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The Emergence of WealthTech: An Opportunity for Islamic Banking?

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ABSTRACT

The paper explores disruptive innovation in the wealth and asset management arena where a new intelligent digital ecosystem is reinventing the rules. The manuscript sheds light on the evolution of the financial sector and expounds on the development of financial technologies, with special attention paid to the various conceptual models related to wealth and asset management. The models describe the Fintech and WealthTech arenas as complex adaptive systems. Authors also investigate the mindset by which WealthTech ventures create, deliver, and capture value—whether such value is economic, social, cultural, or of any other form. Online wealth management was studied via case studies. The conclusion explores the researcher's agenda on WealthTech.
Keywords: disruptive innovation, digital ecosystem, Fintech, WealthTech.

RÉSUMÉ

Le document explore l'innovation destructrice dans le domaine de la gestion des richesses et des actifs, où un nouvel écosystème numérique intelligent réinvente les règles. Le manuscrit éclaire l'évolution du secteur financier et expose le développement des technologies financières, en accordant une attention particulière aux différents modèles conceptuels liés à la gestion de la richesse et des actifs. Les modèles décrivent les domaines Fintech et WealthTech comme des systèmes adaptatifs complexes. Les auteurs étudient également l'état d'esprit dans lequel les entreprises WealthTech créent, fournissent et capturent de la valeur, qu'elle soit économique, sociale, culturelle ou de toute autre forme. La gestion de patrimoine en ligne a été étudiée par le biais d'études de cas. La conclusion explore l'agenda du chercheur sur WealthTech.
Mots clefs : l'innovation destructrice, écosystème numérique, Fintech, WealthTech

INTRODUCTION

The paper's first challenge is to encapsulate key elements of the WealthTech ecosystem despite the complexity of the sector. A focal point: demystify the Fintech and WealthTech mindset arenas. The models presented are original and based on case studies made by the *FinTechLab.ca* in Canada. Ultimately, the document will shed new light on the future of the WealthTech industry.

What exactly is WealthTech? Canada's*FinTechLab.ca* defines it as follows: « *Field arising from the symbiosis of digital platforms, Internet of Things (IoT) and artificial intelligence (AI) in wealth and asset management, generally at odds with traditional advisory firms in the sector* » (Lacasse & Lambert 2017b). With academic knowledge on WealthTech still relatively limited, we concur with Henry Mintzberg of McGill University, who stated: " *It seems far more important to research important topics with soft methodologies than marginal topics with elegant methodologies. (...) Most of the real insight has come from studies that used soft methodologies*." (Mintzberg, 1979).

An exploratory and qualitative approach was selected because of the constraints of WealthTech's exponential growth, which means that the 2016-2018 database is already obsolete. Although Canada's *FinTechLab.ca* investigated the phenomenon in the United States, in China and in United Kingdom, most of the fieldwork and action-research were done in Canada. Data sources ranged from classical ethnography to state and governmental studies, documentary evidence, participant observation, semi-structured interviews, action-research and case studies (*Wealth simple*, *Schwab's Intelligent Portfolio*, *Betterment*, *BlackRock Inc.*and *Wealthfront*). Data from research reports by the Big Four accounting firms (PWC, Deloitte, EY and KPMG) were also very useful.

