# WEALTH MANAGEMENT AND DISRUPTIVE CHANGE

Redesigning Financial Services

## Five key insights from other industries

# WEALTH MANAGEMENT AND DISRUPTIVE CHANGE

## Five key insights from other industries

Disruption can be painful. Other industries provide a reminder of how painful the process can be — from Uber disrupting the taxi business to Apple changing the way people consume music to Airbnb shaking up the hotel industry. But disruption is not a one-time event risk. It is continuous pressure to innovate in the face of changing consumer behaviors, new technological innovations, and new competitors entering the market. Today, this pressure is rising fast, even affecting sectors previously insulated from disruption like wealth management.

Historically, wealth management has been relatively immune to disruption. The reasons for this are threefold: first, a special regulatory status shielded the sector from too much competition; second, clients have historically been slow to switch providers, even in the face of high fees and in cases of unsatisfactory investment performance; and finally, opaque fee structures have made it exceedingly difficult for clients to compare pricing options among competitors. However, today, in a post-Covid world, the industry seems ripe for change as the lockdown period accelerated multiple consumer trends, including the rise of retail investors.

# Signals of structural change in wealth management

Fortunately, as this threat of disruption has become mainstream, more wealth managers are thinking about ways to improve the value they deliver to clients. And with the right response, disruption can offer enormous upside to firms willing to recognize shifting customer and industry trends early. The biggest opportunities will likely belong to firms able to extract key insights from disruptive events in other industries. To this end, we have identified five key insights from other industries that have experienced disruption in the past.

1 Accept that instantaneous arbitrage is here to stay

2 As services become commoditized, define a clear value-add

3 Understand the importance of personalization to deliver value

4 Threats from outside the industry amplify the need for change

5 Learn organizational ambidexterity

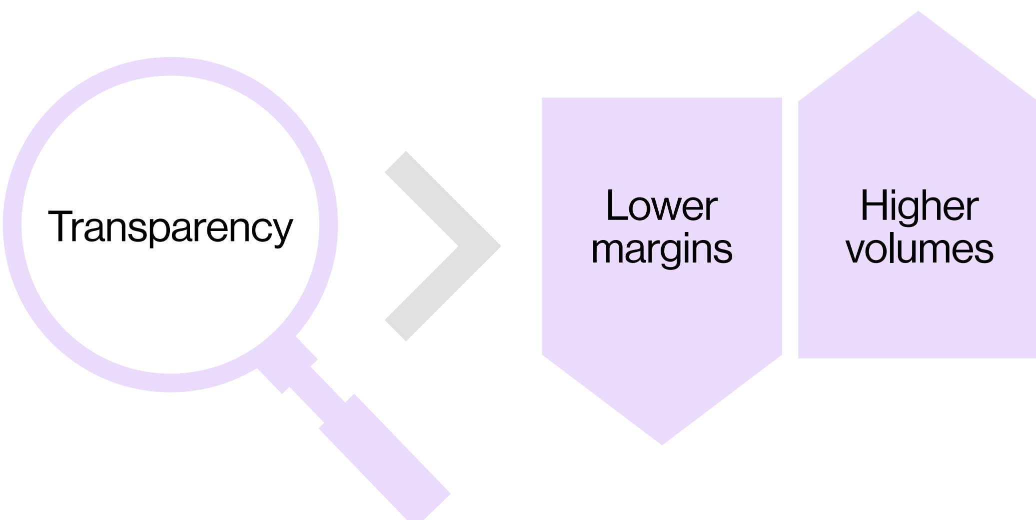
# Accept that instantaneous arbitrage is here to stay

1

The first key insight refers to the importance of learning to live in a world in which online platforms have offered consumers instantaneous arbitrage – or the ability to instantaneously check prices and seamlessly select the most attractive offering. A good example of how this tech-enabled transparency has affected an industry is the retail sector, especially in the last year. Here, online platforms like Amazon have forced retailers with a physical presence, to match Amazon 's prices, with most major retailers following suit, causing average prices to fall.

Clearly, the reality of instantaneous arbitrage in retail was and is painful for brick-and-mortar retailers, but the phenomenon is empowering to consumers. By spurring competition among incumbents, the consumer benefits from greater transparency, access to lower prices, a wider variety of goods, and better service. In this process, incumbents are forced to lower their margins, increase their volumes, and also to carefully re-evaluate their true value proposition beyond low prices.

