

P E R S P E C T I V E

Addressing the Wealth Management  
Requirements of the Indian Mass  
Market Segment



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## Overview

Robust GDP growth over the last few years coupled with significant increase in income levels of middle class families have provided wealth management service providers a significant opportunity in the mass market segment. The Indian mass market can broadly be defined as families having investible surplus between INR 2 lacs and INR 10 lacs. Traditionally, this market has been addressed by independent investment advisors and insurance agents, with some portion of assets being managed through brokers and banks. This segment has been targeted with product-based selling approach, with rebates providing sustenance to the intermediaries. Insurance and mutual funds have been the most popular investment vehicles, followed by direct equity investments. However, the recent changes in mutual fund and insurance regulations have shaken the existing business model, forcing every intermediary to re-examine the feasibility of their business. The sudden loss in commission income has driven several distributors out of business, while many others are struggling to stay afloat and adjust to the new environment. The impact has been felt equally by the organized sector. Many banks have reduced their focus on the mass market for pushing wealth products and are instead using term deposits to capture its investible surplus. Others are still trying to keep their business alive by charging an explicit transaction fee, while some are experimenting with a business model in which the transaction fee is supplemented by advisory income.

This paper highlights the recent changes in the industry, their impact on the business model of wealth management service providers, emerging business models and how better utilization of technology can help in serving mass market customers profitably.

## Trends in the Mass Market Segment

Based on various industry estimates, it appears that the mass market in India consists of more than 18 million families. The segment is expected to grow at a handsome rate of more than 18 percent per annum representing a great opportunity for wealth management service providers. If the players can arrive at a cost

effective strategy to serve this segment, they can make handsome profits.

A large portion of mass market investments has traditionally been managed by unorganized players such as independent financial advisors (IFAs) and insurance agents using the transaction-based selling model. Even organized players like banks and broking houses have addressed this segment in a similar manner. Under the transaction model, financial intermediaries approached customers with a certain available set of products, trying to fulfill their financial requirements. Advisors didn't charge customers explicitly for their services; rather, in some cases they offered discounts to attract business. Advisors were incentivized by the manufacturers of the product in form of sales commissions. In this business model, the financial needs of customers were typically force-fitted to the products available in the advisor's kitty. The products offered were not always best in class, especially when the interests of the advisors overrode that of their customers - for example, selling only those products that attracted higher commission or reshuffling a portfolio to generate further rebates. In a significant number of cases, this approach led to misguided sales resulting in significant financial loss to customers and damaging investor perception about the industry and its products.

After taking stock of the situation, regulators responded with a new set of rules protecting consumer interest. In the last two years, these regulatory changes have changed the market dynamics significantly. The first set of changes ushered in by the Securities and Exchange Board of India (SEBI) significantly reduced commission income on mutual funds distribution. Following are the key regulatory changes that have affected the transaction based business model:

- a. Removal of entry load: Earlier, entry loads varied from 1.75 percent to 2.5 percent, but after their abolition, customers have to remunerate the distributor directly for facilitating transactions and providing advisory services.
- b. Stock brokers to distribute open-ended funds through stock exchanges: While the

move, aimed at reducing transaction costs is yet to pick up, it has created another competitive distribution channel.

- c. Restriction on launching new schemes that are not clearly distinct from existing ones: This has reduced distributors' opportunity to attract new investments as well as cut down their earlier practice of churning portfolios to accommodate new schemes in order to earn additional rebate.

These changes drastically reduced distributors' commission as customers found the 2-2.5 percent fee for advisory services unreasonable. As expected, the market quickly shifted focus away from mutual funds to other vehicles especially insurance products, where manufacturers still offered attractive commissions. However, the latest changes by IRDA, highlighted below, have adversely affected this business as well.

- a. Increase in insurance cover requirements – Insurance cover must be 7 to 10 times of regular premium paid
- b. Change in treatment of lock in period top-ups from pure investments: Now the policy holder must increase insurance cover with every top-up
- c. Increased lock in period
- d. Pension and annuity products offered by insurers must also provide life or health cover
- e. Minimum yield on maturity for unit-linked pension funds
- f. Ceiling on charges allowed on insurance products: Consequently, insurers reduced advisors' commission

The above guidelines worsened the trend of diminishing commissions. Moreover, the higher insurance component will reduce the overall attractiveness of insurance-based products as an investment option. This will again impact distributors, who frequently pushed insurance products to policy holders as an investment rather than a protection tool.

