2015

Fintech Disruptors Report

STARTUP Banking

MagnaCarta

supported by FINTECHMUNDI

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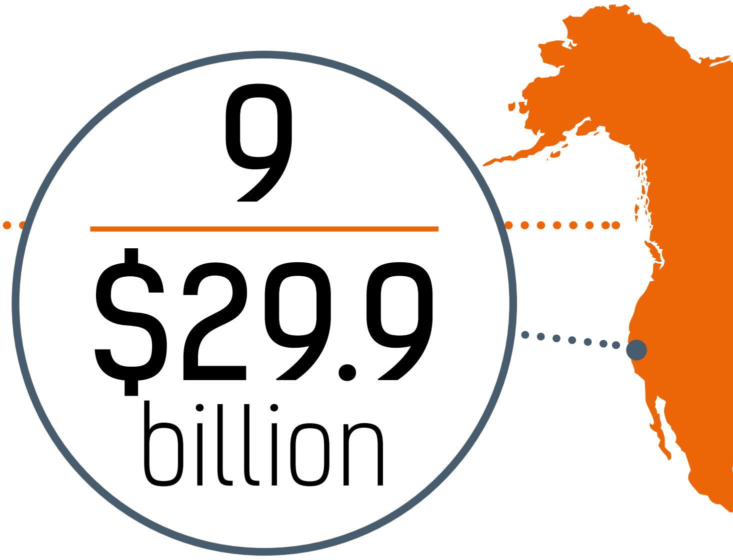
CONTENT

INTRODUCTION



Chasing the perfect storm

Whatever you call the wave of technological disruption confronting banking, the pace of change in the global banking industry over the last decade has been unprecedented. A pace that appears to have accelerated dramatically in the last two years.

The result of a perfect storm of regulatory failure, that ended with the crash of 2008. Rapid growth in smartphone take up, falling technology costs, and the coming of age of the millennial generation, have removed, or lowered, many of the traditional barriers to new competitors in the last major global industry to be disrupted by mass smartphone adoption.

This latest disruptive wave is neither new, nor specific to the advanced economies of the OECD - spawned as much by the first internet boom at the turn of the twenty-first century, as by the successes of direct phone and postal banking in the mid 1990s.

It is arguably the launch of the relatively low-tech M-Pesa by Kenyan mobile network operator Safaricom in 2009 however that presaged the potential for mobile phones to replace the bank branch and payment cards as the primary delivery channels for everyday financial services.

The entry of a non-bank into the financial affairs of unbanked customers, without the traditional banking staple of a retail branch network, and Safaricom's success in fulfilling an unmet need by leveraging a low cost technology to reach new customers, fired a shot that was heard around the world marking the beginning of the redefinition of banking services everywhere.

It is from this starting point, that this report on the disruptive wave rippling through the financial services industry takes its cue. The result of a series of interviews carried out between September and November 2015 with banks, incumbent financial institutions and high profile startups in Europe and the Middle East, the report highlights the forces shaping financial services delivery across the region.

It also seeks to provide insight into the lessons learnt by companies both old and new as they innovate and a roadmap for the years ahead as 'digital' migrates from delivery channel to the driving force in modern banking.

Scaling the digital summit

The notion that financial institutions are having to 'go digital' is in itself a sign of the scale of the cultural and commercial challenge faced by many developed world banks.

Particularly in Europe, a region with high levels of smartphone penetration, where over half of consumers have used their phone to shop within the last 12 months[1], mainstream financial institutions are struggling to come to terms with the implications for their business of wholesale digitisation.

A challenge made greater by the need to integrate digital technologies throughout the organisation to deliver multi-channel banking seamlessly while incorporating insights from the data generated by digital channels to improve service and lower costs. All under the watchful eye of a host of new (mainly single-product) entrants that are unencumbered by the high fixed costs of retail premises, staff or legacy technology.

Against this background, the banking industry as a whole is in startup mode as new competition, cost-conscious consumers and the convergence of offline and online commerce redefine delivery of financial services.

To contribute to the discussion as the region's banking industry adjusts to the new era, insights from the research revealed seven key themes – our lucky seven – encapsulated in the acronym STARTUP, to explain the commercial opportunities and cultural changes that organisations both old and new must adopt to succeed in the digit-all world.

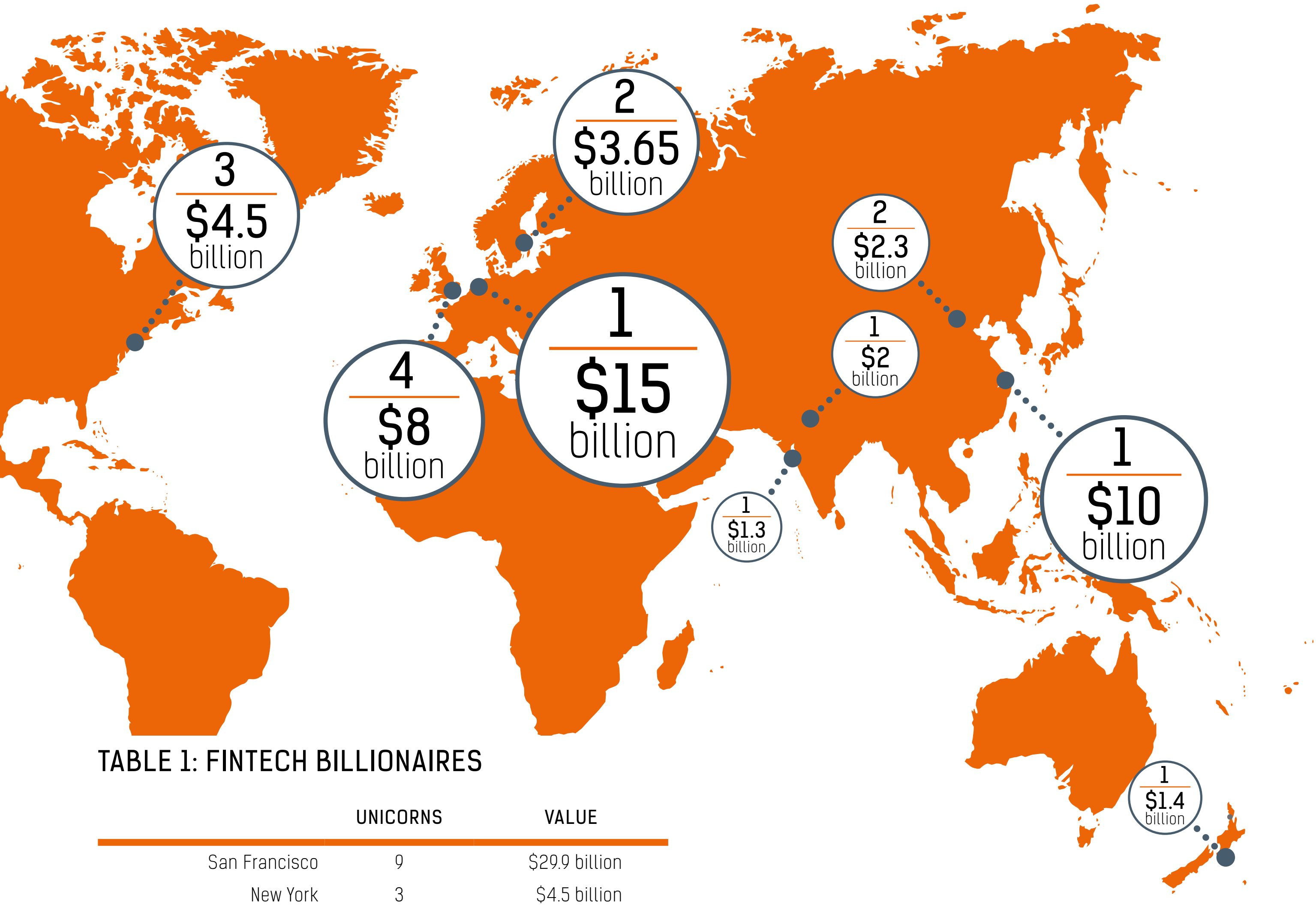


TABLE 1: FINTECH BILLIONAIRES

	UNICORNS	VALUE
San Francisco	9	$29.9 billion
New York	3	$4.5 billion
United States of America	**12**	**$34.4 billion**
London	4	$8 billion
Stockholm	2	$3.65 bllion
Amsterdam	1	$1.5 billion
Europe	**7**	**$13.15 billion**
Beijing	2	$2.3 billion
Shanghai	1	$10 billion
China	**3**	**$12.3 billion**
New Delhi	1	$2 billion
Mumbai	1	$1.3 billion
India	**2**	**$3.3 billion**
New Zealand	**1**	**$1.4 billion**

Source: Business Insider UK

TABLE 2: MOBILE PAYMENTS ADOPTION (% of all transactions)

	2013	2014	2015
United Kingdom	-	41%	44.8%
Europe	18.2%	22.7%	30.4%
North America	16.6%	16.9%	26.7%
Asia	11.4%	14.2%	21.4%
Latin America	-	6.6%	-
Global	**17.5%**	**20.2%**	**28.7%**

Source: Adyen Mobile Payment Index

KEY FINDINGS

STARTUP Banking

The consequences of the financial crisis of 2007-2009 were far-reaching. They are still being felt today – the difference in European output in the second quarter of 2015 compared to that predicted by pre-crisis levels is equivalent to the size of the German economy.

