

Summer 2019



ARE DIGITAL-ONLY BRANDS THE FUTURE OF FINANCIAL SERVICES?

Somo takes a look at how the role of the traditional bank has changed, what today's customers need and expect, and what the future will hold.



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EXECUTIVE SUMMARY

With customer expectations relentlessly shaped by the Amazons and Googles of the world, the ever-increasing demands for immediacy, transparency, ownership, convenience and instant rewards have permeated deeply into the world of banking.

And it's a shift we're seeing across all sectors. As vertical-agnostics, consumers are guided not by the average, but by a leader – wherever they happen to find it. The velocity of behavioural change triggered by the rise of the Big Five (Google, Microsoft, Apple, Facebook and Amazon) and the rapidly growing tech ecosystem is affecting how consumers perceive the brands and services they use and what they expect them to deliver.

Fintechs in particular have turned what was once a novel concept in the banking space into the new normal, carving the path for a fresh generation of banking – one that's real-time, transparent and seamless.

Consumer attitudes aside, the way we deal with money has also changed tremendously. Just twenty or so years ago, appointments with the bank manager were the most effective, trusted and in many cases *only* way of opening an account, arranging an overdraft or applying for a loan.

Now, you can literally do it in a matter of seconds, at the click of a button. Though – as you'll see on the following pages – the shift to digital-only banking has perhaps not been as powerful as the industry assumes.

In this white paper we'll explore the changing role of traditional and digital banks and consider what the future holds for financial services. We'll talk about what best-in-class means in this industry, discuss whether the growing influence of digital-only brands means the bank branch will soon become obsolete, and look at why designing around needs – everyone's needs – is fundamental when designing new products.

1 BANKING DISRUPTED

STATE OF THE MARKET

The advent of mobile has arguably had the largest impact on financial services. For an industry steeped in tradition, this new demand for immediacy (gently but irresistibly reinforced through every digital interaction we have) has created a gap which young digital companies, unencumbered by legacy technology and processes, are happily filling.

Simplicity and ease are the hallmarks of the experience consumers expect. Best-in-breed no longer applies, as banks and other financial providers are compared not against their competitors, but against the leaders in digital and mobile technology across all verticals.

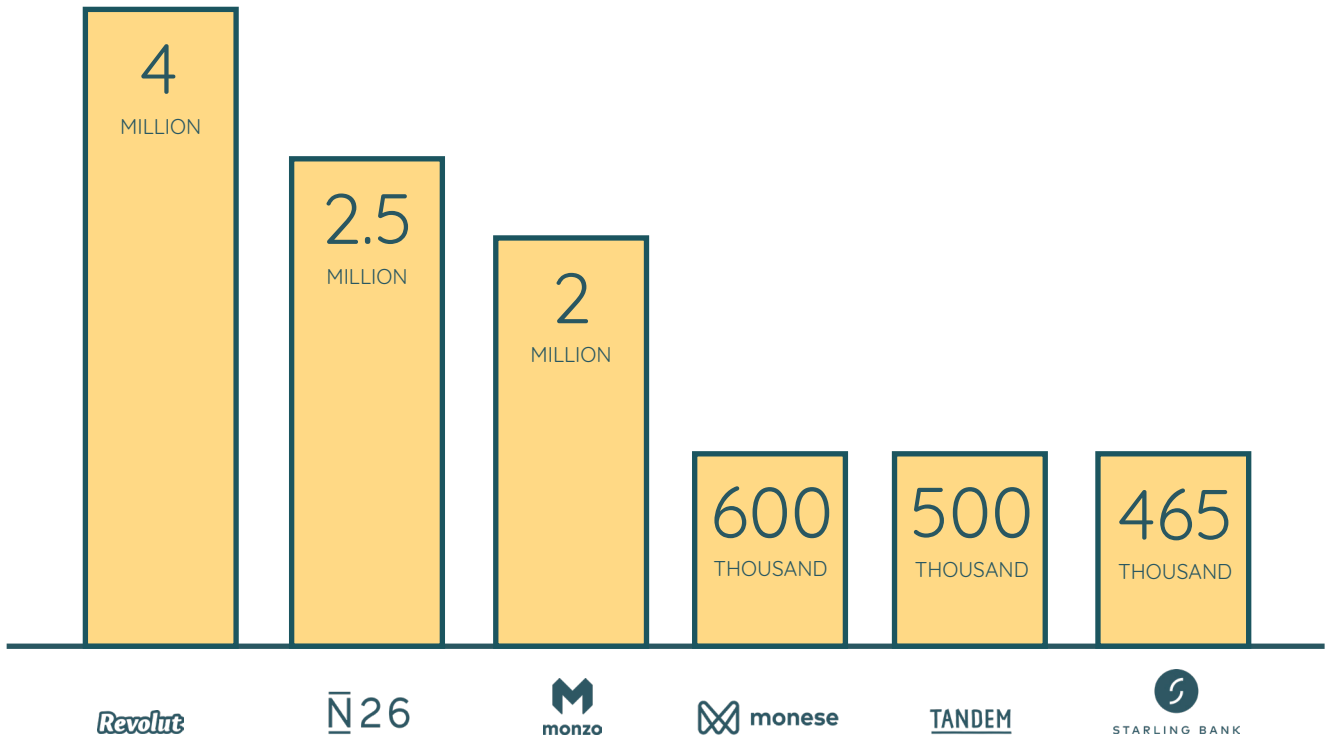
“The UK’s neobank market is flourishing,” Business Insider recently wrote¹, but there is still plenty of opportunity for the budding disruptor. “Early movers like Monzo and Revolut have upended the UK’s retail banking industry, with neobanks holding more than 4.5 million users in the country,” – a daunting prospect for traditional financial services providers, for whom this speed of adoption is unprecedented.

