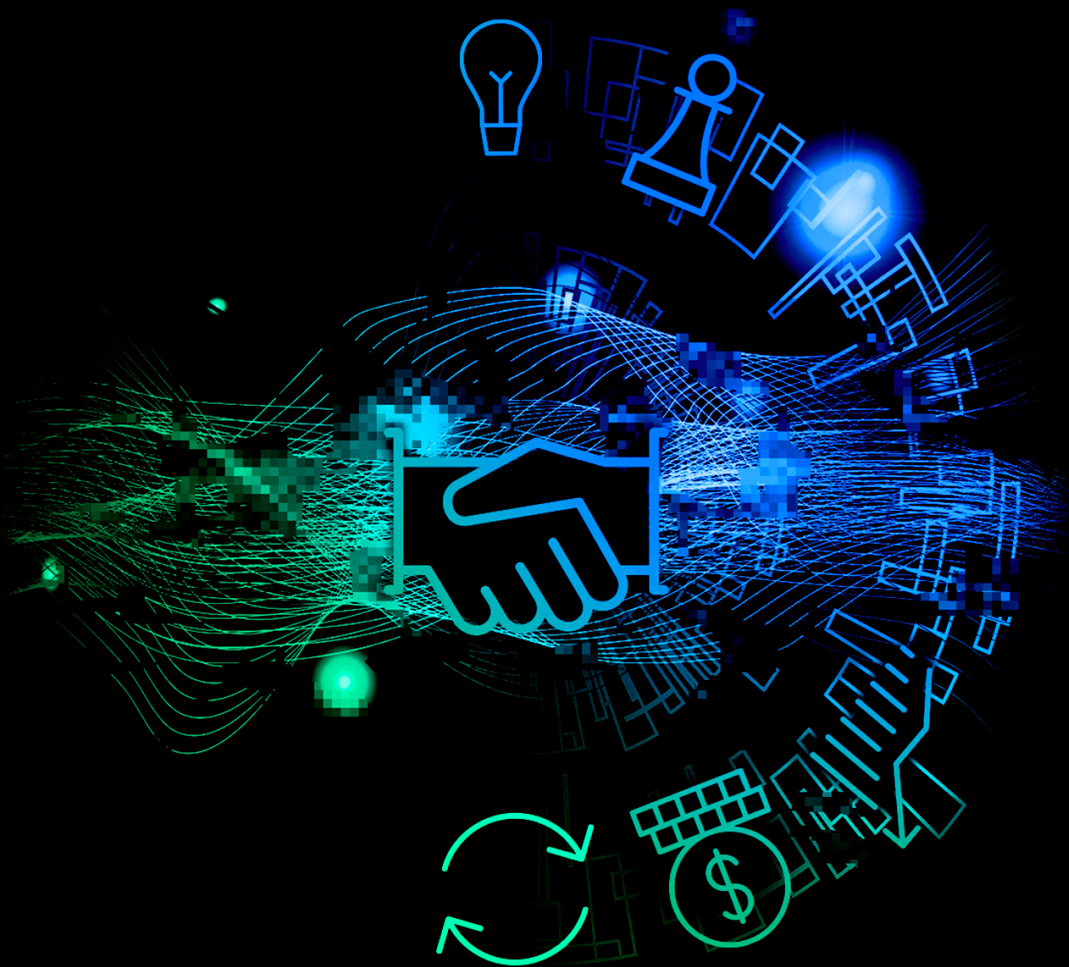


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Driving innovation in investment management:

Learning from—and partnering with—invest-techs

Deloitte Center *for*
Financial Services

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Tapping into invest-techs for innovation

Key messages:



Late stage deals drove total funding in 2018 to record levels and continue to lead funding in 2019.



Invest-techs providing low-cost access and peer-to-peer platforms seem to be gaining the most traction among investors.



Partnerships with invest-techs have emerged as an integral part of incumbent firms' innovation strategy.

Many young, fast-moving fintechs are dramatically changing established practices and challenging incumbents across financial services. Invest-techs, a subset of fintechs, are also driving innovation in investment management, as their creativity is increasingly embraced by investors and investment management firms alike. As invest-techs mature, they are now tasked with striking the right balance between collaboration and competition to secure their place at the forefront of the industry.