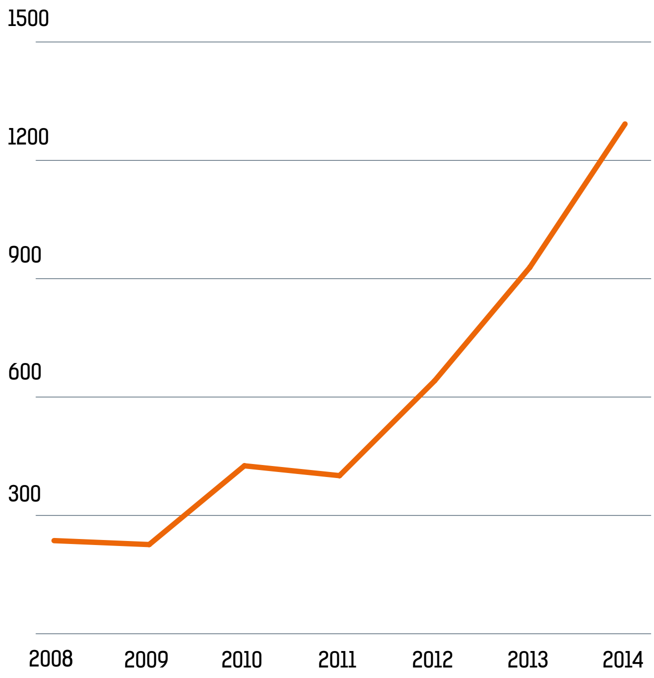
The longer-term implications for the financial services industry are still being interpreted. For one thing, the implosion of global banking and the consequent loss of trust in institutions has opened the market to non-bank competitors that were previously unable to compete. A sea-change supported by favourable regulation to introduce more competition into retail financial services, and cheaper access to consumers through the smartphone revolution.

For established banks the complex array of challenges that are confronting the industry, and helping to level the playing field as a result, mean that in many ways banking – both old and new – is in 'startup' mode.

The report identifies and discusses seven, inter-dependent themes set out below that are dominating the agenda for incumbent banks and financial services organisations, and new fintech entrants. As they seek to define, or re-define, their market position many are asking themselves fundamental questions as to how to transform the digital divide into a digital dividend.

For established organisations the solutions are not easy but they must be addressed if they are to succeed in the startup banking era.

FIGURE 1: EARLY STAGE FINTECH INVESTMENT UP NEARLY 6 TIMES SINCE 2008 (M)



Source: CB Insights Disrupting FS Webinar

Simplicity

Easier access to consumers through digital channels, and specifically smartphones, is driving the trend to straightforward products distributed by new fintech entrants, in most cases themselves simple, single product companies. While this strategy may be impractical for multi-channel institutions, the research highlights the opportunity for banks to simplify the user-experience, rationalise product lines and improve returns, which now stand on a level comparable to utilities companies.

Trust

Trust, once a byword for financial services has been severely damaged by the financial crisis and waves of scandal in the decade following it. Loss of trust has opened the doors to new fintech, non-bank competitors. While most of these have not yet been tested by a downturn, waiting for the next crisis to restore trust is not a viable option. The report shows that winning back customer trust will require an emphasis on re-building the relationship with consumers through transparent pricing and communications, and greater use of technology to replace human interaction with automated systems.

Agility

Smartphone app use has radically altered consumer demand for innovation, with new products launched more quickly, tested in the open market and continuously refined. Organisations in this report underline how banks are adapting to this cultural change with innovation initiatives that include venture capital investment, internal development and acquisitions. Most critically however, greater collaboration with third parties outside the bank and, paradoxically after a wrenching financial crisis, 'getting over the fear of failure' are increasingly viewed as essential ingredients to an agile innovation strategy for large institutions.

Relationship

The focus on user experience by fintech entrants, including those in this report, is drawing attention to the opportunity to redraw the relationship of financial services providers with their customers. For banks, this will mean seizing the potential to leverage deep pools of data for greater customer insight to understand how to monetise their services transparently in a way that fosters the longer-term relationship.

Transparency

The price transparency enabled by the first internet wave at the beginning of the century, in the form of price comparison sites such as Moneysupermarket.com, has been complemented by an influx of new entrants with straightforward pricing and simple business models in the age of the mobile internet. For banks, often characterised by complex businesses and opaque pricing, a response will require a root-and-branch commitment to transparency to help restore trust and re-build the connection with customers.

Unbundling

New fintech entrants are exploiting the advantages of single product focus, following a trend that was set by the launch of mono-line credit cards in the 1990s. The benefits this strategy affords include greater emphasis on the customer to build loyalty and a simpler corporate and revenue model. With fintech valuations riding high, countering this threat solely through acquisition is probably unrealistic. To compete, banks will need to develop a clearer understanding of how to leverage their multiple channel structure to create a better experience and deliver greater benefit, while exploring the potential for unbundled product pricing.

Pricing

The impact of the fintech revolution on product price-setting of products remains the most unresolved area of the ongoing shake-up in the financial services industry. Price is already the primary battleground on which the challenge to existing incumbents is being fought. The research reveals that while transparent pricing is a central pillar of the strategy for new entrants, banks and complex financial services organisations are trying to understand how to reconcile consumer expectations for cheaper digital products with an obligation to maintain multiple delivery channels.

FIGURE 2: FINTECH FOCUS AREAS OF 12 TOP VC INVESTORS SINCE 2007

PAYMENTS | FINANCIAL PLANNING | LENDING | BITCOIN

CB Insights Disrupting FS Webinar

SIMPLICITY

Exploiting the digital dividend

As the popularity of the mobile web has grown, the limitations of smartphone screens are contributing to the need for digital services that have been carefully designed to engage users in order to ensure their success.

The need for greater simplification of business lines in banking was already apparent before the financial crisis – a report by Oliver Wyman identified that despite growing revenues between the big bang of 1988 and the big bust of 2007, financial sector productivity has not improved since 2001[2]. A decade later and the growth in fintech startup activity is revealing the risks of ignoring the need for reform.

This desire to simplify often naturally-complex financial services businesses may in itself be an over-simplification. Even before the era of smartphone banking most banks were expected to service customers through a wide range of channels, often struggling to end products and channels long presumed irrelevant. The UK backlash against doing away with cheques in 2011 is a case in point[3].

> Mobile first, mobile, mobile and more mobile
>
> David Tighe, Bank of Ireland

All of this has stretched financial services firms as they battle to serve widely varying customers across geographies, differing demographics and sectors, and across multiple product lines and channels. Frequently with inadequate legacy IT infrastructure, often inherited from a previous merger or acquisition.

While today's climate of low interest rates, increased regulation and financially-straitened customers is driving demand from boards and shareholders for cost efficiency. Quite often this is not taking into account the need for dramatic organisational overhaul that is required if returns to pre-crisis levels are to be achieved again[4].

Much like its 2001 counterpart, the first internet boom, the era of the smartphone has added an additional layer of complexity for financial firms. Increased consumer demand for pricing transparency, lower prices and fees, usually coupled with expectations of a redefined user experience are pushing the bar for incumbent banks even higher.

A challenge that was reflected by the variety of opinions expressed in the research for this report. Insights from interviews identified the twin competing currents reshaping the delivery of financial services.

An internal demand for cost efficiency among banks and large financial organisations, and an external threat of margin compression from new market entrants - often single product entities – better placed to take advantage of the falling cost of serving and acquiring customers profitably through an 'innovation dividend'.

Craig Moore, founder and chief executive of Dubai-based online peer-to-peer lending startup Beehive.ae estimates that the cost of launching a new financial business in 2015 has fallen 80 percent compared to ten years ago. Operating from modest offices in central Dubai, the company has already been able to service over a thousand customers with a small staff.

Discussion with Beehive and Ireland-based online foreign exchange platform Currency Fair also highlight that widespread adoption of smartphones is creating a new, truly global universal platform for financial services delivery.

An opportunity that is allowing single product financial services businesses to establish themselves in new markets, and become global or regional players, much more quickly than was possible even after the first internet wave.

Simplification from within

Simplifying product ranges and service delivery is as much a cultural challenge for large institutions as it is a commercial dilemma. Large organisations, typically encumbered by layers of internal management and a more conservative approach to risk, particularly after the financial crisis, have been struggling to innovate on the scale of their startup peers.

In response, many financial institutions are choosing a hybrid model for innovation – seeking to leverage the innovation dividend without costly and risky internal change initiatives – by creating dedicated innovation or startup incubation 'hubs' that sit outside the organisation.

Barclays' Accelerator and the Visa Europe Collab programmes are two such examples. In both cases, the firms are seeking to harness the breadth of fintech talent and foster a culture of innovation without the bottleneck of corporate compliance. This involves putting entrepreneurs and startup founders through an intensive programme with the potential to commercialise their business later with the programme sponsor or as independent businesses.

Frustration at the speed of internal decision making with larger organisations was expressed by several interviewees and often cited as a key obstacle to building a culture of innovation. As Adam Davidson of Currency Fair commented, "I'm driven by having the ear of the founder and management team – that's the advantage of working in a startup and the digital sector sometimes – there are fewer hoops to jump through."

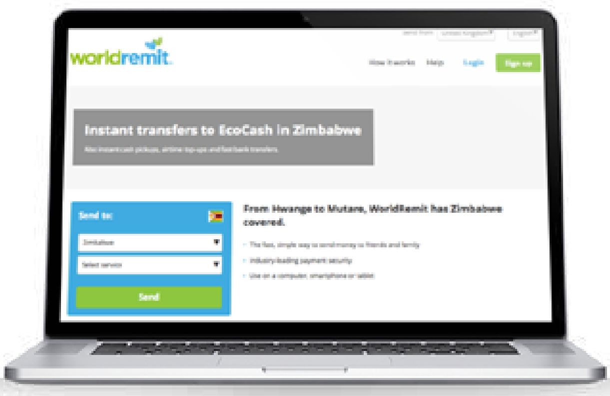
The approach of travel money provider Travelex, a large business established around 40 years ago, is to build an innovation culture from within the organisation. Dave Wascha, the company's chief product officer, previously with Microsoft and online printing company Moo.com, has been tasked with spearheading the company's digital efforts by building a software development company at the Travelex headquarters in London.

For a firm like Travelex, the choice was between what Mr Wascha calls, "a sequestered approach to innovation, through innovation labs outside the organisation or an embedded one, where you're really seeking to change the culture of the organisation." To achieve this the company is forcing senior corporate employees to work directly with their newer peers on the digital side of the business.

The Travelex meeting room where the interview took place is a living example of this strategy at work. One wall is covered with the type of organisational flowchart one would expect at any large firm, while the opposite wall is filled with the low-tech approach favoured by many tech startups, using rows of post it notes to help visualise the layout of a new product.

