

ONLINE WEALTH MANAGEMENT

An investor's paradise to Financial Safety and Prosperity



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Executive Summary

Innovation and Renovation are the key principles that many businesses have successfully adopted to make a name, and also sustain in today's world of evolving and demanding customers. On the other hand, there is technology that is continuously changing and influencing the face of businesses with its trendy gadgets and glowing ideas. The above two phenomenons has in fact transformed our lives by complementing each other's success.

The Wealth Management industry, has most strategically embraced this phenomenon of "Business innovating Technology" and "Technology renovating Business". The most recent and profound technological revolution has now paved way for the use of robots (powered by Investment Algorithms) to drive Wealth Management business. These financial robots (popularly known as "Online Wealth Management Firms") have also started playing their cards carefully and cleverly by attacking the very business models of the Traditional players. The most remarkable challenge being posed is on the major revenue item - "Fees".

This paper discusses the advantages and pitfalls of the emerging trend in Online Wealth Management firms.

Online Wealth Management: In a nutshell

The phrase "financial robots" was used in the above section to introduce Online WM firms. Let's discuss this in further detail, investment planning

involving model portfolios and asset allocation is a typical core function of any WM firm. Every other firm has its unique way of handling these aspects by tailoring them according to their clients needs. The wealth managers and advisors play a vital role in this part of the WM value chain. The online WM firms seek to distinguish themselves by making these aspects driven through technology and software programs powered by carefully thought and designed quantitative investment algorithms. The aspects of risk management, model portfolio, asset allocation, product selection, re-balancing, and tax-harvesting are all automated with very minimal scope for human intervention. The account minimums in their business models are either absent or as low as \$1000. They have surged ahead in the aspect of charging the client with very low fees ranging from 0.15%-0.35% of AUM. On the contrary, the industry average for fees in the traditional model hovers around 1.10% of AUM.

Positioning in the US Wealth Management Industry: Right Services to the Right People?

Figure I clearly indicates the wealth management industry landscape in the US market.