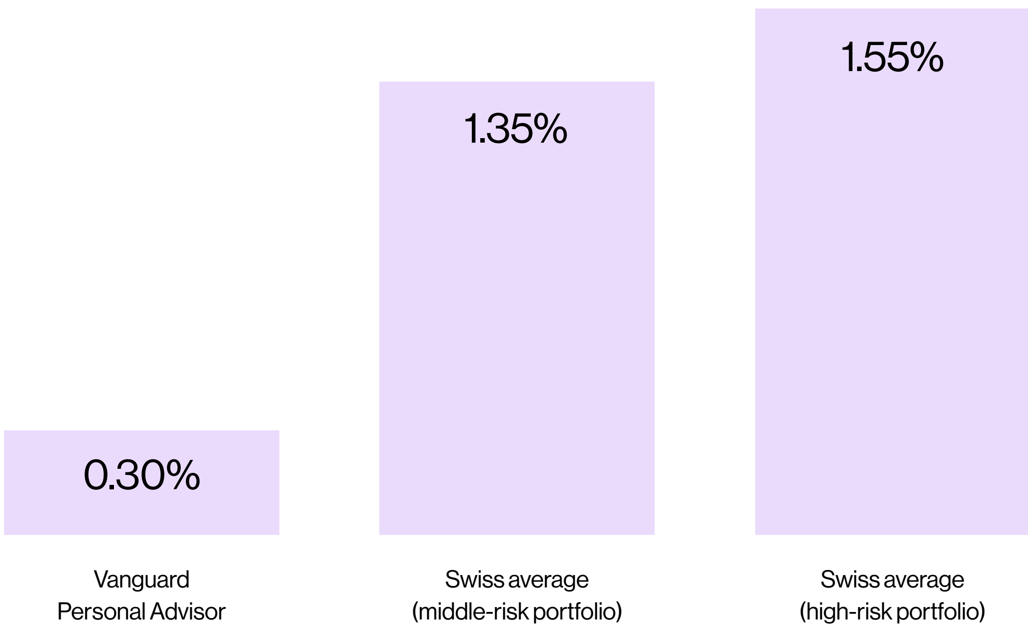
**Higher transparency squeezes margins, forcing incumbents to focus on volume**



In the wealth management sector, a similar price matching trend may be on the horizon. For instance, modern robo-advisor or hybrid advisor platforms are already making fee structures more transparent. And for a good reason. Consider the world's largest hybrid robo-advisory service, Vanguard Personal Advisor Services, which charges a mere 30 basis points for wealth management services (including human advisory when needed). These low costs (often five times lower than those of incumbent operators) and transparent platform services have driven assets under management to more than USD 220 billion over the last year. This may have systemic effects for the industry.

Specifically, the growing transparency that comes with instantaneous arbitrage means that consumers are also likely to ask for more from their providers – better service across more channels at a quicker pace and lower costs. And as investors begin to squeeze fees, commissions are likely to be replaced by more transparent fee-based services. The earlier incumbents respond to this new competitive environment, the better they will be able to use technology to lower operating costs and ultimately build volume by expanding access to previously underserved clients (i.e. affluent).

**New offerings put pressure on fee levels**
Annual management fee: Vanguard Personal Advisor versus average Swiss wealth management products



# As services become commoditized, define a clear value-add

2

The second key insight comes from the travel industry. Around the year 2000, the rise of online travel platforms Expedia, Ebookers and TripAdvisor disintermediated large parts of the tour operator value chain. At the same time, airlines and hotels started distributing capacity directly to consumers, after having sold seats and rooms to intermediary tour operators for decades. Suddenly, consumers were able to book flights and hotels online from home, and at lower costs than ever before. In short, there was no need to consult a travel operator anymore.

A similar phenomenon is occurring in the wealth management space at the moment. With the proliferation of dozens of automated wealth advisors on a global scale, many wealth management services are at risk of being slowly but surely commoditized. The key threat arising from commoditization is that products and services become more similar from a buyer's perspective, causing customers to opt for the cheapest. So, just like tour operators packaging airline seats and hotel rooms for high margins were forced to consolidate, many of today's traditional wealth managers face a similar moment of truth. In a world in which automated wealth services are setting new standards in terms of transparency, convenience, and costs, incumbents are invited to creatively re-evaluate the real value-add they deliver to their clients that goes beyond merely competition on price.

In this environment, the service quality or advice will likely turn into the ultimate differentiator among wealth advisors. In the travel industry, the surviving agencies adapted to new market dynamics by embracing online and mobile channels to better serve their clients. For example, onmi-channel strategies allow customers to be served through whichever channel they prefer – both online and offline.

# Understand the importance of personalization to deliver value

3

The third insight refers to the growing relevance of delivering a differentiated customer experience. Consumers have become accustomed to the uncompromised customer focus pioneers like Amazon, Zalando and Google bring to delivering a simple, convenient and highly personalized user experience. Just like Spotify personalizes the music you hear, Netflix personalizes the movies you watch, and Amazon personalizes the selection of books that might capture your interest, wealth management clients also expect to be understood and appealed to in their full emotional complexity — and not crudely segmented according to wealth or age.