> Sending money to Zimbabwe is now as easy as sending an instant message
>
> Ismael Ahmed, WorldRemit

Old versus the new – the story of moving money simply



Streamlining the product range

Beyond their in-built culture of innovation, for many of the startups interviewed for the research their ultimate advantage in the smartphone age lies in the simplicity of their product range.

As mentioned above many of the highest profile fintechs of recent years are single product entities, with a simple commercial premise. A better customer experience combined with transparent pricing at (often much lower) cost than mainstream competitors.

With the possible exception of new retail bank Atom, this was the approach of all the new market entrants interviewed for this report. The commercial attraction of the mono-line product strategy is obvious.

Whether by lowering the absolute cost of the transaction in the case of WorldRemit, or a combination of lower cost and exposing the hidden costs of foreign exchange at Currency Fair or financial planning app Squirrel, new entrants are able to exploit the advantages of the low cost of innovation and translate this into a compelling marketing message to win market share. Increasingly across multiple markets and regions within a shorter timeframe than was previously possible.

While single product focus is unlikely to be a realistic option for large multi-channel banks, consumer expectations for product simplicity and transparency in terms of pricing, design and user experience are something to which banks can respond robustly.

The proliferation of single product fintech startups partly reflects customer preference for digital channels. Research of banking customers shows that preference for internet, mobile or social channels is growing for simple transactions such as checking balances and making payments. For almost anything else the branch remains overwhelmingly the preferred channel indicating a window of opportunity for multichannel banks.

Although their track record at leveraging their retail footprint through more effective use of technology has so far been patchy. Banks often feel compelled to jump when their competitors issue products based on new technology, for fear of losing out. As Sylvie Boucheron, vice president at ACI, the US core banking and payment technology provider explained, "at the moment [banking customers] often focus more on the technology than the customer... the biggest challenge we [at ACI] have is trying to get customers to think about their business from the point of view of the customer and to adapt their products accordingly."

Mrs Boucheron cites the pressure for instant payments in Europe as an example of this, "we [all] know that instant payments are coming but instead of worrying about the challenge of updating their systems, banks need to understand what is the problem they are trying to solve for customers first and how they can make a difference to them."

The Barclays Accelerator and Visa Europe's Collab show signs of a shift in attitudes however and explicit acknowledgement that the banking model, largely unchanged for much of the last century, is due for a tune-up.

A realisation reflected across all the banks interviewed for the report. Highly aware of its customer's shifting expectations and the need to respond or lose out, Bank of Ireland has prioritised customer research as a means of understanding how best to interact with customers through a mix of digital and traditional channels. David Tighe, the bank's head of innovation explains, "we're undertaking regular customer research, we're talking to BoI customers on a monthly basis and ensuring continual interaction through digital mailings and the same for the executive team."

TRUST

> When you launch a bank you can't afford to take on too many customers too quickly – we've got to build it well and in a bomb-proof fashion
>
> Edward Twiddy, Atom Bank

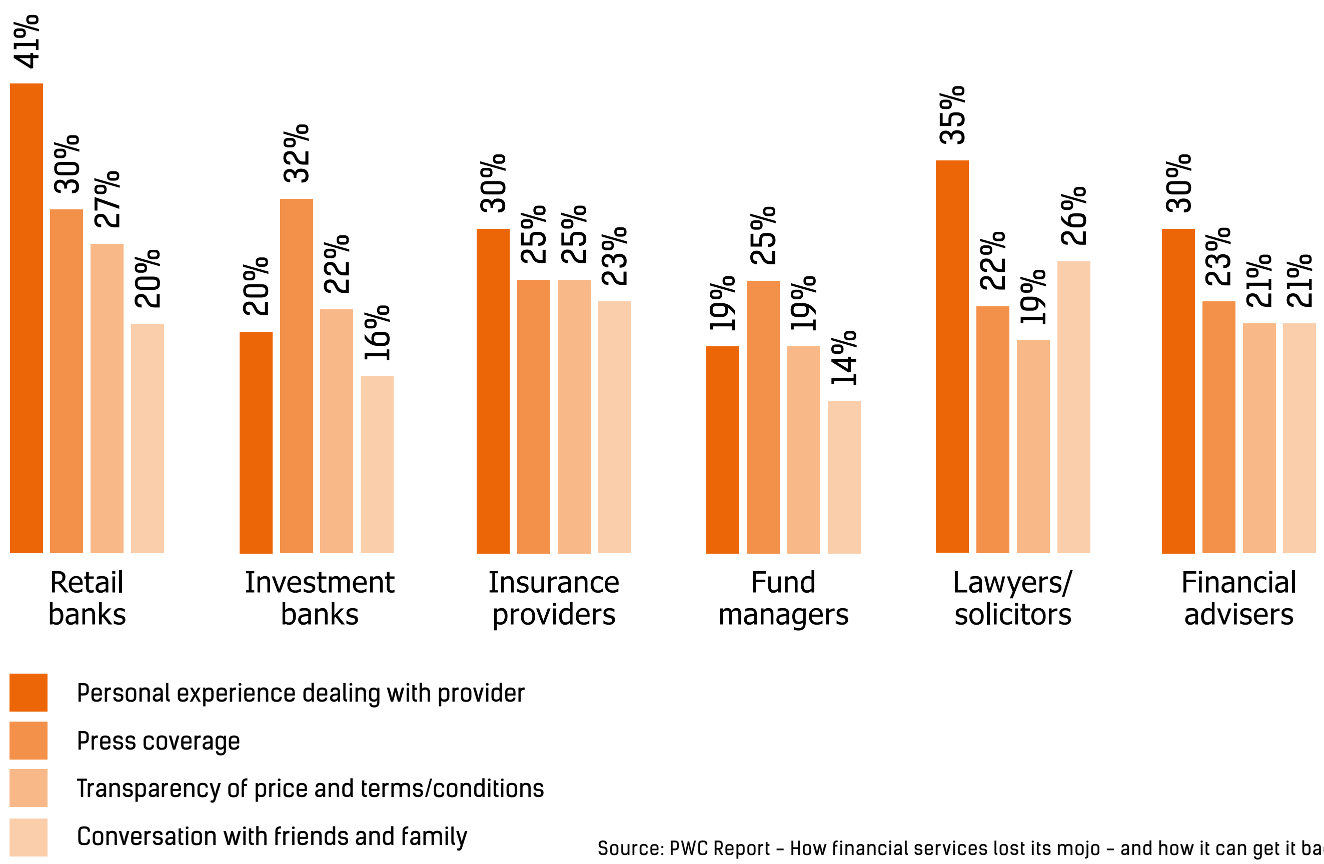
From watchword to 'once' word

In the decade after the crash, restoring trust has been the central focus of regulators and, sometimes grudgingly, of financial services providers. Apparently with not much success. In fact, the situation has deteriorated further since 2008. The financial services industry as a whole is among the least trusted global industries with a trust score of 54 percent, compared to 78 percent for the technology industry, according to a global survey[5].

By some measures, the financial crisis marked the end of trust in finance. While the extent to which it underpinned the financial system was laid bare, the fintech revolution that has followed it is changing its role in shaping and defining the financial services landscape substantially.

A 2014 study of banking customers in the UK showed less than a third of consumers said they trust their bank[6]. More damaging, the same study revealed that customers are largely apathetic to their bank's initiatives to restore trust, choosing only to stay with existing providers because there's nowhere else to go.

FIGURE 3: INFLUENCERS ON PEOPLE'S TRUST IN FINANCIAL SERVICES PROVIDERS



Source: PWC Report – How financial services lost its mojo – and how it can get it back

Poor credit history

Since banking's inception, implied trust, backed up by regulation, sat at the heart of what made it a reputable business. The dividing line between shifty loan sharks and thrifty, responsible bank managers. The financial crisis to one side, repeated mis-selling scandals, data breaches and opaque pricing have made that line increasingly invisible. At least in customer's eyes. The perception of financial services as a 'sick' industry has infected every area of banking operations from products to pricing and staff pay.

Perceptions that have been brought blinkingly into sharp relief by new digital entrants suddenly able to charge fees between 50 and 90 percent less than traditional banking incumbents.

The implications of this are only starting to become clear now. The creeping of digital technologies into nearly every aspect of consumer life has also increased their reputability, opening doors previously closed to new, non-bank financial services providers in the process.

The threat of retail financial services being offered safely and securely, beyond the confines of the bank, was perhaps first understood with the success of M-Pesa in Kenya at the start of the century, creating a whole new market at low cost, without the hefty burden of banking infrastructure. The pace of smartphone adoption in the developed world since then has furthered the cause, enabling a long list of new entrants to break into every corner of the marketplace from lending to payments, to financial planning, fund management and retail banking.

Worryingly for banks, often with startling results. P2P payments app Venmo, popular among American teenagers, already processes around $2 billion in payments every quarter just three years after launch. Irish online currency broker Currency Fair, interviewed for this report, says revenue and customer numbers for its service are doubling every year. Proof, if needed, that a reliance on trust as the primary means of differentiation between banks and their upstart non-bank competitors is no longer the expensive barrier to entry it once was.

Nor is regulation on their side in quite the same way. Scrutiny of account opening practices and regulatory incitement to encourage account switching, such as the UK's account switching guarantee scheme, is piling on the pressure. More damagingly, the continuous flow of new rules is sustaining a prevailing view that banks are inherently like naughty children, needing constant supervision, or customers will lose out.

While the majority of new fintech entrants, including any of those interviewed here, are yet to be tested in a downturn, a strategy of 'wait-and-see' for the next financial crisis to unfold before responding, as the ground shifts beneath them may be too late. The technology on which bitcoin is based, the blockchain is already attracting attention for its ability to replace third party human intermediaries in financial transactions with an automated process that quite literally manufactures trust (see box). Banks need to take action soon or risk irrelevance.

Re-establishing the connection

The research indicates they can. While trust in finance may have been damaged over the last decade it is not beyond repair. In the same study of UK consumers referred to above, nearly 70 percent ranked experience and pricing transparency as the main influences behind consumer distrust.