Transaction Type	Commission Earned @ 2.25 percent *(Prior to Aug 1, 2010)	Fee Charged by ICICI Direct Now	Loss of Revenue
Monthly SIP of Rs 10,000 for 12 months	2,700	360	2,340 (86%)
Rs 100,000 as lump sum investment	2,250	100	2,150 (95%)
Monthly SIP of Rs 1,000 for 12 months	270	180	90 (33 %)
Rs 10,000 as lump sum investment	225	100	125 (55%)

*Loss of revenue in mutual fund business due to removal of entry load*

*Assumed average commission for processing a mutual fund transaction was 2.25 percent. Fee structure is taken from ICICI Direct website.*

Should the tax benefit on insurance products be reduced under the provisions of the proposed direct tax code, the business will take a further hit. The exclusion of Equity Linked Savings Schemes from the list of approved tax-saving instruments will cause more damage. These losses may prove catastrophic to many distributors with high cost operations. Since mutual funds and insurance-linked investments are push-based products, advisors spend considerable effort to procure business. In the mass market segment, where both consumer awareness and confidence are low, the recent market volatility has added to the collective woes of investors and advisors. A large section of the society which is comfortable with wealth management instruments prefer to invest directly, typically online, without involving a distributor, since this is both cost-effective and convenient. Hence, a significant portion of pull-based, low cost business from self-motivated investors is lost to the direct channel. All these factors are driving the need for a new business model for both organized and unorganized wealth management service providers.

#### **Need for a New Business Model**

The changed business environment may lead to significant reorganization, with less committed or inflexible players moving out and others with a

strong mass market focus seeking a new business model. These trends would affect unorganized participants more, and possibly render them unviable given their limited product portfolio. Only those unorganized players who can transform their business to provide credible structured investment planning and advisory services along with wide array of products may survive. Mass market would wish for players from unorganized sector to succeed as the personal touch, intimacy and long term association offered by them cannot be matched by organized sector easily.

Transaction-Based Approach	Customer-Centric Approach
<ul style="list-style-type: none"> <li>• Product-based selling</li> <li>• Non-personalized service</li> <li>• Commission-based business model</li> <li>• One size fits all approach</li> <li>• No differentiation</li> </ul>	<ul style="list-style-type: none"> <li>• Structured investment planning</li> <li>• Need-based sales</li> <li>• Focused, personalized advice</li> <li>• Commission + fee on value added services</li> <li>• Right-sell based on specific requirements</li> </ul>

Organized players must redesign their business model after taking into account their limited transaction income; in the new environment, it may be advisable to shift from a purely transaction-based business to one that is customer-centric and has a higher focus on value-added services like financial planning, need-based advice, structured investment execution, periodic portfolio review and rebalancing, to name a few.

Structured investment planning and advisory services have traditionally been offered to high net worth individuals (HNI). The challenge now would be to make those services or components thereof accessible to a mass market audience. It's safe to assume that given a choice, every family would like to have a competent financial advisor. However, since these services come at a significant cost, they are out of the reach of the mass market. That being said, the customer-centric advisory process can be made cost effective using innovative technology solutions. Before looking at technology options, it is important to understand the generic attributes of the mass market:

#### Generic attributes of mass market segment

- Low ticket size per investment
- Lack of experience in managing investment in volatile environment
- Tax saving influences decision on investment instruments
- Highly sensitive to capital loss
- Higher investor education requirements to counter inexperience in investing in complex products
- Sensitive to costs, especially those explicitly associated with investment

In line with India's demographics, a large part of the mass market is young with families whose main earning member is less than 35 years old. The size, risk-reward profile and behavior pattern of this group make it an ideal platform to launch a new cost effective customer-centric business model.

#### Generic attributes of young sub-segment of mass market segment

- Desires to grow capital
- Higher risk taking capabilities
- Long time horizon to grow capital
- Tech savvy generation; high penetration of internet banking and mobile applications
- Comfortable with self-service
- Values independent thinking; considers advice an enabler of the investment process
- Expects timely response to service requests
- Prefers real-time access to portfolio positions
- Open to new products

Wealth management firms can drill down the mass market into multiple sub-segments (based on income, assets, age, region etc.) to identify their own focus area. Each sub-segment brings different opportunities and challenges, requiring advisors and organizations to configure their strategy differently. Many organizations may decide to target only specific sub-segments with their mass market offerings based on their business model and profitability expectations.

#### Technology Landscape

Technology adoption by India's wealth management service providers is generally low, with most still managing a large number of investment processes manually. Investment requests for instruments like mutual funds,

insurance and corporate fixed deposits are serviced manually, without system support to record, process and track these transactions and subsequent holdings. Such an operating model does not enable organizations to provide customer-centric wealth management services on a large scale. Wealth managers need to take a big leap in IT strategy to make mass market services profitable. Here, IT vendors can play a significant role by delivering solutions which do not necessitate big capital spending; the market will welcome hosted solutions which reduce both time and cost of launching services.