Robo-advisers that use digital platforms to provide financial advice based on mathematical rules or algorithms with minimal or zero human involvement tend to be the most well-known invest-tech. They mainly had their heyday in the mid-2010s and learned some hard lessons along the way. As a result, many have shifted to a business-to-business (B2B) model, merged with incumbents, or simply disappeared.

The future for invest-techs appears bright. Investment managers' continued search for innovative solutions is propelling the next stage in invest-tech development. One important point is the fact that private equity and strategic investors continue to provide funding at accelerating rates.

Deloitte's analysis of invest-tech funding data from the Venture Scanner database, along with conversations with these tech startups and incumbents, reveals that new invest-techs are keeping their eyes on the retail investor prize, albeit with a seasoned value proposition. Invest-techs are also looking to use their ability to tap new data sources to help both institutional investors and the investment management firms that traditionally serve them.

In this report, we'll provide an analysis of startup and funding activity, uncover global trends in invest-tech, and offer suggestions as to how incumbents should position themselves for success as the startup world continues to evolve.

What are invest-tech startups?

We define "invest-tech" as a type of fintech startup that uses advanced technology and data analytics to provide innovative investment solutions, seamless investing platforms, or alternative data insights across retail and institutional client segments.



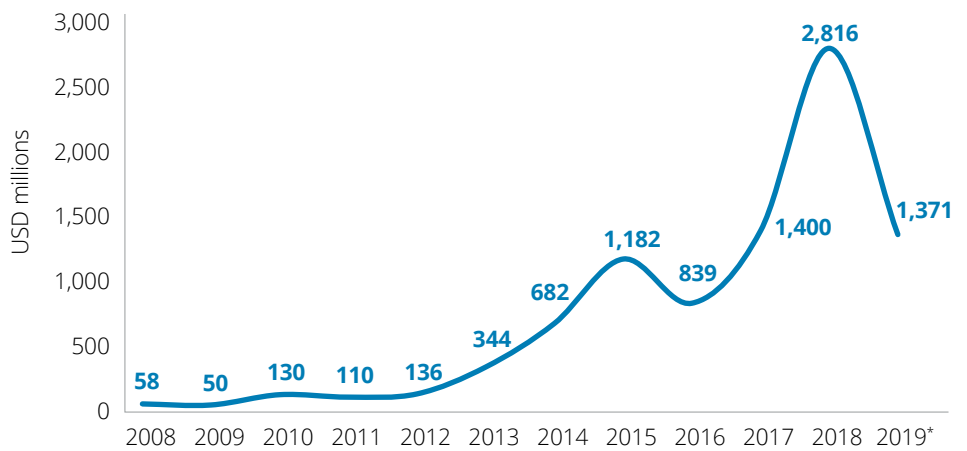
Funding touches record high in 2018 despite a slump in launches

Invest-tech funding reached new heights even as the number of launches fell in 2018. Overall funding touched a record high of \$2.8 billion, growing at a compound annual growth rate (CAGR) of 47 percent since 2008 (see figure 1). The surge in large late-stage deals for invest-techs specifically targeting retail investors has pushed funding to this record level. These invest-techs are developing low-cost solutions for retail investors through community and crowd-sourced advice and investing platforms.

The year started strong for 2019, with funding levels second only to 2018 in terms of investments made during the first quarter of the calendar year. However, a slow second quarter caused 2019 to fall behind the pace recorded in 2018. Some invest-techs were likely waiting for a more opportune time to seek additional funding following the busiest quarter in four years for initial public offerings (IPOs).¹ The third quarter of 2019 recorded an uptick in funding activity, with invest-techs receiving \$600 million in funding, as compared to \$513 million for Q3 2018.²

While funding has touched record levels, annual launches have slowed drastically to single digits from the peak of 81 launches in 2014 (see figure 2), to only four occurring in 2018. Only one launch has been recorded in 2019. Startup activity in other financial sectors, which also saw launches peak in 2014, recorded a similar steep decline starting in 2015.³ This trend is in line with our *Fintech by the numbers* report published in late 2017, covering banking, insurance, and commercial real estate, along with investment management.⁴