Banks need to understand however that the perception of trust in financial services providers has changed, and not just among next generation millennial customers. A large proportion of Currency Fair's clients are older customers with second homes overseas. As Edward Twiddy at Atom Bank notes, targeting customers for some new entrants is "actually less about demographics than it is an attitudinal issue - because we're a full service bank, there's no single age group we're going after."

Consumer comfort with the digitization of personal life, including payment and financial data increasingly means the key to regaining customer trust for tomorrow's bank requires that window-dressing is replaced with a strategy for packaging safe, secure, reliable services into friendly, friction-free experiences, "build it well and in a bomb-proof fashion," in the words of Mr Twiddy.

Fintechs in every corner of the marketplace are pointing the way forward, including those that operate behind the scenes. Integrating meticulous attention to customer and partner feedback to inform product design with their communications strategy to build their reputation and win trust in the open market.

> Blockchain will increase consumer confidence, enable a system of frictionless duties and taxes, and reduce fraud and financial risk
>
> Leanne Kemp, Everledger

Restoring the lustre

Restoring a tarnished reputation along these lines implies a fundamental overhaul of company culture, hand in hand with a commitment to transparent, fairer pricing and communication. For financial planning app, Squirrel this meant targeting customers on lower incomes with an affordable product that helps them meet financial goals.

Where new challenger banks - Atom, Moven, Fidor among them - are going, some incumbents are starting to follow. Barclays launched its accelerator programme in conjunction with Techstars to highlight the importance of partnership. The proliferation of bank and high-finance sponsored incubators, labs and accelerator programmes around the globe also signifies the seriousness with which the threat to the traditional banking relationship is being taken.

There are some chinks of light. In the everything-connected, digital world, data security is increasingly the battleground on which reputations are fought, or forged. Despite the damage to their reputations over the last decade banks consistently outperform other industries in perceptions of customer data protection – three times as much as social networks and more than twice as much as retailers in one study.

Using affordable digital channels to drive openness, and improve the customer experience, banks now have a window of opportunity to profit from the digital dividend by building on a trusted reputation as custodians of their customers' finances.

Everledger: A mint for trust

The blockchain shows how our understanding of transactional trust, conferred by human third party processes for centuries, could be transformed by an automated system. Affording greater transparency and encouraging greater participation in the financial system on a global scale.

London-based startup Everledger is applying blockchain technology to authenticate ownership of diamonds. A system the company hopes can help stem the flow of blood diamonds by verifying that stones on the market comply with industry standards of provenance.

Leanne Kemp, Everledger's chief executive is evangelical about what she sees as, "an ideal way to ensure transparency and integrity when two parties in business don't trust each other… the potential is quite possibly limitless, using a global, distributed ledger that cannot be tampered with to complement traditional methods of recording information, all of which have been shown to be vulnerable."

Everledger works by verifying rough diamonds against a series of international warranties that adhere to the Kimberley Process (an industry code of conduct). Details of the provenance of these diamonds, can be accessed by governments and individual buyers, providing greater transparency and assurance that the diamonds have come from legitimate sources.

AGILITY

Flexible friends

Startup companies are agile by nature. The ability to make decisions quickly without being held back by layers of corporate bureaucracy is what gives them their 'edge' compared to established competitors, allowing them to respond or match customer demand more quickly. Fintech startups are no different, and agility is a defining attribute of the group of fintech startups interviewed for this report. More interestingly, in a sign of the competitive threat posed by digital-only entrants, it is also a widely expressed aspiration of banks and mainstream providers, keen to demonstrate their commitment to innovation, and their continued relevance, in the digital age.

New technologies are rapidly redrawing understanding of financial service delivery and product development. Previously dominated by a closed model of innovation, new financial products were designed and tested rigorously by companies behind closed doors before being released to the market.

As the fintech revolution gathers pace this model is fast being outstripped by consumer expectation for a process of continuous improvement, inspired by companies like Google and Apple – launching new products more quickly and then refining them by monitoring and responding to the data they generate as the products are used.

The interviews in this report reveal the extent to which this message is being taken to heart by large financial services organisations as much as their upstart peers. Adopting an open approach to innovation that relies on collaboration with external developers. In particular, the research reveals three approaches to addressing the innovation challenge among established providers, characterised here as 'build in', 'build out' and 'buy in'.

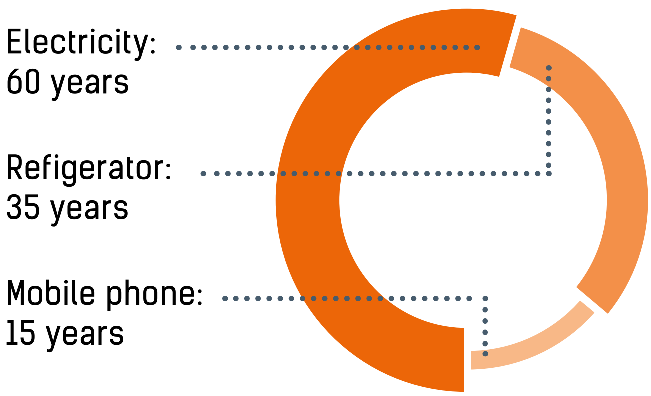
FIGURE 4: SPEEDING UP THE SALES CYCLE

18 months » 12 weeks

A typical sales cycle is 18 months. Accenture Fintech Innovation Lab helps startups create and identify products and services for banks in 12 weeks

Source: CB Insights Disrupting FS Webinar

FIGURE 5: SPEED OF ADOPTION FOR US HOUSEHOLDS TO HAVE



Source: CB Insights Disrupting FS Webinar

Build out: Innovating outside the business

Interviews for the report identify the extent to which innovation in financial services is increasingly taking place outside the confines of the bank.

There are clear commercial benefits to such a strategy, particularly for constrained company balance sheets. Companies large and small are taking advantage of the quicker time to market and easier access to consumer insight enabled by mass adoption of smartphones and wider internet availability.

Digital technologies have the added advantage of flexibility built-in, allowing providers to respond to customer demand more quickly and adapt their products accordingly. Adam Davidson of Currency Fair explained that improvements to Currency Fair's online foreign currency trading platform have included "improving our product by enabling regular payments. We also launched our first app – we relied previously on a phone friendly site. It was the first p2p currency transfer app and has around 80 percent of the functionality of the full site."

> The reality is that it's three times faster and cheaper to innovate this way [Barclays accelerator programme] than to do it internally
>
> Derek White, Barclays

The growth in bank-sponsored incubators and innovation funds, Barclays' Accelerator programme and the Visa Europe Collab among them, is proof of how seriously the challenge to the traditional model of banking delivery is being taken. Available data suggests this is the right approach. Consultancy CapGemini estimates that over 40 percent of all financial products globally are already sold online[7]. A trend that will continue as digital banking becomes the norm.

Digital technologies are at the heart of enabling agile innovation. Craig Moore of Beehive estimates that the time needed to launch a new product is now down to one quarter what it was a decade ago. In effect meaning that a product that would have taken a year to get off the ground ten years ago, today takes barely three months. A feat that both Barclays and Visa Europe are trying to emulate with their 100-day acceleration programmes.

A proliferation of chief digital officer roles across the industry is also trying to capture the startup spirit. As Derek White, Chief Digital Officer at Barclays acknowledged, "it's no longer enough to be a big business and run that business," (see box).

While the concept of agility is desirable, insights from the interviews also reveal some hesitancy on the part of large firms around innovation for its own sake. David Tighe at Bank of Ireland was keen to underline that the direction of travel for the bank's innovation initiatives is centred on the customer, citing growth in the bank's use of social media as an example of how the bank is changing how it interacts with customers. A view shared by Sylvie Boucheron of ACI who says one of the greatest challenges is getting banks to think less about the technology and more about how to use it to make customer lives easier.

Speeding up on the outside: Barclays and Techstars

LAUNCH DATE: 2013
PROGRAMME TERMS: 6 PERCENT EQUITY STAKE IN RETURN FOR SEED FUNDING
OUTCOMES: 20 COMPANIES PUT THROUGH THE PROGRAMME
£27 MILLION RAISED

Barclays announced its Techstars-powered accelerator programme in December 2013. Through the accelerator, Techstars offers successful applicants seed funding of £12,500 in exchange for six percent equity, and gives them access to office space in London's Whitechapel, near Tech City.

Startups are also given access to Barclays data and technology, mentorship and coaching from industry experts and introductions to the Techstars and Barclays networks. To further the bank's ambition to play a leading role in developing the future of financial technology, the company has now launched Rise, to provide physical facilities and a digital community in key cities around the world. It plans to have Rise hubs in North America, Europe, Africa and Asia by the end of 2016.

Despite initial scepticism within the bank, says Mr White, "The overpowering insight and the magic moment is when Barclays can become a customer of a startup and also if we can find the best technology to innovate for us and create new customer experiences." According to Mr White it has turned out to be three times faster and cheaper to innovate this way than do it internally.

Mr White is happy with the results from the programme so far. Two out of the first 10 companies going through the 13-week programme secured agreements with Barclays. This grew to seven out of ten in the second cohort. The increase in cumulative value of the companies was 160 percent and they have raised £27 million of investment after participating in the programme.

Bank of Ireland says it follows market development closely to explore ways of innovating with its own products where it makes sense. These include new ways of working with startups and small businesses such as workbenches and innovation labs that connect entrepreneurs, at the branch, by offering free space for co-working, along with seminars, clinics and events to encourage innovation and new ideas. The bank is also experimenting with i-Beacon technology and data driven marketing to deliver location-based and customer-focused offers.

The cultural shift in approaches to innovation is epitomised by the change of heart at Visa Europe. Where once the company's innovation efforts were a closely guarded secret, the barriers have been lowered and the Visa Europe Collab is letting outsiders in to help inspire ideas that could become Visa products in future and improve the company's digital capabilities. Steve Perry, founder of Visa Europe Collab, explained that the launch of a new card with Citibank in partnership with an external provider presented "a eureka moment" and the sudden realisation that the organisation should stick to "building the stuff it understands and use trusted partners that are better at the areas outside Visa's specialism".