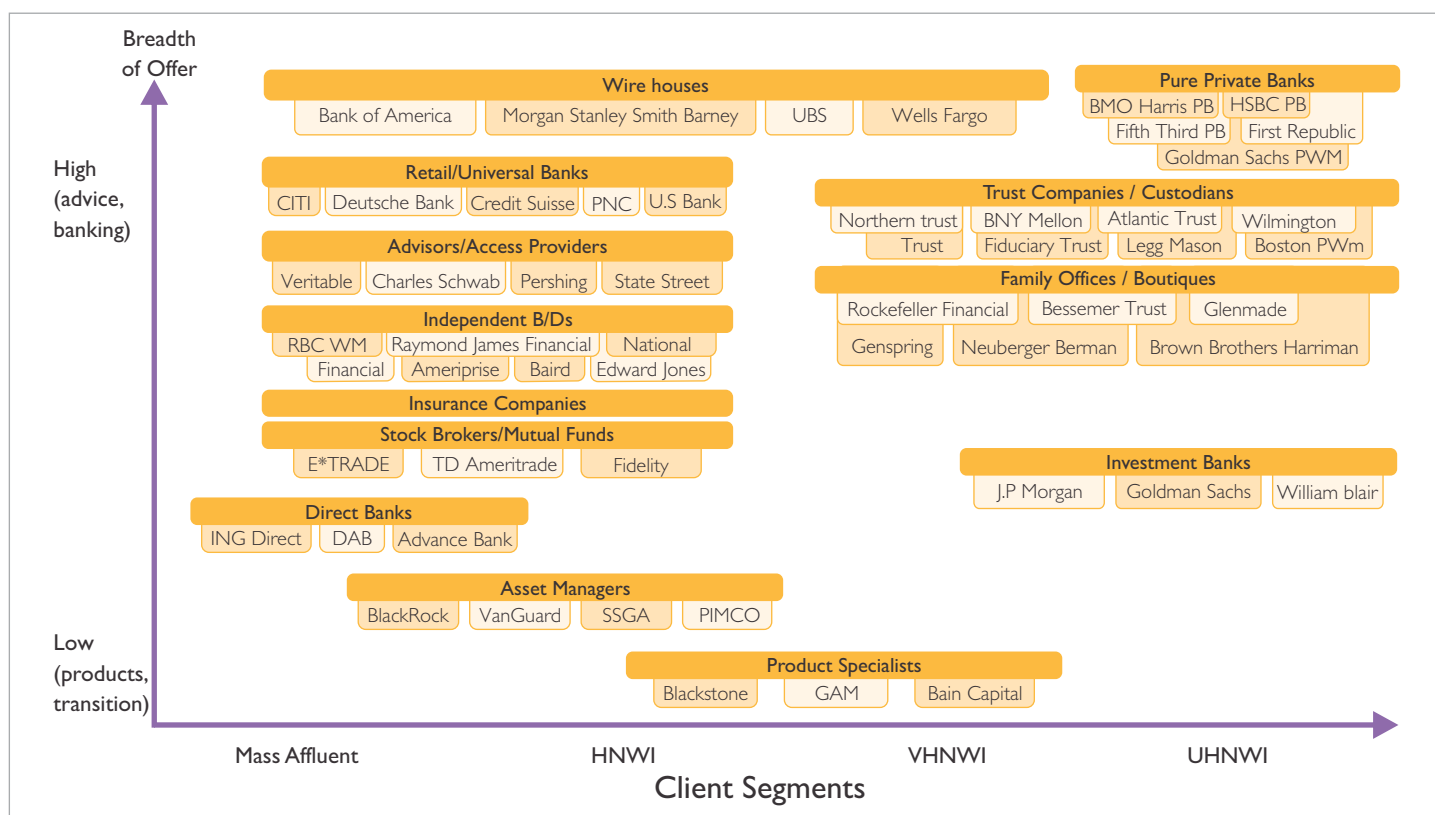


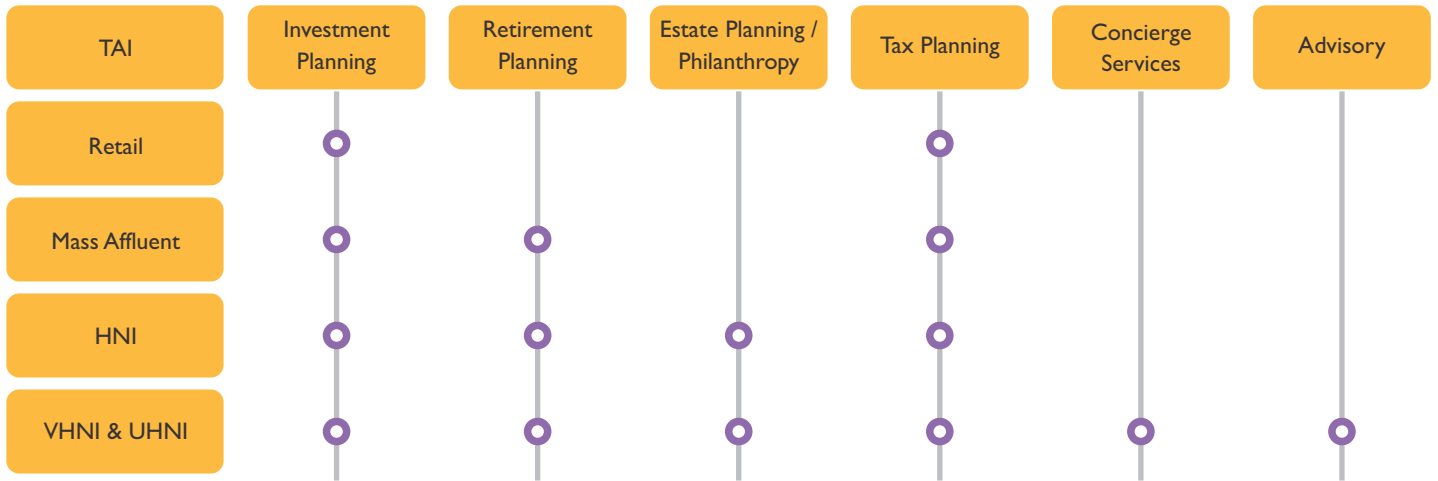
Figure I: US Wealth Management Industry – A Service Landscape.