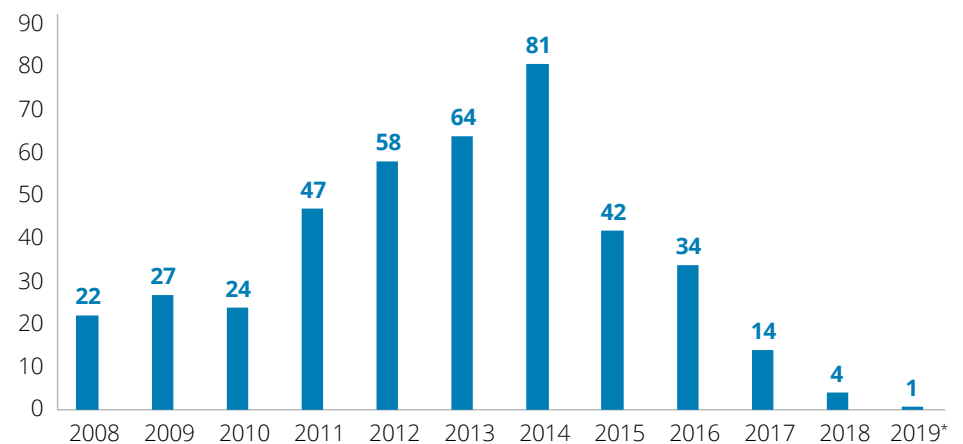
Figure 1. Invest-tech funding exploded in 2018
Overall invest-tech funding by year



* Through September 30.

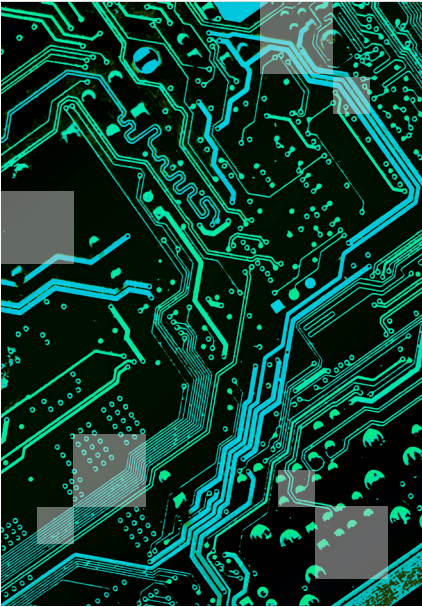
Source: Venture Scanner data, Deloitte Center for Financial Services analysis.

Figure 2. Fewer new invest-tech firms are coming to the market
Number of invest-tech launches by year



* Reporting through September 30, often these numbers are revised upward due to reporting lag.

Source: Venture Scanner data, Deloitte Center for Financial Services analysis.



Lessons from the robo-advisor experience

Up-and-coming invest-techs can seek a sustainable path to profitability by taking cues from the struggles of pure-play robo-advisers. Some successful direct-to-consumer invest-techs have taken steps to lower customer acquisition costs and increase account balances.

One approach includes engaging clients with free personal finance and money management applications. Once hooked, active users are then sold advisory services and investment offerings. Some invest-techs are also further diversifying their product mix to include advisory, portfolio management, and career counseling services.⁵ To increase account balances, some invest-tech firms are waiving management fees or even giving cash bonuses so long as a high balance is maintained for a set period. Additionally, some invest-tech firms are utilizing a tiered service approach by offering lower fees for higher account balances.

While the approaches have found some initial traction, the challenge will be to meaningfully engage with the client during the promotional period so that they not only stay once it has ended, but commit additional assets to the platform.

Intense competition likely means new invest-tech startups have reached peak levels

The steep drop in invest-tech launch activity can be attributed to actions taken by incumbents coupled with a hyper-competitive pricing climate. Some incumbent financial institutions took notice of the new robo-advice offerings in 2015. They countered by creating their own digital advice offerings designed to compete with the startups. Others determined it best to quickly gain these capabilities through an acquisition. It mattered less that these new platforms contributed meaningfully to profits than they would help to keep current clients locked in to their own digital platforms. These assets were secured for little incremental cost, much to the chagrin of some direct-to-customer (D2C) pure-play robo-advisers. This shift also opened an opportunity for the B2B robo-advice model, which transitioned these former competitors into service providers. This dynamic between invest-techs and incumbents played out many times during the middle part of the decade.