Buy in: Acquiring agility

As company balance sheets recover, investment in technology is also picking up. Derek White of Barclays admits that as the digital shake-out continues, a strategy for acquiring fintechs with the right product or cultural fit will form part of the strategy for many institutions as they re-tune their operations and seek to buy-in innovational agility. The acquisition of digital startup bank Simple in the USA by Spain's BBVA is one example of this.

The payment schemes, American Express, MasterCard and Visa have been actively acquiring companies across a range of fields. Both Visa and MasterCard have stayed close to their companies' core focus with acquisitions related to new payment technologies, authentication and biometrics. American Express has moved further afield

including a partnership with home rental site Airbnb and consumer focused acquisitions in digital retail. US payment technology vendor ACI has also been actively acquiring companies in a bid to keep up with rampant innovation on its home turf.

Build in: Innovating inside the business

The middle way, of innovating from inside the business, still has a role to play. Among interviews for the report this was best characterised in ACI and Travelex. Both companies aware of the importance of innovation for their businesses but still committed to innovation from within.

For travel money retailer Travelex this involved establishing a digital product development team in its London head office. Dave Wascha says the team has already developed three products that are currently on trial and set for launch in 2016. Mr Wascha says although the business was established over forty years ago, the company's retail footprint affords them a head start over digital only competitors when it comes to launching new products.

The challenge for large vendors of banking technology in the age of digital disruption to stay current is even more acute. US payment technology company ACI is fully aware of the dilemma. According to Sylvie Boucheron-Saunier, vice president and general manager Europe, the solution lies in the company's commitment to research and development. Mrs Boucheron says the company invests 20 percent of its annual in R&D, which translates to approximately $200 million each year invested in new technology.

The company has two labs in the US where it experiments to test new innovations and understand how they can be integrated into ACI's existing products. Another is set to open in 2016 in Ireland to accommodate growing demand across Europe, the Middle East and Africa, a move geared to enabling ACI to adapt better to the changing regulatory landscape.

The choice between innovating internally, externally, or by buying-in technology, each come with their own specific challenges. With far-reaching implications for company culture, service delivery and the business model. The interviews in the report underline that it is too early to tell which strategy will deliver the best results. More certain however is that for both new entrants and established banks a strategy for agile innovation will enable greater differentiation and play an essential role in their success.

RELATIONSHIP

For decades, the banking industry prided itself on its uniquely placed ability to maintain a strong bond with its customers first through the branch, then the phone and, more recently, online. This lucrative 'relationship premium,' aided by the high cost of entering the banking marketplace, a favourable regulatory climate, and limited transparency in the real cost of banking transactions meant that the banking landscape across most advanced markets remained largely unchanged.

If the first internet wave partially loosened the grip of financial services companies on their customers, by enabling direct price comparison between banking products, by some measures the mobile internet boom appears to be helping to disintegrate it entirely. New regulations designed to improve consumer choice, compounded by reduced respect for large banks, and growing consumer comfort with online-only providers has meant that the relationship between account holder and customer has become more fluid, even fickle.

Data from the first full year since launch of the bank account switching service in the UK, designed to make it easier for account holders to change banks, shows that the UK's four largest banks lost a quarter of a million customers through account switching in 2014 (see Figure 6). While consumer research revealing that around a third of customers were enticed by promotional rewards as one of the main influences to switching bank accounts[8].

Against a backdrop of declining customer satisfaction with banks around the world, new fintech entrants are recognising the opportunity to redraw traditional means of customer interaction and engagement, with mobile at the heart of their strategy. The latest data on channel use shows the extent to which the banking relationship continues to be redrawn, with digital channels growing rapidly (see figure 7).

While the concept of a direct relationship with their bank might still hold for some customers at the top of the income pyramid, 'the perfect storm,' coupled with the success of technology companies like Google and Apple, has shifted consumer expectations of financial services delivery and accelerated banks' search for new ways to relate to their customers in the virtual world.

In particular, the research revealed the dual challenge confronting providers of banking services as they struggle to redefine banking relationships. Making consumer lives simpler through greater transparency in product benefits and costs, coupled with an easier user experience, at the same time as making greater use of technology to manage organisational complexity and improve profitability.

As Edward Twiddy, chief innovation officer at UK digital challenger-bank Atom, explained, "beyond everything to do with being direct and digital and being a full bank – which does differentiate [us] – the most important thing is that it's brand new – we've put together the components and revenue streams we wanted."

Taking inspiration from online gaming Mr Twiddy says the bank will introduce game-like features into bank account management when it launches in 2016. In a sign of the blurring of lines between banking, gaming and other digital technologies Atom, like Currency Fair, has intentionally combined staff with retail banking expertise alongside others from digital industries in its hiring strategy.

Using gaming to drive product use and improve engagement is also an approach taken by Moven in the US. The bank's founder Brett King reckons that millennial consumers are the least financially literate generation of the last fifty years. The Moven retail banking app helps customers manage their accounts better by using a traffic light system to indicate whether an account is in debit or surplus.

For mainstream banks, a complex product range is adding to the scale of the challenge ahead of them as they seek to streamline their relationship with customers. As an example, in the 20 years to 2013, the average number of mortgage products offered by the 20 largest banks in the UK grew from 10 in 1993 to over 60 in 2013. This complexity is not likely to go away. While digital channel use is growing, customer preference and use of branches holds strong.

Redefining the retail relationship is about more than using technology to cut operational costs. There may also be opportunities for preserving existing or adding new revenue streams. Consumers are looking for trusted advisors and the record of the mainstream banking industry in achieving this is uneven. One industry survey of banking consumers across nine developed and

FIGURE 6: BIGGEST LOSERS: HOW 'BIG FOUR' BANKS LOST 250,000 SWITCHERS

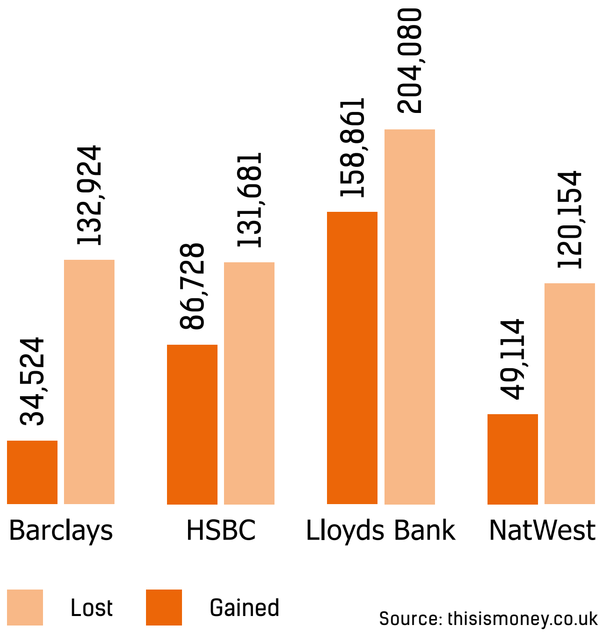
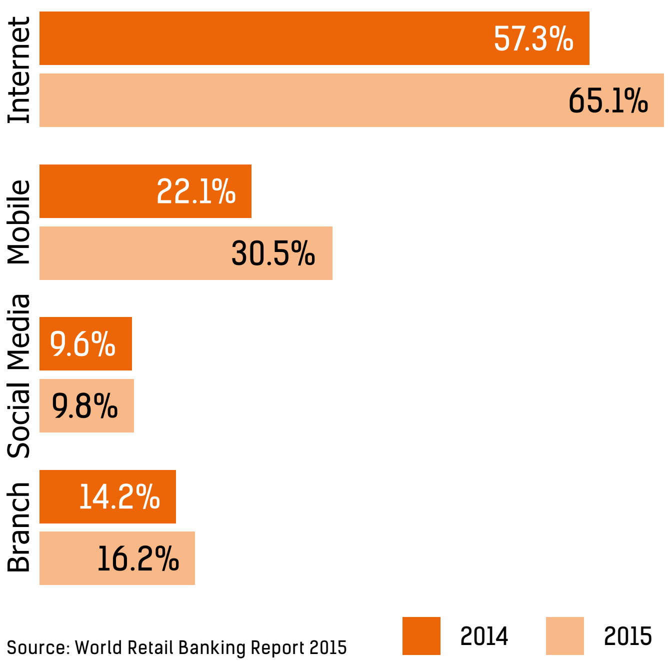


FIGURE 7: CUSTOMERS PREFERENCE OF CHANNELS (USAGE PERCENTAGE AT LEAST WEEKLY (%)



emerging markets, showed that 77 percent felt that banks failed to meet service expectations across a range of areas including helping customers stay in control of their finances[9].

Derek White, Chief Design and Digital Officer of Barclays, recognises what this opportunity means for a large institution, "our [product] design principles - are about a shared glass. Some things people are not comfortable doing themselves. [As consumers] we take comfort in taking guidance, from getting advice - and some customers will place a premium on the value of the personal interaction."

Taking a lesson from the new fintechs, rediscovering the relationship premium hinges on banks' ability to use technology to improve efficiency and deliver greater insight on their customers. Copying the success of Google and Apple, banks need the technical architecture to introduce processes of continuous product and service refinement based on customer data, breaking down the walls between siloed divisions in the process.

It is a race they need to enter soon or they risk losing out. As Todd Latham of Currency Cloud points out new payment industry regulation in the form of PSD2 will stretch the distance between bank and customer as it opens the market to new non-bank payment aggregators , "[while] banks are needed as the payment gateway and to access central bank funds, they are getting further removed from the point of the transaction… this is an ideal space for the likes of Facebook, Google, Microsoft and Apple – the opportunity to have sight of the underlying customer data and then be able to target financial products for example on the back of it is just too good an opportunity to miss."

While trying to understand how to integrate and make sense of data streams from multiple channels and products banks have been more successful at using technology.

Leveraging automation, advances in credit assessment and fraud detection are now already carried out by computers. Some banks in emerging markets have also made progress in adapting their product ranges to the new channels favoured by consumers. Turkish bank Deniz Bank uses Twitter to allow consumers to apply for loans and has launched a Facebook banking branch which the bank claims is now used by 10 percent of the bank's customers for money transfers and account management.

