Robo-Advisors: Threat or Opportunity?

Over the past few years, billions of dollars have been invested through Robo-Advisors, a relatively new type of internet-based investment intermediary. These automated systems offer investment management (and in some cases financial planning) at dramatically reduced fees by cutting out the middle man – the traditional broker/advisor.

Robo-advisors Betterment and Wealthfront are each approaching $3 billion in assets under management. Within four years, robo-advisors will collectively control $255 billion in end-client assets, according to research by MyPrivateBanking.com.

Should the multi-trillion dollar advisory industry view robos as a business threat? Or should advisors view their emergence as an opportunity? We believe that rather than fight the robo-advisor trend, advisors will be better served by incorporating the philosophy into their business as they see appropriate.

As background, venture-capital-funded entrepreneurs originally developed robo-advisors to address the needs of smaller investors, typically with little money to invest and little or no investment experience. Investors can simply sign up for the service, fill out a profiling questionnaire, and invest in the appropriate asset-allocation model for a low minimum investment and at a very low fee.

The original concept targeted millennials, as they fit this investor profile. And many millennials are more comfortable with an online service that is quick and efficient. However, robo-advisors have shown that their markets can extend past millennials and other small investors; some investors with substantial assets have embraced the concept as well.

In our estimation, the early growth and success of robo-advisors is evidence that they are here to stay. Advisors can fight them and stick with the line that nothing can replace personalized and individualized advice, or advisors can ask themselves the question, how can I utilize the emergence of robo-advisors and their technology to my advantage? Here are three ways:

- **Assist with client segmentation.** As many advisors grow their businesses, they face the issue of having too many clients — and they often have to grapple with the issue of what do to with smaller, less profitable ones. They also have to turn down prospective new clients who don't meet their account minimums.

Advisors can use robo-advisor services as an alternative for clients or potential clients who don't fit into their current business model. Rather than turning them away, advisors will be able to keep them.

As client assets grow over time, and these clients need more-sophisticated services, they can be migrated into the advisor's core business. And at that point they become more-profitable clients. Or, if they are happy, they remain as robo-type clients — the advisor's revenue from them might be smaller, but they are not spending a lot of time or money on client service.

- **Attract family members of clients.** Advisors often struggle to effectively attract the family members — typically children — of current clients. This is a serious setback, as developing such relationships is crucial to building a longer-term sustainable business. But a robo-advisor service component can mitigate this threat, as such systems allow these family members to become part of the firm even before they amass assets. As a result, these new clients will learn the basics of investing and be more apt to become long-term clients.

- **Attract millennials**. Similar to the matter above, as advisors grapple with the issue of how to service the newest generation of investors, they are offering them what the competition is offering — again without disrupting their current business model. Over time, as advisors attract more millennials through the robo-advisor model, they will learn more about them and their long-term needs and traits. Indeed, they will be better prepared to adjust their entire business model in the future if necessary.

So from many perspectives, I think it is better for advisors to embrace robo-advisors rather than fight the trend. Many sponsor firms — such as Schwab and Fidelity — have joined the trend and are offering or developing their own robo-advisor platforms.

Hey, if you don't like the term "robo-advisor" — or think that it diminishes you somehow — don't call it robo-investing. Characterize it as a virtual advisor or an online or digital supplement to your current business model, which, for a lower fee, affords investors some alternative investment options.

Whether you develop your robo-advisor capabilities or use those of a third party, and regardless of what you call it, I think ignoring or fighting this trend is less advantageous than going with the flow.