For consumers, the accessibility of robo-advice reduced the incentive to switch. Pure-play robo-advisers were left to battle one another for clients who lacked the assets under management (AUM) to provide ample revenue, often Millennials.⁶

While gaining an early relationship with smaller-balance Millennial accounts is a sound strategy for long-term sustainability, an issue can quickly arise once one considers the long break-even path. High customer acquisition costs and low revenue yields on client assets often leave little headroom to survive any financial hiccup. Many invest-techs had severely underestimated the initial customer acquisition costs, which turned out to be as high as \$300–\$1,000 per client.⁷ A pure-play robo-advisor charging the average fee of 0.25 percent on account assets requires \$20,000 in a client account to generate \$50 in revenue per year. In a very heated competition for assets, pure-play robo-advisers were often unable to raise fees and were faced with a minimum of five years to a decade-long journey just to break even on a client. The double impact of rising customer acquisition costs and low average revenue per user led some D2C invest-techs to cease operations, while others attempted to survive by targeting niche investor segments.⁸ Faced with this environment, some invest-techs decided the best course of action for survival was to abandon the D2C business model altogether and adopt a B2B model.⁹ However, this does not mean that there is nothing to be gained from the consumer segment. In fact, funding has been flowing toward those targeting this market with a greater array of capabilities than a typical robo-advisor while maintaining a low cost.

Pockets of invest-tech success

On the other side of the invest-tech coin stands a solid set of firms that have pushed funding to record levels. Funding activity has gained traction among firms focusing on natively digital products and services; some of these firms are in new areas with limited competition, and others are entering existing markets at competitive prices. Invest-techs with an eye toward Asia have benefited from the largest population to serve and also from strong governmental support.

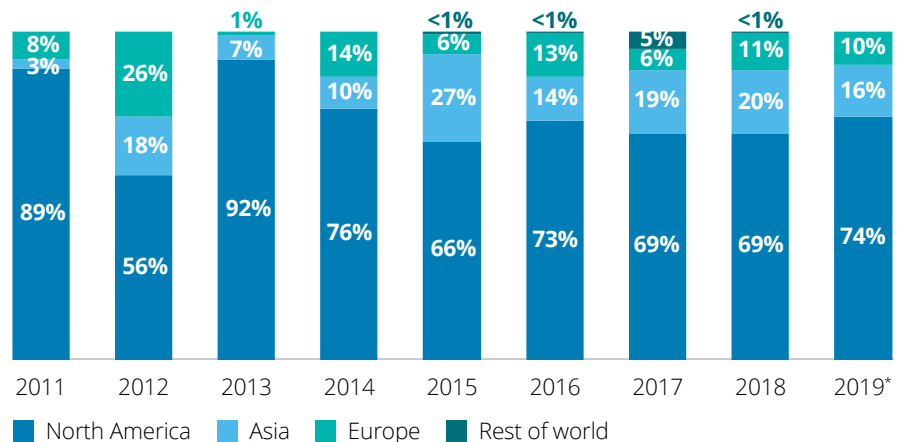
New themes emerge

Interestingly, the invest-tech retail segment has succeeded in attracting investments on par with other types of invest-techs, despite private equity investors stepping back from robo-advisor platforms since 2016. The story for new funding includes some institutional-focused invest-techs as well as data and analytics firms that provide investment management infrastructure. However, some of the most interesting activity is happening in the retail invest-tech space, as firms develop solutions beyond robo-advice.

The favored retail-focused invest-techs are driving innovation largely in two aspects of the investor experience. The first is providing low-cost access to investment solutions (see “lessons” sidebar). The low-cost access theme has attracted more than one-third of the funding raised by retail invest-techs in both 2017 and 2018. This theme is gaining ground across countries as well. Invest-tech firms with low-cost investment solutions from the United States, China, Japan, Hong Kong, and the Netherlands have garnered more than \$1 billion in funding from the start of 2017.¹⁰

The other aspect gaining ground is the development of community and crowdsourced investment platforms. These invest-tech firms have succeeded in generating considerable interest from private equity investors by developing community-based investment and trading platforms across asset classes. This peer-to-peer and community aspect of investing plays heavily into the Millennial preference of sharing their experiences. Sharing stock sentiments, trading ideas, and replicating investment strategies of top investors are just a few ways these platforms utilize community and gamification features to keep users engaged. One firm utilizes crowdsourcing to pull publicly filed trading activity performed by insiders so that users can follow “smart” money in real time.

Figure 3. North America dominates, but significant funding flows to Asia
Invest-tech geographic share of funding received by year of investment



* Through September 30.

Note: Rest of World includes Australia, New Zealand, and South America.

Percentages may not total 100 percent due to rounding.

Source: Venture Scanner data, Deloitte Center for Financial Services analysis.