Indeed, the examples mentioned above suggest that a deep understanding of the drivers informing consumer behavior is necessary to deliver truly personalized wealth advice. To this end, advancements in customer analytics can help companies create more sophisticated psychographic profiles of their clients' aspirations in order to better understand and predict their behavior. But the power of customer insight and predictive analytics is not just about understanding consumer behavior but also influencing it. Indeed, many companies today already use big data techniques to build algorithms intended to influence the choices that consumers make.

For instance, by harnessing game-playing principles (gamification) or by carefully designing the presentation of different choices (choice architecture), companies can nudge human behavior in areas where traditional incentives may fall short. For example, in health-care, choice architecture and gamification techniques are used to help people improve behaviors such as diet, exercise and other patient compliance topics. Such techniques are also being used by Vanguard to nudge clients to save (and invest) more for retirement.

Indeed, advanced customer analytics tools offer wealth managers new possibilities to better understand their clients and to customize their value proposition. And in a world in which technology is commoditizing more products and making value chains more transparent, highly personalized advice may well turn into the ultimate differentiator for incumbent wealth managers. Customer analytics tools especially those building psychographic profiles can help shape this new value proposition.

# Threats from outside the industry amplify the need for change

4

The fourth key insight from other industries is that incumbents increasingly face new competitive threats from previously unrelated sectors. For instance, the auto industry offers a clear example of how new competitors are challenging traditional boundaries of the car industry. Today, value in cars is shifting away from its traditional reliance on hardware and increasingly focusing on software and services with a focus on connected, autonomous and shared driving experiences. This shift is allowing companies that excel at code and algorithms like Google, Uber and Apple to compete directly with car manufacturers for "ownership" of the driver experience.

In a similar way, non-traditional wealth services providers like technology firms could emerge as the main competitive threat to incumbents. Indeed, Apple Pay and Samsung Pay are already reshaping transaction and payment processing within the financial services sector. And in 2015, the Chinese online platform Alibaba added Ant Financial to its ecosystem of companies, which operates as an open-architecture platform for asset managers. According to Alibaba, the number of users on the platform has quickly grown to over **380 million people**, representing assets under management of over **USD 120 billion.**

In the face of such strong industry convergence trends, the future of competition in the wealth management sector is likely to shift from company versus company within the industry to cross-industry ecosystem versus ecosystem. As such, incumbents will need to transform their strategies, processes, and business models to become integrated, digitally driven businesses. Partnering with technology providers can accelerate this process, allowing incumbents to offer their clients a seamless, technology-enabled, personalized experience.

# Learn organizational ambidexterity

5

The fifth key insight refers to the importance of a firm being able to manage its current business while simultaneously exploring new market opportunities in response to impending structural change. Stanford Professor Charles O'Reilly calls this ability "organizational ambidexterity". Firms unable to adapt in this way tend to be incumbents who prematurely dismiss new consumer trends as inconsequential relative to established services, concentrating instead on optimizing existing businesses by cutting costs. Kodak offers a picture-perfect example here, as it missed the shift to digital photography, leading to its 2012 bankruptcy. In 1999, Kodak was the world's largest camera and film producer, generating profits of over USD 2.5 billion. However, when worldwide film sales declined rapidly in 2000, it became clear that structural change was imminent. In response, Kodak focused on cost reductions to preserve its profitable film business, even cutting experimental divisions. This started a painful downward spiral of desperate attempts to revive the core business of selling film.

Meanwhile, Kodak's main competitor Fujifilm followed a different path. Realizing that digital photography would not be very profitable, the firm developed a two-pronged strategy: first, maintain the profitable film business as long as possible, and second, prepare for the switch to digital by transferring existing expertise to new markets like flat-panel screens, cosmetics, and pharma. By the end of 2016, Fujifilm had annual sales of over USD 20 billion, while Kodak generated a mere 5% of this figure.

The example illustrates the importance of organizational ambidexterity in the context of disruptive change. In the same way, wealth managers should also maintain their existing businesses while simultaneously exploring new market opportunities with their in-house skillsets enriched by external views. For instance, by leveraging the capabilities of automated wealth advice, incumbents can keep costs lower and thus gain access to parts of the mass market, effectively creating a "nursery" of clients whose financial wealth may grow over time.

# Conclusion – act soon

This is a time of significant disruption in wealth management. Disruption will not be a one-time event, but rather a continuous pressure to innovate that will shape customer behaviors, business models, and the long-term structure of the wealth management industry.

Moreover, with regulatory changes also reshaping the industry, two themes are clear: first, wealth managers will be increasingly discouraged from receiving commissions when their clients buy products; and second, advisors will be forced to provide independent advice in the best interest of the client. With all these changes in the industry, the five key insights mentioned above can help companies navigate this new disruptive environment. But there is no time to lose.

## Authors


**Zaniyar Sharifi**
Head Research, RFS

**Robert Ruttmann**
Founder, RFS

**Sebastian Mojsa**
Creative Director, RFS

Redesigning Financial Services

**www.redesigning-fs.com**
Zurich 2021