1. An Intelligent Digital Ecosystem Reinventing the Rules

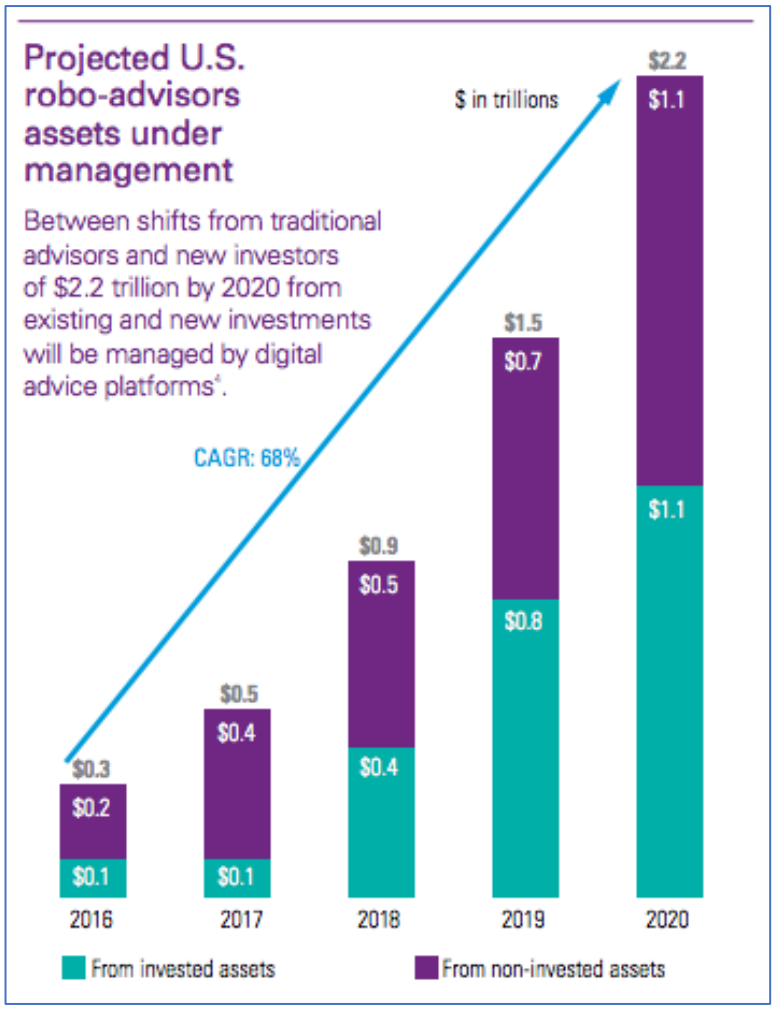
A new intelligent digital ecosystem is reinventing the rules. Geographical limitations no longer matter and information is relayed in real time. Uganda, Botswana and Ghana communities reinvented microfinance in 2004 via money transfer and mobile wallets; in 2007, Vodaphone's M-Pesa's recuperated the concept in Kenya and Tanzania. In North-America, the millennials (those born between 1982 and 2000) are changing transaction patterns. According to the Millennial Disruption Index, 73% of millennials would be more excited about a new offering in financial services from Google, Amazon, Apple, Paypal and Square than from traditional institutions.

Business models in every field of activity need to be updated and redesigned. The advent of the Internet of Things (IoT) has brought about an economic tsunami: "*Innovations in IoT, which has its roots at MIT, are driving remarkable new technologies and enhancing existing platforms in almost every major industry*." (Conner-Simons, 2016).In the world of wealth and asset management, artificial intelligence (AI) and deep machine learning is starting to have a major impact on investing and risk management. In some cases, IA plays the role of consultant, interacting directly with the user, with no human interface. Even a computer algorithm has been appointed to the board of directors of Deep Knowledge Ventures, a company in Hong Kong; the robot is entitled to vote, and supplies series of statistics on subjects discussed by the board.

According to the World Economic Forum, thousands of new ventures are disrupting the traditional financial services sector. An EY Report states that " *Fintechs are moving in on the traditional financial services landscape and their products and services are catching on. For traditional services companies, including banks, insurers, wealth and asset management companies, the risk of disruption is real.*" On the other hand, the Global FinTech Report states that FinTech and traditional financial services are partnering and « competing less and coming together » (PWC 2017). Digital deposits, crowdlending and wealth management suggest alternative models, thereby changing the market dynamics of traditional players. In the coming years, online capital raising will transform the role of traditional intermediaries; the empowerment of clients through intelligent systems will also transform the role of investment advisors. Intelligent digital tools will disrupt capital markets and bring about a world where clients and providers will be better connected in real time than ever before. IoT and telematics are also reinventing the value chain of the ever-more-connected insurance and wealth management industry.