Government support and favorable demographics propelling Asia

With the importance of market efficiency and reaching vast numbers of people through mobile devices, it may be no surprise that many invest-tech firms would be headquartered in China, the largest fintech market in the world measured by total investment.¹¹ However, a growing force in fintech and invest-tech innovation is emerging in other parts of Asia. In an effort to raise its stature with an eye to perhaps even overtake China, the government of Singapore set aside funds specifically for fintech startups. Singapore also created several initiatives to support fintechs as they navigate the complexities of forming a business.¹² As a result of this favorable environment, Singapore now calls itself home to more than 40 percent of the fintechs in Southeast Asia.¹³ This trend is expected to continue to attract emerging invest-techs.

While the funding providers in other markets seem to focus squarely on mature invest-techs, financiers looking toward Asia are often less concerned with longevity so long as the invest-tech facilitates a different theme: opening the global markets to Chinese investors. A study of the largest deals in Asia highlights that invest-techs in the region have capitalized on a macro trend involving Chinese retail investors and smartphones. Notable funding has moved into invest-techs that give Chinese retail investors the ability to access real-time market data and execute stock trades. Funding activity in Chinese invest-techs may remain hot considering the rising domestic investor wealth, transition from savings to investing, and relaxation of foreign ownership limits for asset managers.¹⁴

Funding, acquisitions, and partnerships target mature invest-techs

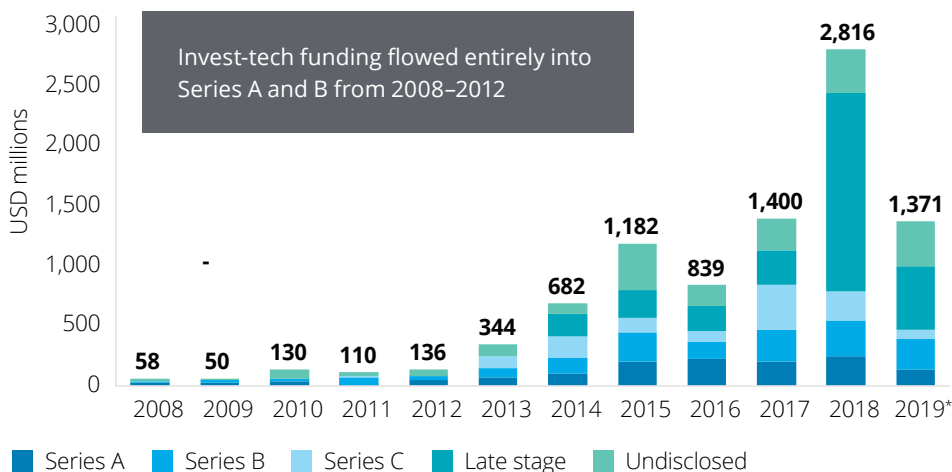
Investors increasingly look to established invest-techs for investment

A close look at funding data indicates that PE investors and incumbent financial institutions are investing in more mature invest-techs. The share of late-stage deals jumped to 58 percent in 2018, compared to an average share of 22 percent for the previous four years, and through the third quarter, 2019 is more like 2017 (see figure 4). Most of the late-stage funding was directed into invest-techs that have completed at least five years of existence. In fact, nearly 75 percent of the invest-tech funding from 2008–2018 went to firms that were founded between 2009 and 2014.¹⁵ In the last two to three years, several D2C invest-techs have either shut down, like Hedgeable, or shifted to a B2B business model, like SigFig.¹⁶ Perhaps learning from the trials of the pure-play robos, some private equity investors are willing to pay a premium for a share of invest-techs that have a proven business model, solid revenue-generation capabilities, or a strong client pool.

Acquisitions to gain digital capabilities

Many incumbent investment managers are looking at invest-techs as an effective way to acquire digital capabilities. Twelve acquisitions took place in the first three quarters of 2019. Traditional financial data vendors have focused on expanding product offerings by incorporating alternative data capabilities. Factset integrated alternative data into its platform through a business partnership approach with an invest-tech data aggregator while others have obtained similar alternative data capabilities through acquisition, such as that

Figure 4. Late-stage deals surged in 2018, early-stage funding remains steady
Invest-tech funding stages by year



* Through September 30.