The Online WM firms have been targeted at the young technical, entrepreneurial and professional minds in the Silicon Valley. From our analysis of the competitive landscape in the industry, the retail segment of clients is clearly being neglected as shown in Figure I. This is because the traditional WM firms do not find it profitable. Profitability is also a concern in the mass affluent segment. The online WM firms are powered by technology as the virtual wealth managers and advisors could afford such services to the retail segment and also make it easily profitable in the mass affluent segment. This enables such a business model to eliminate the hiring of expensive wealth managers, advisors and more importantly reduce the fees being charged to the clients.

Will an arm's length of services attract the retail and mass affluent segment?

- Now that online WM firms have targeted the retail and mass affluent segments, it would be prudent to examine the expectations of these

segments and conclude if the demand and supply are aptly married. The retail and mass affluent segments have their expectations built mainly towards financial growth and prosperity. A sub-section in this segment is also far-sighted by planning towards their retirement. Tax planning is another aspect that is very rampantly sought after by certain sub-sections. It is also necessary to note that these sections of clients are not really worried about estate planning or charity planning or concierge type of services. Their financial goals are usually oriented towards wealth accumulation in shorter time horizons. "Wealth Management driving Personal Finances" is the tagline being used by majority of the players in this new business model. Table below is a depiction of the services needed and demanded by various client segments in this industry. By analyzing all these various aspects, the positioning of the online Wealth Management firms is very well and aptly placed to serve the **Mass Affluent and Retail segment with Low Breadth of Service offerings.**



Primary offerings by online Wealth Management firms:

Listed below are some of the offerings that have been packaged exclusively for the retail and mass affluent segments:

1. Customized Risk assessment and Asset allocation strategies
2. Investments in ETFs and Emerging markets
3. Automated Portfolio Re-balancing and Tax-Harvesting
4. Transparent client reporting and Performance attribution
5. Enhanced customer service and low-end Advisory services

Online Wealth Management Firms: A Competitive Cloud

The Figure 2 below gives a clear snapshot of the external competition faced by the Online Wealth Management Firms.

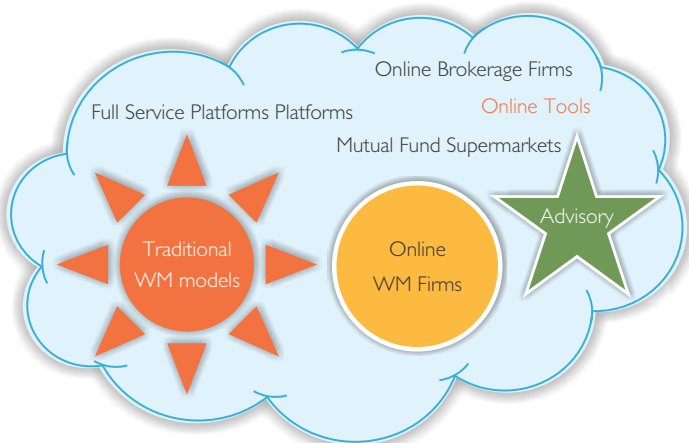


Figure 2: External Competition – An Outsider’s View

A CSF (Critical Success Factor) Analysis (table below) was also carried out for the Online WM Firms on the existing business models in the Wealth Management Industry. It reveals the bright (in Green) and grey (in Red) areas in 15 different aspects that would drive the future of these firms. Let’s analyze in detail how the online WM model stands against each one of them.

A. Traditional Wealth Management Models:

Ever since the launch of Online Wealth Management firms there has been a huge uproar from certain segments in the Wall Street that this disruptive innovation would steal the AUM of the traditional WM players. The traditional WM players in this context could be Private Banks, Wire houses, Investment Banks, Asset Management companies, Trust Companies, Independent Broker/Dealers and Retail/Universal Banks. By the very positioning of the Online Wealth Management firms, such uproar could be justified, but only minimally.

The most important factor to be emphasized is that Online Wealth Management firms target only the bottom of the pyramid (Technology Mass Affluent/Retail clients seeking limited products/services). This is a dismally low percentage of overall segments of clients catered to by the traditional Wealth Management players.