> [while] banks are needed as the payment gateway and to access central bank funds, they are getting further removed from the point of the transaction… this is an ideal space for the likes of Facebook, Google, Microsoft and Apple – the opportunity to have sight of the underlying customer data and then be able to target financial products for example on the back of it is just too good an opportunity to miss.
>
> Todd Latham, Currency Cloud

Using engagement to improve the relationship

The advantage of digital channels is the ability to improve customer engagement with the right strategy and combination of digital interaction backed up by robust customer service. Something that Bank of Ireland sees as pivotal to the bank's repositioning for the digital era "social media are being used extensively by our customers to contact the bank, request support and engage with the bank and also used by BoI to promote events, services, new products."

The key to success is more nuanced than adding Twitter or Facebook as yet another point of entry for a new customer-type. Bank of Ireland's approach has also been to reflect customers' growing digital appetite in some of the company's branches. At a pilot branch in central Dublin cashless devices are supported with advice from branch staff. The bank has also based its innovation team there with space allocated for startups, co-working and fintech events.

Industry-wide investigation of potential to use blockchain to improve back office processes, including managing bank ledgers and storing documentation. Bank of Ireland is one of many banks exploring the opportunity of the blockchain to streamline internal bank management. As David Tighe remarked, "it's important to conduct the research first and it's still too early to talk about uses but we suspect considerable opportunities."

Specifically, the research revealed the breadth of recognition of this across the large financial institutions interviewed for the report. Payment scheme Visa Europe's new open innovation approach to product development – opening the doors to collaboration with other partners, including startups and entrepreneurs – and the Barclays' Accelerator programme are examples of this.

As David Tighe of Bank of Ireland notes "the key is working with partners and innovators to expand and improve its financial services and products, both in terms of offerings and geographic reach – e.g. from wealth management strategies to insurance to lending (crowd funding) and other areas that provide potential for new growth."

Companies like Atom Bank in the UK, and Moven and Simple, in the US are already transforming banking relationships by focussing on the customer. By placing greater emphasis on user experience, providing timely, relevant information and advice and easier to use products, they offer a glimpse of how the retail banking relationship is likely to develop.

The opportunity to redefine it however is still wide open. Both for startups and new entrants as well as incumbent providers. In an echo of Steve Jobs, customers don't know what they want - and don't know what the new model of banking should look like. It's up to the market to create the platform that will shape banking relationships for the next decade.

Built for innovation - Bank of Ireland's Canal Square branch which features one of the bank's work benches

TRANSPARENCY

Visibly transparent

The concept of transparency as a value proposition for retail financial services organisations was first made apparent with the launch of price comparison sites in the first interent wave. Ever More connected consumers and a financial system deemed untrustworthy in the years since have thrown open the doors to non-bank competition, accelerating the transformation of transparency from regulatory doctrine to commercial priority.

> [there's] quite a lot of disinformation out there so although some providers might offer and advertise free transfers, banks are quite good at masking the true cost.
>
> Adam Davidson, Currency Fair

In the decade and a half since, the scenario for mainstream providers has deteriorated further as successive waves of scandal have eroded consumer trust in bank communications, creating a deficit in trusted financial advice. At the same time banks have failed to respond to the threat to their business of direct price comparison on the internet by articulating the value they offer their customers.

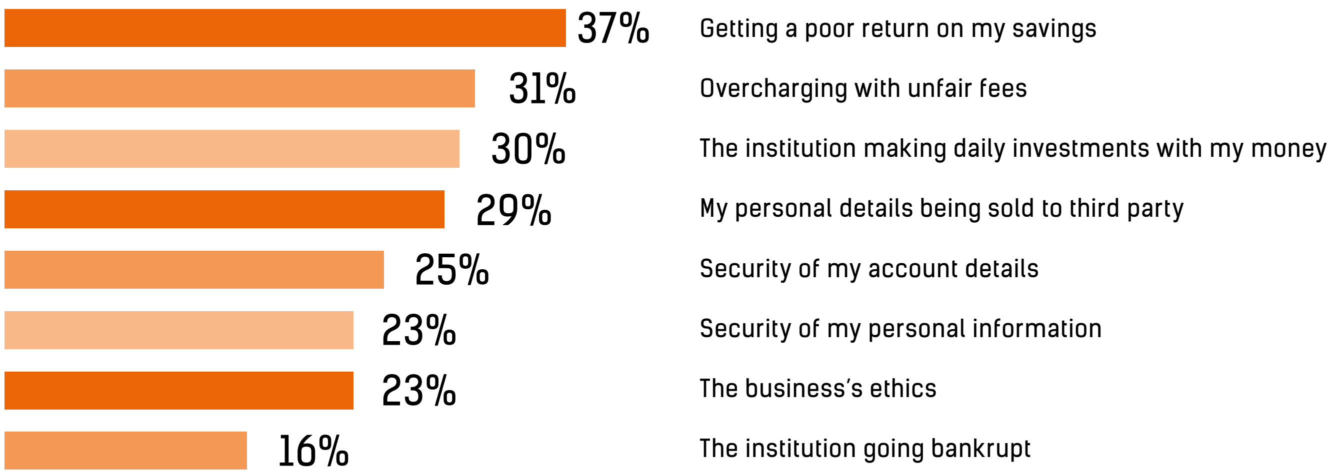
While transparency comes naturally to most fintech startups, including those interviewed for this report, the challenge for multichannel financial services organisations is more complex. Its impact infects every area of the business from management style to communications, product development and pricing.

Consumers want greater control over what happens to their money and much greater visibility of what the institution is doing with it when they decide to leave it with them. 'Doing transparency' much like 'doing digital' runs the risk of consigning organisations to irrelevance.

Paradoxically, increased transparency enabled by the advance of digital finance has probably contributed further to the loss of trust in banking. WorldRemit, Currency Cloud and Currency Fair, interviewed here, offer services as low as one tenth that of mainstream competitors, leaving a significant proportion of consumers perplexed as to what exactly they've been paying their banks for up until now (see Figure 8).

Failed attempts by banks in some markets to reintroduce fees for their current accounts provide a valuable lesson. It's not that customers won't pay, just that they want to know how the pricing is arrived at, and increasingly expect less rigidity. Being able to pay only for what they want or use just as they can with unbundled digital competitors.

FIGURE 8: CONSUMER'S MAIN CONCERNS



Source: PWC Report - How financial services lost its mojo - and how it can get it back

See through competition

Complex financial organisations are caught in a bind. While communications drawing attention to greater institutional transparency and disclosure are relatively straightforward to implement, research indicates this may not be enough. As indicated elsewhere in this report, these initiatives are likely to be dismissed, consumers are not likely to believe the information they receive from their bank is impartial. At the same time, banks' higher costs compared to new digital entrants mean they are unable to compete directly on price alone.

Re-installing customer confidence in their communications is the key to rebuilding the retail bank in the digital age. Achieving this will require a cross-organisational effort to explain the value providers offer their customers in a manner that they will trust. In the vocabulary of digital business this may involve providing services, advice or information that offer no immediate commercial benefit to the organisation.

Retail banks do have a track record here. In the pre-digital era UK banks were successful in attracting new student account holders through promotions and incentives. Creating a valuable stream of new customers and setting the foundation on which to build longer-term relationships with the affluent customers of the future. In the digital age providers need to rediscover their acquisitive zeal, underpinning this with honest, responsible communications and a user experience that keeps them engaged.

Digital challengers like Atom Bank and Squirrel in the UK, and Moven in the US, are seeking to help fill the advice deficit by helping customers manage their finances. Brett King, founder of Moven, reckons that millennial generation consumers are the least financially knowledgeable generation in decades – the Moven app uses an interface that takes its cues from gaming to engage customers and make controlling their spending intuitive. Atom Bank, when it launches in 2016, is planning a similar approach.

New companies offering remittance and international payment services provide the clearest illustration of the new model of financial services that prioritises fairness and responsibility, allied with price transparency. Targeting customers in rich countries sending money to poorer friends and relatives back home at a fraction of the price of traditional providers.

> Business models have had to change because people are no longer prepared to pay for what they see as basic services and we strongly believe that the mobile phone is fundamental to delivering quality, low-cost financial services in a way that is completely transparent
>
> Alix Murphy, World Remit

With no hidden mark-up or price hike dependent on the destination of the funds. In some cases sending money to sub-Saharan Africa can cost two and a half times as much as sending to a developed country[10].

A sharp contrast to mainstream banks where the real cost of international transfers might be hard for the customer to determine. As Adam Davidson of Currency Fair notes, "[there's] quite a lot of disinformation out there, so although some providers might offer and advertise free transfers, banks are quite good at masking the true cost."

For banks to get customers to believe them again is not just about imitating new entrants through short-term price reductions or game-like gimmicks and free offers for which the music industry is well known. With the window of opportunity still wide open as the digital shake-out continues, investment in new technology platforms to combine the data streams from their customer's activity, often across multiple products, would finally enable the 'holy grail' of the single customer view. The enormous potential to tap customer insight, if used intelligently, could help rebuild the bond between bank and customer, and close the advice gap.

Banks have less need to fear than might be imagined. One clear advantage of the collaborative era of innovation is that bank and financial product technology is increasingly being designed with a back-door to enable future evolution and update, while enabling easier integration between technologies.

As this trend plays out across the industry and across regions, the contribution it will make to ease of use of banking services will drive usage and likely help draw in new customers increasing the size of the overall marketplace. The growth of mobile money across Africa offers some valuable lessons here for the developed world.

Interviews for this research reveal banks are highly aware of the need to re-connect with their customers and making strident efforts. Initiatives to re-position bank branches and a less secretive approach to innovation are examples of this. What is yet to be established is whether this will be coupled with a sustained commitment to providing impartial advice that goes beyond selling products to meet short term internal targets.

Transparent to the point of invisibility

As discussed in the section on trust, cementing a culture of transparency in financial transactions will increasingly mean replacing human intervention by automated processes. The concept of using blockchain to prove ownership of an asset is one such example that could, if pursued, encourage wider participation across all areas of the financial marketplace.