Traditional financial transactions are on the decline in America. Agent involvement will become more and more obsolete in the future, and wealth managers need to adapt their computer systems and distribution channels accordingly. Insurance and wealth management are now clashing with a heavily regulated industry that is less and less able to compete with the low operating costs of virtual agents. Some banks have already automated the process of providing advice to customers: asset allocation, management services and tax optimization are all provided online. This democratizes access to financial advice, traditionally a privilege of the wealthy. In response, traditional wealth management funds have adopted similar tactics through robo-advisors.

Chart 1: Projected U.S. Robo-advisors Assets under Management



According a KPMG Report, the projected U.S. robo-advisors assets under management will be $2.2 trillion in 2020 (see Chart 1).Some $30 billion in assets of the largest fund in the world, BlackRock Inc., will rely more on robots rather than humans to make financial decisions.

2. Exploring the FinTech and WealthTech Arena

Exploratory research can be useful to decrypt a new phenomenon. In a collaborative brainstorming exercise on the emergence of Fintech and WealthTech with Dee W. Hock, the *FinTechLab.ca* identifies the problems to be tackled and the questions that need to be answered. Dee W. Hock is the founder and former CEO of VISA International, a Fintech precursor in the Seventies. In addition to his successful career in the financial industry, Hock has been active in developing new models for social and business organizations. He has been

particularly interested in forms of organization that are neither rigidly controlled nor anarchic, a hybrid form coined as « chaordic ». Hock has authored a book on the subject, *Birth of the Chaordic Age* (2000) ; he argues that traditional firms are inefficient because their organizations have become too complex.

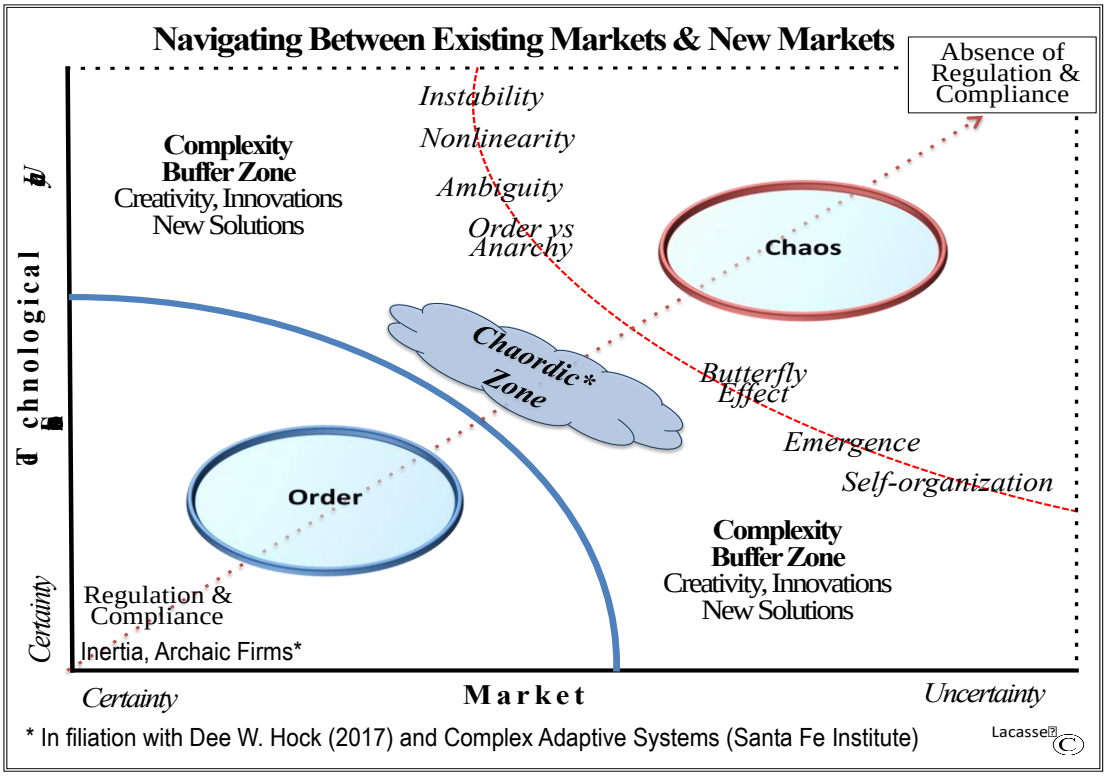
Hock advocates a new organizational form that he qualifies as "chaordic," or simultaneously chaotic and orderly. Hock credits the worldwide fintech success of VISA to its chaordic structure (complex, adaptive, and self-organizing). On January 22 2017, *FintechLab.ca* contacted Hock for his insight ; he brougth the following contribution : « *The FinTech and WealthTech phenomenon is an evolutional adjustment from over-control toward that ground nature and evolution ever seeks and finds - the harmonious combination of chaos and order, which I coined the word "Chaordic" to describe. One might say the financial service industry is escaping control to come into order. It could overshoot for a time and create some chaos.* »