Source: Venture Scanner data, Deloitte Center for Financial Services analysis.

of Quandl by Nasdaq.^{17,18} An examination of the invest-techs that were acquired demonstrates a very similar trend to that of the late-stage funding deals. Invest-techs crossing the five-year existence threshold are prime acquisition targets, with more than 70 percent of acquired invest-techs having reached that milestone. In fact, the average age of acquired invest-techs has remained above five years since 2014.¹⁹

Partnerships with invest-techs as a strategic element

Three invest-tech partnership approaches

Our discussions with invest-tech firms indicated that partnerships were often being used to attain strategic outcomes. For invest-tech firms, three key considerations seem to emerge for pursuing strategic partnerships: picking the right partner, allocating resources wisely, and securing management buy-in.

Partnership for collaboration

To ensure a successful integration, an invest-tech firm should evaluate the partnership alignment from a strategic, cultural, and customer perspective. Invest-tech firms highlighted the importance of understanding and focusing on the true pain point being solved. This alignment is important to secure buy-in from the incumbent firms' senior management. Top-leadership buy-in provides middle management the required confidence to make quick decisions when collaborating with the invest-tech firm. A strong cultural alignment can allow resources to be maximized. It will be to the long-term benefit of the alliance if the innovative mindset of the invest-tech firms' workforce is allowed to permeate the larger organization. Identifying the appropriate target market for each partner is important. Whether the purpose is to gain traction within the same segment or to branch into a new market, each partner's ability to provide its unique perspective can help deliver innovation for clients.

Partnership for stability

As an invest-tech firm building a digital adviser solution, Jemstep had to pitch its solution at the doors of incumbent financial institutions. These financial institutions have stringent reporting and compliance processes to safeguard client

information and often require specialized industry knowledge and experience. To bridge this gap, Jemstep entered into a strategic acquisition by Invesco, which provided the credibility to pass through the vendor review process. Jemstep was afforded the ability to maintain its entrepreneurial development path rather than have its development strategy and key resources redirected into its new parent's priorities. This autonomy, combined with added credibility, resonated with Jemstep's target market and enabled the company to innovate with incumbent-like stability. This strategic acquisition by Invesco has fueled positive results: Jemstep managed to grow its business by five times since January 2016 with virtually no turnover.

Partnership to develop capability

Marstone approached partnerships as a way to create a unique wealth management platform to fit the specific needs of large advisers and wealth managers. To develop a differentiated capability in its product offering, it entered into strategic partnerships with custodian firms. Developing a deep integration with the custodians allowed Marstone to reportedly build an efficient electronic onboarding process for new clients of advisers and wealth managers. The high level of integration in the back office enabled advantages such as one set of records for the adviser as well as the possibility to facilitate other types of account openings for the client. This partnership allowed Marstone to integrate the features most valued by its clients.

What can we expect next in this space?

Structural changes seem to be on the horizon for the investment management industry, and technology is expected to play a transformative role. The debate may center around whether incumbent financial institutions will partner with invest-techs to strengthen their existing client relationships or use invest-techs as a springboard into new client segments. Regardless, the investment experience will likely be enriched through a symbiotic partnership between investment managers and invest-tech firms.

Funding toward early-stage invest-techs is not expected to cease, but to continue because incumbents appear to be on a constant lookout for talent, innovative ideas, and fresh technology. Acquiring incumbent financial institutions are increasingly targeting “acqui-hiring,” (i.e., striving to integrate the innovative culture and ideas brought in by the target firms’ employees). From the incumbents’ point of view, partnering with invest-tech firms early on can not only offer a talent acquisition opportunity, but also help to develop an innovation incubation center.

At the other end of the funding spectrum, late-stage funding is expected to continue to account for the largest share of invest-tech funding over the next 18 to 24 months. Most invest-techs are preferring to remain private longer, as access to capital for private firms

remains strong. Private equity investors and incumbent financial institutions also contribute by continuing to fund those invest-techs that have reached a higher maturity stage.

Partnerships, as opposed to outright acquisitions, are expected to continue to remain the central theme around which incumbent investment managers pursue digital innovation (see “partnerships” sidebar). Investment managers could aim to cultivate an invest-tech partner network by forming partnerships with multiple invest-techs. Each of these partner invest-techs would boast different digital capabilities, adding to the overall capabilities of the investment manager.

An exciting decade is ahead as investment managers adopt and deploy new technologies through partnerships with invest-tech firms. These collaborative efforts can bear fruit, provided incumbent investment managers consider the broader and longer-term objectives when engaging with invest-techs. Investment managers should encourage innovative thinking and collaboration with nontraditional partners or face the risk of falling behind on this transformational journey.

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