In some places this is already happening. As Steve Perry of Visa Europe Collab underlines, while financial services brands will likely remain important guarantors of transactional security, in much the same way as the 'Intel Inside' principle of the PC industry, the best payment experience in future will be one that is invisible to the customer. Where Uber blazes the trail to easy, 'friction-free' taxi rides, the banking industry may be forced to follow.

The World Payments Report 2015 names 29 key regulatory and industry initiatives aimed at stimulating innovation, increasing competition and transparency, standardisation and risk reduction.

The report shows that more than 50 percent of key regulatory and industry initiatives either directly or indirectly support payment innovation and this area is gaining genuine momentum. It states that in many cases where innovation is the primary objective, such as mobile wallets, the initiatives have resulted in more transparent and improved payment experiences for the consumer and has become an important focus when regulators design new regulations.

Writers of the report believe that immediate payments will have a wide impact on origination, processing, and reporting of payment service providers. Such payments will also influence the pricing, features/options, and security of products.

For the consumer, immediate payments promise greater price transparency, faster transaction times, a safer payments environment, and enhanced user experiences.

Disrupting technologies

Many of what the industry calls 'emerging technology' have finally emerged and we are already witnessing some trends that show what the future will look like once banks, merchants and consumers fully tap into their potential.

In 2015 change has been particularly visible in the areas of foreign exchange trading and international money transfers traditionally associated with high fees, the long time it takes for money to reach the payee and hidden costs such as agent commissions.

The big enabler is mobile technology through closed loop cards/mobile applications, digital wallets and mobile money, otherwise known as the 'hidden payments market', which the World Payments Report 2015 estimates at between 6.3 percent and 10.5 percent.

WorldRemit born out of personal experience

For former London Business School student, Ismail Ahmed, sending money home to Somaliland has been a frustrating experience as it is for millions of others facing the fundamental issue of high fees and the time it takes to get money through to someone in another country. In fact, the experience was painful enough for him to tackle it personally.

In 2010 Ismail established WorldRemit, a startup that vows to deliver this service instantaneously and at vastly reduced cost. In addition, the benefits of moving remittances online include a reduction of cash and anonymous transactions, robust authentication of payees and a digital audit trail to reduce the incidence of fraud.

Fundamental to WorldRemit's business lies the issue of transparency and, according to recently published figures, traditional practices could not be more ripe for disruption.

- The cost of transferring money internationally is still not settled. In developed markets the cost makes up 7-8 percent of a transaction. To send money to countries in sub-Saharan Africa, however, can cost as much as 12-20 percent of the transaction amount – fees being inflated to combat money laundering and fraud. (Source: World Bank Send Money to Africa Report)

- The World Bank estimates that money transfers cost Africans as much as $2 billion each year. (Source: Africa Progress Panel Report)

"Business models have had to change because people are no longer prepared to pay for what they see as basic services and we strongly believe that the mobile phone is fundamental to delivering quality, low-cost financial services in a way that is completely transparent," argues Alix Murphy, senior mobile analyst at WorldRemit.

UNBUNDLING

Break-up or build up?

The current trend for disintermediation, or unbundling, of financial services products is not new. Inspired by the introduction of direct price comparison sites like Moneysupermarket.com and alternative channels like PayPal in the first internet wave, the mono-line credit card industry in the US and UK of the late 1990s, and postal and direct banking before them.

The pace of uncoupling is accelerating however as the maturing of millennial customers and smartphone adoption continues, aided by the boom in fintech investment (see chart). In contrast to previous periods of industry expansion or the dotcom bust of 2000, the scale of change this time is unprecedented, infecting every area of the banking value chain. From customer-facing sales and marketing activities, all the way to processing, administration and the back office.

The clash of cultures

The rise of the fintechs is where the clash of cultures between old-world banking and the digital age is most evident. Underpinning the surge in single service fintech startups is a fundamental shift in belief that risk is more reliably mitigated by analysing quantitative sources of data than by qualitative interaction between bank and customer.

The scale of ambition of the fintech sector – and, equally importantly, its investor base – is best outlined by Marc Andreesen, co-founder of technology investor Andreessen Horowitz, "Financial transactions are just numbers; it's just information. You shouldn't need 100,000 people and prime Manhattan real estate and giant data centers full of mainframe computers from the 1970s to give you the ability to do an online payment."[11]

The upheaval is already well under way. German digital startup Kreditech claims it taps up to 20,000 data points ranging from e-commerce transactions to social media activity to score customers, including those without a credit history, and offer them tailored products, from micro-loans to revolving credit. Doing this, the company reckons, offers the potential to target an estimated 4 billion unbanked consumers around the world. PayPal's real-time credit scoring, based on eBay purchase history is famously more reliable than the FICO score used by three quarters of American consumers.

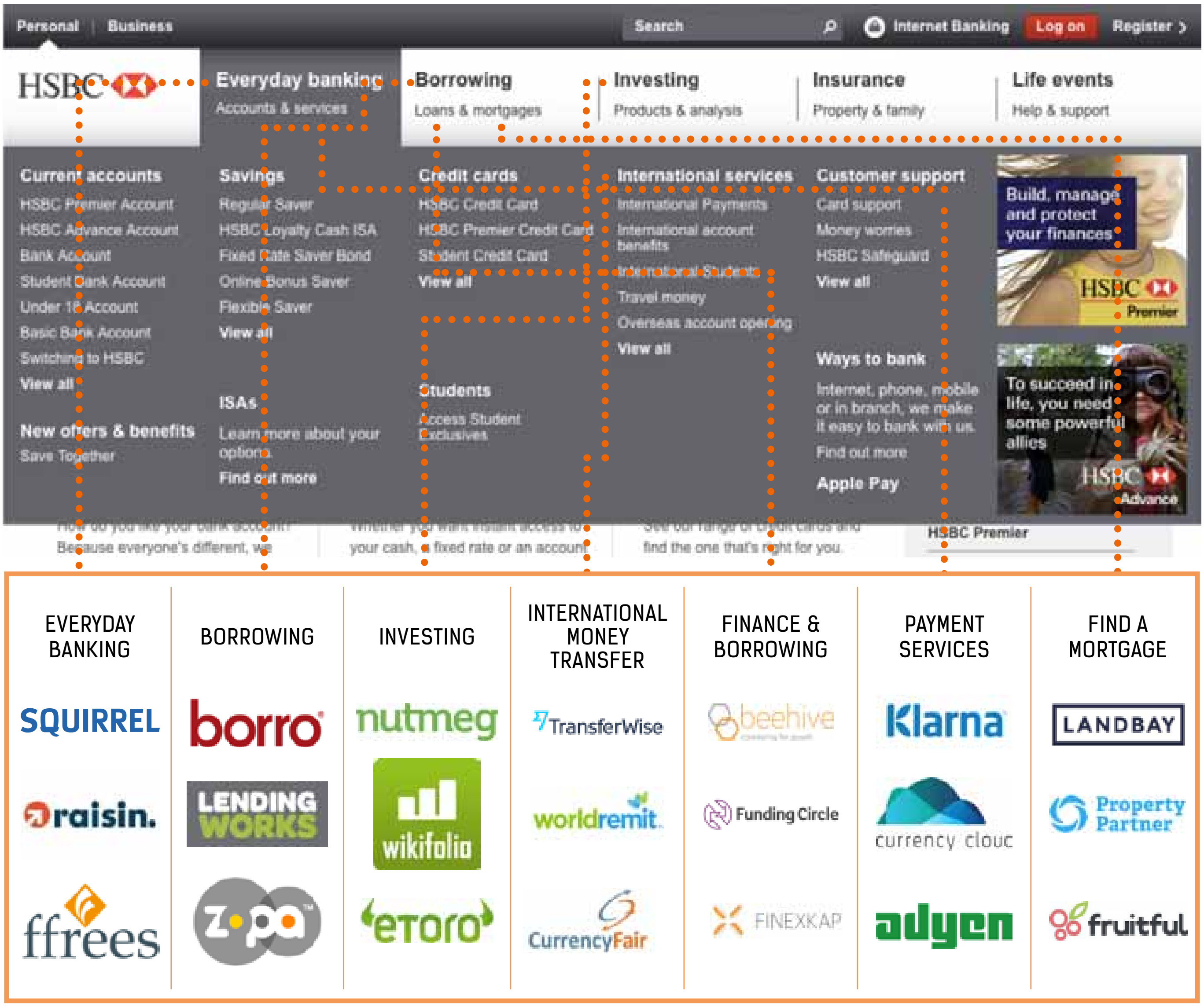
Peer to peer lenders, such as UAE startup Beehive, interviewed for this report, that connect lenders and borrowers directly online, were one of the earliest adopters of using non-traditional sources of data to score borrowers, so far with successful results. Investor returns at Zopa in the UK, launched during the first internet boom in 2005, dipped only slightly in 2008. Ratesetter, launched in the UK in 2010, after the financial crisis, says the default rate on its loans is below 2 percent (below the UK industry average of 3.5 percent[12]).

Consumers benefit too. Direct, single product fintechs often provide a better experience at substantially lower prices than their established competitors. With a transparent pricing model that helps build a loyal customer base in the process. The money transfer business is the most obvious example. WorldRemit charges fees that are less than half those of bigger providers Western Union or Money Gram.

As Adam Davidson of Currency Fair explained, the pricing of international foreign currency transfers by large banks is often opaque "there's quite a lot of disinformation out there - although some providers might offer and advertise free transfers, banks are quite good at masking the true cost because of the margins applied after the transaction has been confirmed."

The unravelling of the packaged model of financial services is an extension of a trend seen across all other industries disrupted by the advance of the internet over the last decade. Consumers want to know what they're getting for their money, want to pick what they want, and pay only for what they use.

While some new entrants may be bought up by the larger institutions, experience from other disrupted sectors such as the travel industry suggests this is a trend that is here to stay. With full-service providers carving out a more specific role alongside single-product peers. Among the startups interviewed for this report, none of them expressed any immediate desire to offer products outside their current area of focus - apart from anything else, valuations for fintechs are already high and, after a decade of poor returns, the banking sector is not well-placed for risky bets on unproven businesses.



