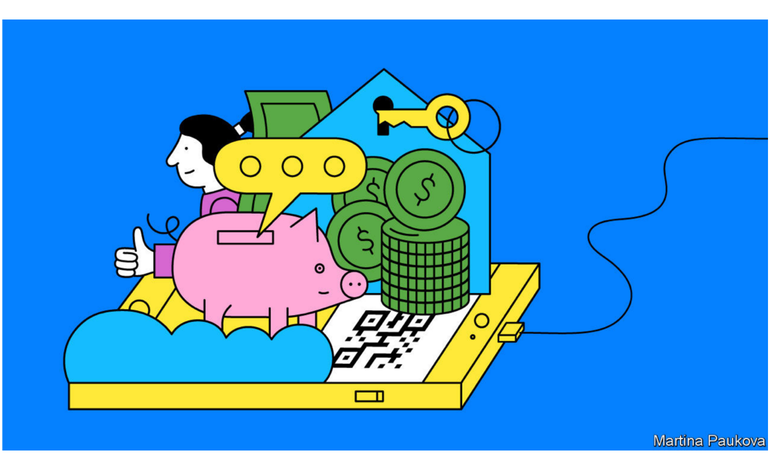
SPECIAL REPORT: BANKING

The future

The banking revolution is great for customers

Finally banks are giving people what they need



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TO A MATHEMATICIAN, a transformation is what happens when a geometric object is shifted in space, resized, reflected or rotated. Bankers, too, are in the business of transformation, but it

on their big corporate borrowers, says Kevin Travis of Novantas. "It's revealing that leading high-street banks are generally described as the 'big lenders'."

Switching banks is rare. According to Novantas, only 8% of American customers switch bank in a given year, even though moving state often means moving bank. In Britain, where bank licences are national, only 4% do. Low churn is often cited as evidence that customers are satisfied, but it would be more accurate to say that they cannot envisage anything better, says Jason Bates of 11:FS, a British banking-technology consultancy. "People would have said they were satisfied with taxis until Uber came along. Then all of a sudden they didn't want to stand on a street corner holding their hand out in the rain."

Outside Asia, few have yet woken up to the arrival of new banking options, but there are signs that more are starting to. Britain's neobanks have managed to sign up millions of customers largely through word of mouth. McKinsey's annual digital-payments surveys used to find that banks were more trusted than tech firms. Now, Amazon is running neck-and-neck with banks. And Raddon's research into Gen Z Americans finds that two-thirds expect tech firms will change the way financial services are provided.

The rise of fintechs and neobanks that act as marketplaces for other institutions' products presents incumbents in developed markets with a choice: are they willing to leave customer acquisition and service to the newcomers, or do they want to compete head-on? White-label banks, which carry out regulated financial services for other companies, show that focusing on products can work. But the margins are low. In retail banking 70% of shareholder value is typically captured by the customer-relationship and distribution channel, and just 30% by product manufacture, says Jan Bellens of EY, a consultancy.

If the incumbents want to fight, the customer relationship is theirs to lose. Most people still open a high-street account in their teens at a bank chosen by their parents, and caution may make them stay put. Regulators are often pro-incumbent, whether because they have been captured by lobby groups or because they fear big changes could cause financial instability. But banks would be unwise to depend on customer inertia and regulatory caution. If the alternatives are attractive enough, both may evaporate.

Adapting will be hard on incumbents, but customers have a lot to look forward to. The newcomers have lower costs and can therefore offer better value. As China shows, they can offer loans to people and small businesses that could not previously have been profitably served. And their arrival will push down account charges and fees for extras such as overdrafts and foreign exchange.

As Alibaba demonstrates, online retailers may not start out intending to offer financial services, but the logic of online commerce leads them in that direction. McKinsey's analysis suggests that once an online marketplace selling direct to consumers offers products in several categories and has a market share of at least 15-20% in its main category, it tends to move into payments. This, says Philip Bruno, who co-leads the consultancy's global payment practice, is not necessarily because it is seeking to increase revenues from payments or to reduce costs (though having its own payment system does allow it to avoid the "interchange" fees charged by card issuers). Rather, it allows a retailer to control the shopping experience from start to finish.

Chinese platforms show how it can be worth providing frequently used financial functions such as payments without making much from them—even, potentially, at a loss—if they act as a hook for consumer lending and advertising for related non-financial services, says Brian Ledbetter of McKinsey. This is the logic behind speculation that a Western tech giant like Amazon might team up with a bank to offer current accounts. The benefit to the retailer would be increased customer loyalty. Or accounts might be offered for a monthly fee, suggests Brett King, the author of "Bank 4.0: Banking Everywhere, Never at a Bank" and founder of Moven, one of America's handful of neobanks. Perks could include a rolling line of credit, discounts on purchases, or a rewards programme—all of which would boost the retailer's sales.

Financial services will increasingly become links in value chains that also contain non-financial services, predicts Mr King. Mortgages, for example, could sit in the "home-buying chain", offered on a platform that also displayed property listings and arranged viewings, surveys, conveyancing and home removals.

The biggest benefit for customers will come from a rethink of what banks are supposed to do. As traditionally conceived, says Ted Moynihan of Oliver Wyman, a financial consultancy, what a bank offers its retail customers is a way to store, spend and borrow money. It has not been a core part of its job to help them decide whether a purchase or loan will make them happier or wealthier. Often it will not. Research by the consultancy into credit for the American mass market shows that 30% of those who had taken out revolving credit regretted doing so; just 10% were glad they had.

The pursuit of happiness

Those loans may have been at market-beating rates. And they may have been "good", as defined by the industry—that is, repaid on time. But that is not how they look to customers who wish they had not borrowed. And it is not how a neobank or fintech firm seeking to act as a platform for third-party financial products can afford to view them, either. To convince customers that it is acting in their best interests, it must do more than sell products that are affordable, or even at the keenest rates: it must sell them what they actually need. The most formidable challenge the newcomers pose to the rich world's banking incumbents is not their lower costs or greater technological prowess. It is that their business model requires them to put customers' needs first.

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