Service Models	Critical Success Factor Analysis						
Vs.Critical Success Factors	Online WM Firms	Traditional WM	Advisory	Full Service Platforms	Online Brokerages	Mutual Fund Supermarkets	Online Tools
Client Segment	Retail & Mass Affluent IT Professionals	HNW & above	HNW & above	Mass Affluent & above	Mass Affluent or HNW	Mass Affluent	Retail
Fees or Commissions	Very Low	Very High	Very High	High	High	High	Very Low
Range & Richness of Services	Very Low	Very High	Very High	High	Low	Low	Very Low
Customized Services	Very Low	Very High	Very High	High	Low	Low	Very Low
Account Minimums	Very Low	Very High	Very High	High	Medium	High	NA
Asset Classes	Mostly ETFs	WideRange	Wide Range	Wide Range	Limited	Mutual Funds	NA
Technology	High-End	High-End	Mediocre	High-End	High-End	Mediocre	High-End
Geographical Footprint	Local or National	Global or National	Global or National	Global or National	National	National	Local or National
Scope for Innovation	Very High	High	High	High	Medium	Medium	High
Operating Cost	Very Low	Very High	Very High	Low	Low	High	Very Low
Expertise	Very Low	Very High	Very High	Very High	Very High	Very High	Low
Experience	Very Low	Very High	Very High	High	Very High	Very High	Low
Human Element	Low	Very High	Very High	Medium	Medium	High	Low
Track Record	Yet to Prove	Proven	Proven	Proven	Proven	Proven	Yet to Prove
Automation and STP	Very High	High	Low	High	High	Low	High

Secondly, although the technology/entrepreneurial/professional mass affluent segment in the US forms a small percentage, any small amount of success by the online WM firms could spread like rapid-fire with the strength of social-media that is very abundantly used by such clients. If handled with care and marketed with caution, online WM firms do have the capabilities to attract more revenues from other sub-segments in the Mass Affluent and Retail segments. Thirdly, online wealth management firms lack the strong experience possessed by traditional WM players who have even withered the storm, in 2008. Though the true strength of online WM firms is yet to be tested for a complete economic cycle .

B.Advisory Market:

Advisory, by its very meaning invokes a personal touch. Online wealth management firms are attacking this aspect of personal touch by forming focus groups of advisors who can be reached via web communication channels. This model has been launched by the online WM players to tackle the growing need for financial planning advisory. But, how dose a model address the other majority of the advisory aspects, still remains gloomy. The major players in the Advisory market are Family Offices (SFOs and MFOs), Boutique firms, RIAs, Insurance Companies and Private Banks. Although advisory fees is one aspect that swings the pendulum in favor of online WM firms, there are many crucial aspects that would keep the wealthy clients away from online WM firms for advisory and concierge services.

C.Full Service Platforms:

Technology has enabled seamless integration and has transformed client service deliveries from kiosks to self-service platforms to full-Service platforms. End Client Portals and websites have been launched by major traditional WM players to keep the tech-savvy client segment transparent with all the books of client’s assets. These initiatives, have also taken a step forward with integration of such channels to the back-office systems of their WM platforms in order to provide for a STP (Straight Through Processing) flavor to the services. If the right resources are gamered by such initiatives to fully integrate and automate the Front-Office to Back-Office activities, they could very well spell doom for online WM firms. To name a few, Deutsche Bank’s dbWealthPro and Northern Trust’s Private Passport have already made a high impact on the existing clients of these firms.

D.Online Brokerage Firms:

The likes of Fidelity, Schwab, and TD Ameritrade have successfully revolutionized the Brokerage industry in the US market through their online delivery of services. They are also slowly and steadily foraying onto the Wealth Management arena by reckoning their existing highly satisfied client-base. Although, their clients are mostly Mass Affluent and the HNW segments, they have the strong base and experience to shake up the mind-set of the young-talented technology mass affluent software professionals

targeted by the online WM firms. Although the current momentum is clearly towards the online WM firms, some aggressive Wealth Management marketing/sales pitch (such as bringing down the account minimums and the fees) for the retail clients by the online brokerage firms could very well turn the momentum towards them.