Concepts drawn from Complex Adaptative Systems Theory (Santa Fe Institute) also offer new ways to observe the evolution of traditional services toward a FinTech and WealthTech mindset. The Santa Fe Institute describes the notion of « edge of chaos » : healthy, adaptive systems will always exhibit a kind of dynamic tension between chaos and order. WealthTech fits in beautifully with the dynamic tensions observed in the financial service arena : competition and initiative as throughout traditional financial services — "chaos" — while building in mechanisms for cooperation — "order."

Exploratory modelling and analysis can also be useful to have an overview of the empowerment of clients in the wealth management arena. Concepts drawn from complexity theories offer new ways to observe a phenomenon. The model(Figure 1) plots issues according to the level of certainty among stakeholders concerning solutions to a problem versus certainty that a given intervention will have the desired result. The vertical axis (Y) indicates movement from solutions close to certainty toward solutions far from certainty, while the horizontal axis (X) indicates movement from stable markets to uncertain markets. The diagonal axis (Z) indicates movement from "respect of regulation and compliance" to delinquency. If there is a high level of certainty in solutions and in the market, the problems are simple, i.e., a right answer exists and the traditional players stay in the comfort zone. Moving away from certainty and compliance, issues become complicated, complex, and even

chaotic. Traditional firms prefer to operate within the comfort zone, according to regulation and compliance.