Since the core science of structured customer-centric investment planning and execution is applicable to all market segments equally, organizations with wealth management solutions for HNI and private banking clients must leverage their components, combining them with an appropriate operational strategy to meet mass market requirements.

Technology vendors keen to exploit the mass market opportunity need to understand its dynamics and include specific system processes, features and capabilities to help organizations address this segment profitably. Some of the key aspects to be addressed in application design are:

- a. Since profitability in the mass market segment is limited, the system design must optimize the time spent by advisors and relationship managers with each client without significantly compromising investment planning or execution. For instance, during the financial planning stage, a relationship manager should be able to load a pre-populated plan which closely matches the customer's requirements and only make specific changes to it, to

save time. Similar time- saving options must be available for all aspects and stages of investment planning and execution.

- b. Servicing the mass market calls for a large and experienced workforce. Since margins would be low in this segment, it will not be feasible to hire a lot of experienced professionals to manage clients. This is where systems and organizational processes can step in to provide comprehensive support to a smaller number and relatively inexperienced relationship managers, so that they may guide investors effectively. An ideal system is one that supports a simple, step by step approach to financial planning and execution, which can be easily used by advisors and customers alike. The system should also provide collaborative features that enable relationship managers consult product experts or senior advisors when required.
- c. Since the mass market has little experience investing using a structured investment approach, the solution must provide easy to understand goal planning tools. All the important components of structured planning namely risk profiling, model portfolio suggestions, goal planning, client portfolio creation and maintenance, portfolio alerts, performance evaluation, periodic rebalancing features etc. must be available in the offering.
- d. Clients must be allowed to execute their portfolios online and the system must provide a comprehensive view of their financials including assets and liabilities managed through other organizations. This is crucial as financial planning cannot be successful unless a holistic view of customers' net worth, income and expenses is taken into consideration.

### Design Preferences

- Easy to use tools, Simple and intuitive design, Self service options, Efficient processes, Low COO

CRM & Advisor Tools	Financial Planning	Client Portal & other channels
<ul style="list-style-type: none"> <li>• Lead Management</li> <li>• Client Management</li> <li>• Portfolio Management</li> <li>• Alerts</li> <li>• Tasks Management</li> <li>• Dynamic Inquires</li> <li>• Customer Communication Management</li> <li>• Service Requests Management</li> <li>• Market Intelligence</li> <li>• Colloboration features</li> </ul>	<ul style="list-style-type: none"> <li>• Goal planning</li> <li>• Investments based on risk profile of investor</li> <li>• Portfolio creation and maintenance</li> <li>• Asset allocation tools</li> <li>• Portfolio review and rebalancing</li> <li>• Portfolio statements</li> <li>• Goal evaluation</li> <li>• What if analysis</li> </ul>	<ul style="list-style-type: none"> <li>• Interactive dashboards</li> <li>• Comprehensive portfolio view</li> <li>• Self help tools</li> <li>• Ability to view and execute investments</li> <li>• Intuitive design, graphical representations</li> <li>• Client education artifacts</li> <li>• Product returns simulators</li> <li>• Mobile and e-mail support</li> <li>• On demand reporting</li> <li>• Alerts &amp; Constraints Management</li> </ul>

### Middle & Back Office Features

Investment Processing, Accounting, Risk & Compliance, Interfaces Management

- e. The solution should provide organizations the flexibility to bundle various capabilities into different service plans offered at multiple price points. This will help service providers create a menu of services which can be subscribed to by clients based on their needs.
- f. There must be emphasis on self-service by providing interactive dashboards designed to help clients take investment decisions easily. This will help self-motivated clients manage portfolios with little or no guidance from their advisors, and thereby reduce the organizations' cost of servicing.
- g. Straight Through Processing, required to execute investment orders, is crucial in lowering transaction processing costs.
- h. Application design must also allow organizations the flexibility to configure their specific planning and execution philosophies.

The above list is indicative and merely touches upon the design tenets of a successful mass market wealth management platform. Many other features supporting various securities and background processes will be called for.

Independent financial advisors and small organizations will seek specialized entities that deploy such solutions and license their platforms to advisors. A similar model has already been successfully implemented in many developed

economies. Vendors like Advice America and Ampsys Consulting (WealthERP) have launched hosted-solution for advisors in financial planning space in India. This model is expected to gain significant traction with advisors and organizations transforming into customer-centric service providers.

### Conclusion

The mass market offers tremendous opportunity. With the industry undergoing unprecedented change, the erstwhile mass market business model suddenly looks unviable. Organizations that quickly get their customer-centric strategy together are likely to benefit. Since this segment is highly value conscious, every component of organization strategy, be it people, processes or systems must work to keep costs at a minimum. Innovative technology led solutions will be at the core of the transformation strategy and will help organizations and advisors serve their customer profitably.

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