The incumbent opportunity

It will be another decade before we know what the bank of the future will look like but the research does provide some clues on how single product and multichannel financial services companies will begin to differentiate themselves beyond price. For Barclays' Derek White, part of the answer lies in the relationship "we take comfort in taking guidance, from getting advice – and some customers will place a premium on the value of the personal interaction."

To survive in something approaching their current form banks will also need to combine this with a laser focus on overhauling the user experience across all customer touch-points, integrating digital technologies to keep costs at a sustainable level. Something that Bank of Ireland is trying to get right with its new branches that include workspaces for startups while using social media to improve customer interaction. As Mr White, explained, "we recognise that it will be organisations that can translate technologies into new experiences for clients and colleagues that will be the winners."

The focus on engagement needs to impact every element of the customer lifecycle, most importantly at the account opening stage. Opening a current account is the single most important opportunity for creating a lasting relationship with customers. Research shows that about three-quarters of all cross-selling opportunities come in the first three months of an account holder's time with their bank[13]. Striving to get the right balance of virtual versus real world interaction can make multi-channel businesses viable for the longer term.

Hybrid banking

As insights from the interviews reveal, many established institutions are aware of the challenge and trying to tackle it head-first. They are right to do so. While maintaining extensive branch footprints in developed markets will remain necessary in the medium term, new technologies will contribute to expanding the overall size of the industry by tapping parts of the market that were previously unreachable. Peer to peer lending is one example where this is already happening.

'Getting digital right' offers a rich seam of opportunity on a truly global scale. Much of it in emerging countries. The launch of M-Pesa in Kenya provides a valuable lesson here in the power of technology to create solutions where none were available. The gradual replacement of analogue mobile phones by smartphones around the world (Ericsson estimates there will be 5.9 billion smartphone users by 2019) opens the ultimate opportunity to reach the 2.5 billion people who don't use banks or formal financial institutions. Reaching customers at much lower cost than previously possible.

The flexibility afforded by the always-on internet to serve ever-greater numbers of customers with a greater degree of specialisation is here to stay. With Facebook's move into peer to peer payments in the US, and a rumoured application for an electronic money licence across Europe, so too is the normalcy of financial services provision from companies with no previous track record in the sector, partly fuelled by the maturing of millennial generation consumers.

Operationally, the hybrid banking model - using data and automation to facilitate decision making at high volumes where possible, complemented by a more personal, relationship-oriented approach to understand needs and increase sales where appropriate – seems the most likely scenario for the future of multi-channel organisations.

Success of bank, non-bank and fintech alike however will depend on the ability of financial services brands to build an emotional connection with the customer, prioritising user experience to ensure customer retention and drive acquisition. As Steve Perry of Visa Europe Collab remarked, In the case of payments this may even mean "getting out of the way." Trust, solidity, reliability – the familiar watchwords of banking since its inception – while still important, are no longer enough on their own in the digital age.

> "You would not today, starting from scratch, invent any of these financial businesses in the same way. To me, it's all about unbundling the banks.
>
> Marc Andreesen, Andreesen Horowitz

PRICING

Pricing of retail financial services is more relevant than at any time in a generation. The issue infects every dimension of the challenge facing multi-channel retail banks today as they re-orient their businesses for the digital customer of tomorrow. From simplifying the user experience to improving transparency, restoring trust and re-building the relationship, a radically new approach to pricing is the central pillar for building tomorrow's bank.

The explosion in new fintech entrants, particularly in some segments of the marketplace such as money transfer, is already driving down fees rapidly. In mature markets this is also being aided by regulatory enforcement to improve competition – and reduce market concentration – in retail banking provision, by making it easier for consumers to switch bank accounts. As mentioned earlier, the primary determinant of the longer-term relationship between bank and customer.

Its impact is evident everywhere in the interviews carried out for this report. Money transfers using WorldRemit cost less than half the price of established incumbents Western Union and Money Gram. A host of other new entrants in the space that includes TransferWise and Azimo of the UK, offer similar price discounts.

In the online currency marketplace, the difference is even more extreme. New entrants are charging commission fees as low as one tenth the cost of their broker competitors.

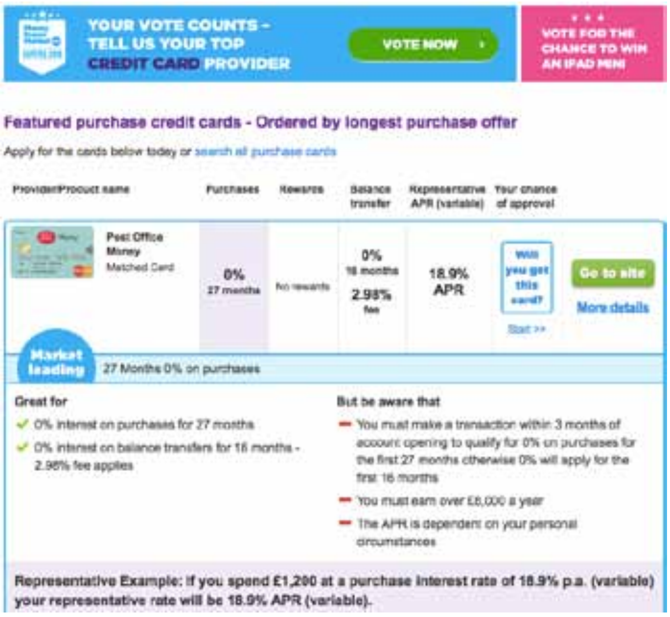
It's not just about lower costs. Partly inspired by the trend to direct price comparison enabled by the first internet wave and other industries previously disrupted by the internet, such as airlines, the research indicates the fundamental shift away from packaged to unbundled, pay-per-use, pricing.

As a result, banks will have to re-learn how they charge for the products they offer and understand the price customers are willing to pay. It's a difficult task, requiring a combination of digital experimentation and a robust strategy for using the data thrown off by new products and services to keep improving them.

Banks do have a window of opportunity to respond. Although unsustainable in the long term, the integrated pricing model of retail banking is relatively secure for the moment. As Adam Davidson at Currency Fair remarked, "banks and brokers make so much money [in this sector] why would you in the short term lower your rates? We're still small in comparison to them." A reflection echoed by David Tighe at Bank of Ireland – the bank has so far not recording any fall in customers as a result of new fintech competition.

As the doors are flung open, however, by specialist competitors shining a light on the true cost of transactions,

The first internet wave brings price comparison



competition is intensifying. To avoid irrelevance banks will have to respond creatively. High overheads and legacy infrastructure will prohibit them from competing directly on ground of price alone. At least in the short term.

The existential crisis in retail banking is compounded by the expectation in some markets, such as the UK and USA, that account services should be free, making it difficult to re-introduce monthly account fees to compensate for revenues lost elsewhere.

There is cause for optimism. The banks interviewed for this report are aware of the dilemma, and of the need, for a digital-first approach that reappraises the cost to serve customers. The variety of innovation initiatives being undertaken to enable experimentation at lower risk, and efforts to re-think the role of the branch, are proof of this.

In practice the cultural shift should not be so hard. Many banks already segment account holders along income lines, offering accounts with additional features to wealthier customers. With a robust digital strategy that prioritises data collection to interpret customer activity, breaking up the packaged account model to allow them to pay for the parts they need, or use most, is merely an extension of that.

A new model of user-defined pricing presents a significant opportunity for providers if they can get it right. Aside from the potential to introduce a new banking experience – building loyalty and restoring trust between bank and customer by demonstrating a commitment to transparency – a digital-first pricing strategy will likely contribute to creating a larger playing field. Potentially one that is not limited by national boundaries.

Banks do not really have much choice. In the near future all banks will be direct, digital banks. They will need to heed the lessons of fintech peers and other industries previously disrupted by the internet, like airlines and mobile, to survive.

The revolution in pricing and financial services delivery is only just beginning. As the fintechs interviewed here show, revenues and customer numbers are growing exponentially. Doubling every year in the case of Currency Fair. Sooner, rather than later, they will pose a serious challenge to long-cherished income streams.

The journey will not be easy. Success will depend on tight cost control, and experimentation with digital technologies to determine price thresholds for essential and added-value services while paying careful attention to the customer journey to improve engagement. Commitment to user experience and a communications strategy that repositions bank brands will be key. As Derek White at Barclays notes, “there are some things that [customers] don’t want to do themselves.” Precisely what those things are, and at what price, is still to be determined.

...the second is enabling competition

ENDNOTES

1 ING International Survey of Mobile Banking, New Technologies and Financial Behaviour, April 2015

2 Managing Complexity: The State of the Financial Services Industry 2015, Oliver Wyman

3 Source: www.dailymail.co.uk/news/article-2013953/Cheques-scrapped-2018-better-alternatives.html

4 Average returns from large firms are now on a par with utilities companies – having fallen from 20% in 2000 to 7% 2013

5 Edelman Trust Barometer, 2015

6 Stand out for the right reasons, PwC, 2014

7 Michael Leyva, CapGemini, quoted in Bank Technology, 2014

8 Atmia Loyalty Lens, April 2015

9 FIS Consumer Banking PACE Index, 2015

10 World Bank, Send Money to Africa Report

11 Marc Andreesen, interviewed in Bloomberg Markets, October 2014

12 World Bank Data 2015

13 McKinsey Global Banking Annual Review 2015

INTERVIEWEES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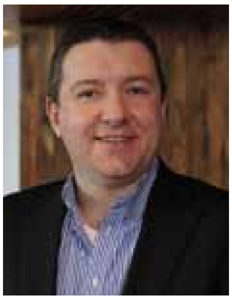
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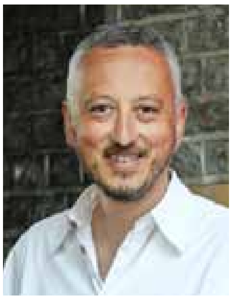
BANK OF IRELAND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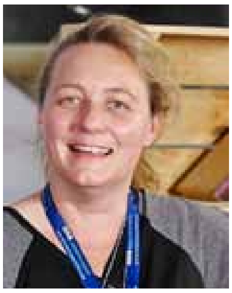
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