Figure 1: Decrypting the FinTech Phenomenon

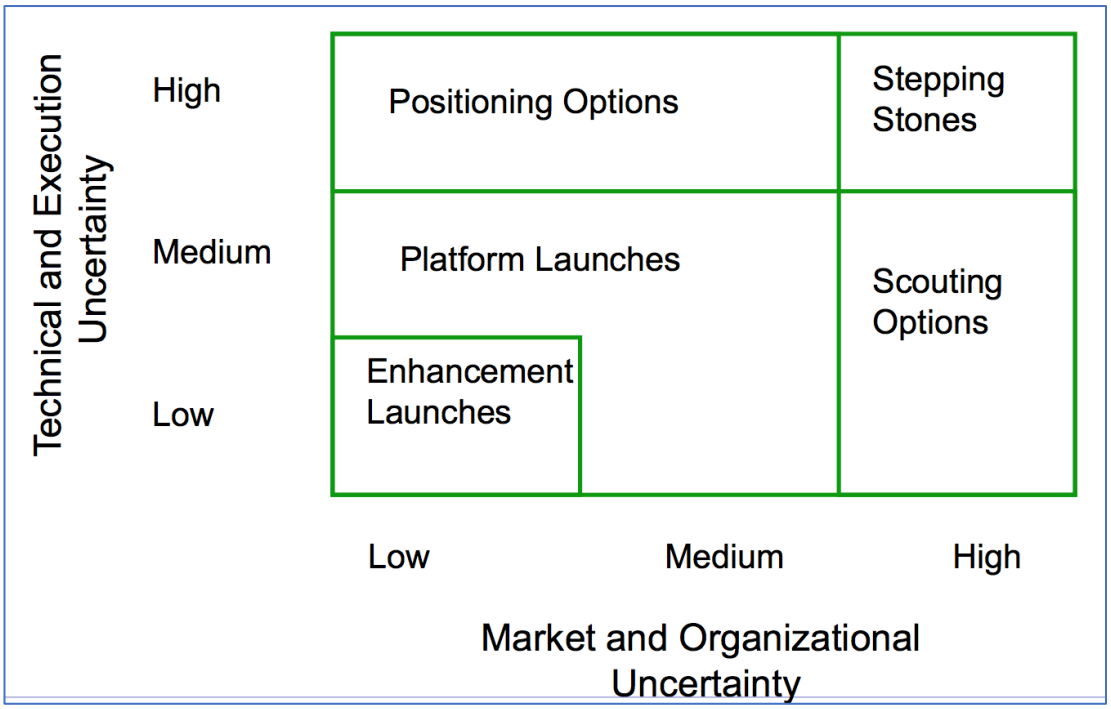


A new generation of wealth and asset managers, especially WealthTechadvisory, are excited and even attracted by the "complexity zone" or Dee Hock's *Chaordic Zone*. To attract millenials, promoters can be very creative in the development of new financial models and niches. Some models of digital bankers, not far from the *chaos zone*, are hazardous but can have a very lucrative journey. In some cases, innovative ventures are in the chaos zone where there is absence of regulation and compliance. Generally speaking, most WealthTech managers and venture capital funds prefer the «complexity zone» with a blue ocean strategy.

Traditional banking services are challenged by disruptive online innovations. We recommend that wealth and asset management firms build portfolio options in order to capture a new generation of clients (the millenials). McGrath and MacMillan (2000) identify three kinds of options (Figure 2) in filiation with Hock's *Chaordic Zone*:

1- Niches where the market is broadly known, but the technologies are still uncertain ;
2- Niches with a strong technology, but very uncertain about the appropriate market ;
3- The *stepping stone* option where there are high technical and market uncertainty.

Figure 2: Towards a WealthTech Portfolio Niches



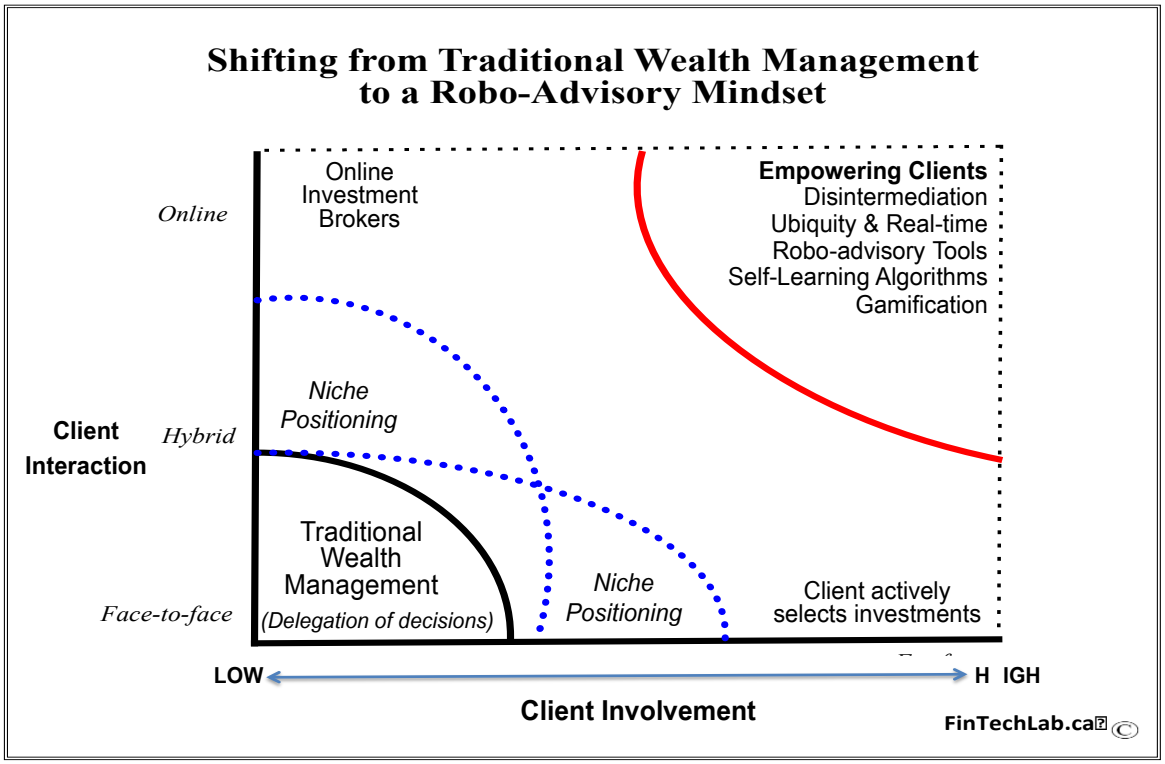
Adapted from the*Harvard Business School Press*. Authors: McGrath and MacMillan (2000)

