixed cost structure and offers predictability of income.

Finally, a blended fee model can be used combining multiple of the aforementioned fees. Blended fees allow advisors to optimize their fee income but might lead to a less transparent and higher perceived fee from the investor's point of view – and is that not part of what robo-advisory wants to overcome?

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## WE WELCOME YOUR QUESTIONS, COMMENTS AND SUGGESTIONS

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