E. Online Tools:

With the technological innovations in Cloud, Social Media, Analytics and Mobility, there has been a huge rush of tools, utilities and apps that are being pushed to the youth segment. There has been a sizeable number of personal finance online tools and utilities such as Mint.com, Wesabe, Geezeo, Jwaala, Goal Investor, Microgen etc., which could very well shrink the market share of online wealth management firms. The online WM firms will have to play their cards very carefully by isolating their business models from those of online tools.

F. Competition Within

Figure 3 below is a pictorial view of sample online WM firms that have been battling to win the young minds and shape their financial plans. By and large, Wealth Front, Betterment and Personal Capital share a major market share due to their early entry into this arena. New firms are being launched and few firms are also going defunct. For instance, Fi Life had closed their shop within few years of their launch. One of the new entrants that are trying to foray into this field is Wealth Bar.

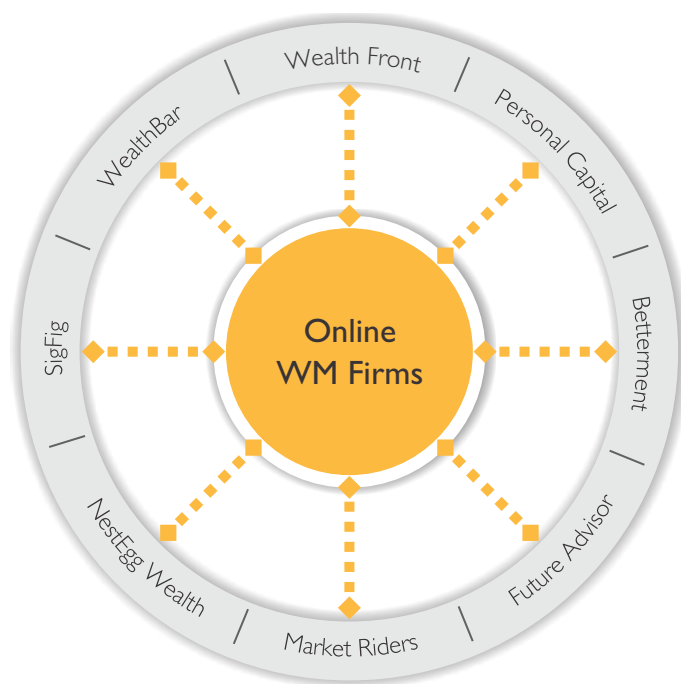


Figure 3: Competition within – An Insider’s View

On the whole, firms are facing stiff competition and their capabilities are emerging as a result to make a difference within. It would be interesting to know how these players are beating the competition and at the same time, trying to pose a business challenge to traditional players.

Conclusion: The Paradigm Shift - Will it sustain?

The idea for online business model was first seen doing rounds around a decade ago and it has taken a while for this idea to take-off, aided by the financial crisis in 2008. After the investors wealth were badly bit by the worst ever financial crisis, their sentiments had dampened and eventually began losing hope in the financial gizmos. Their portfolio values shrunk by 50% and they started questioning the abilities of the wealth managers and advisors. The online WM firms, found solace in these negative client sentiments to attract them with very low fees. However, these firms have failed to repose the faith that the money invested is safe and would not be lost. Either guaranteed returns or assuring a no-loss strategy is very impractical in current volatile markets. It would only take another mini financial crisis for their clients to change their mind-set, if the algorithms fail to achieve what the Wealth Managers and Financial Advisors could not ensure. The competition has also got stiffer and players such as Wealth Front and Betterment are continuously trying to launch innovative services. But the life span for such an innovation is very low as the competitor is always trying to match any new services being introduced. As a classic example, Wealth Front on its launch did not possess Tax Harvesting services. While one of its competitors came up with such service, they were hooked up to provide similar offerings. Such trend has resulted in commoditization of the services offered by the online WM firms. Going by this trend, it would not be far off when margins reduce and they face stiff competition to introduce new services and continuously innovate to sustain the growth momentum. If they fail to do so, they could easily end up as acquisition targets for the Traditional players.

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