3. Cracking the Code of a WealthTech Business Model

A business model describes the means by which a venture creates, delivers, and captures value—whether such value is economic, social, cultural, or of any other form. When a WealthTech professional manages money, he has an obligation to create value (WealthTech ventures with low profits but having a large online community has also great value). Whatever the model, WealthTech use intelligent online platforms in creative ways as they attempt to craft solutions that are more cost-effective than traditional financial services. They often draw on original activities to generate a better return on investment. WealthTech ventures are inventive regarding cost structures, revenues, and capital requirements.

The WealthTech Mindset Model (Figure 3) consists of interlocking elements that create and deliver value for stakeholders (Empowering Customers). WealthTech ventures must create a better customer value proposition than traditional financial services. For example, ING's ambition: make 32 million customers in 40 countries feel financially empowered by 2022.

Figure 3: Shifting from Traditional Services to a Client Empowerment Model



The profitable formula is the blueprint that defines how a WealthTech venture creates value for itself while providing value to customers. It consists of the following formula: revenues often come from very small fees originating from a very large online community. The cost structure is predominantly driven by efficient online platforms, good marketing strategies and «phishing via gamification » for millenials. It is important to identify the key resources, which are the assets such as intelligent technology, whiz kids, facilities, venture funds, networks and brands required to deliver the value proposition to the targeted customers. The aim is to effectively interlock the key resources: charismatic leaders, major business sponsors, media, and expertise. Some successful WealthTech ventures, using gamification, design complex operational and managerial processes that allow them to deliver value in such a way as to successfully repeat their activities and increase their revenue and their online community week after week.

CONCLUSION

A conceptual model's primary objective is to convey the fundamental principles and basic functionality of a system which it represents. Our conceptual models are developed in such a way as to provide an easily understood system interpretation. Our conceptual models should

satisfy the following objective : enhance an individual's understanding of the WealthTech arena.

WealthTech will completely transform financial services all over the world. In every case, the advent of digital technology will benefit customers and beneficiaries: new services will meet or exceed expectations, and will often provide a product that is superior to that of the traditional industry. Academics have a plethora of new research avenues: How does WealthTech create value? How will smarter and faster machines transform capital markets? How will customer and beneficiaries needs and behaviour changes in a cashless payment ecosystem? Why is there an odd mismatch between the attitudes of WealthTech players and compliance practitioners? How WealthTech will transform the value chain of the insurance and financial service? What is the social return on investment (SROI) of the WealthTech industry? What will be the impact WealthTech on future employment and the job market? How will cyber security landscape develop ? And finally, how does one explain the relatively slow development of WealthTech in Islamic Banking?

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