What have these new players done right? For sure, they know how to create a buzz – the waiting lists for Monzo and N26 attest to this – but of course the key is knowing what their customers want, and delivering it quickly.





Major European Neobanks' Customer Numbers²



Neobanks vs digital banks: the differences



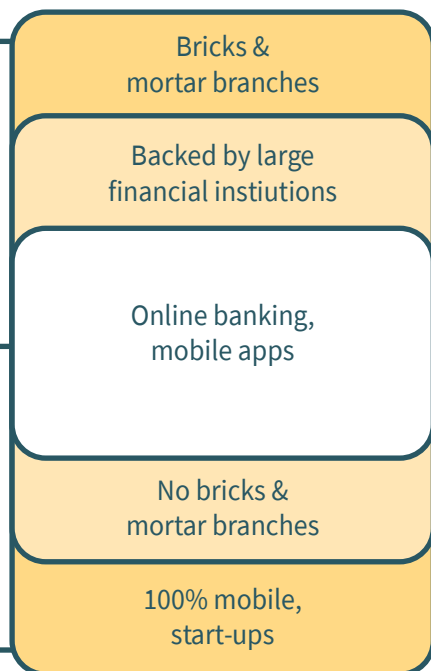
TRADITIONAL BANKS



DIGITAL BANKS



NEOBANKS



THE RISE AND RISE OF THE NEOBANK

Neobanks don't carry the weight of legacy technology, allowing them to rapidly leapfrog over clunky and traditional operations and infrastructure to disrupt the norm.

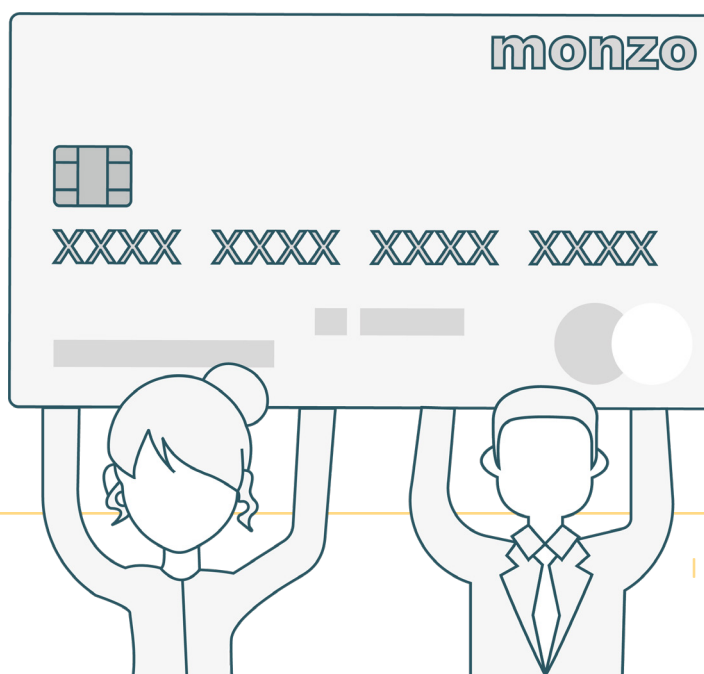
The UK has been a breeding ground for neobanks for two main reasons: the UK hasn't been saturated with big banks like the US, so a large-scale opportunity for non-traditional financial services players to enter the market has been created. Secondly, the UK was an early adopter of online banking right back to the late 1990s, which has enhanced the shift towards challenger banks and other alternative finance models.

Important to note is that, whilst customers are signing up fast, few use digital-only banks as their primary place of banking. This time last year, when Monzo were nearing 1 million customers, they reported that 1 in 5 paid their salaries into their Monzo account – which means the large majority are using it to meet very specific needs (or just for the perks of the experience). Without liquidity of funds, as these neobanks' current accounts have little cash in them (47% of customers had less than £1,000³), it's harder for them to run profitably. And to cross-sell other products, such as loans and insurance, in order to bring additional

revenue streams into the business, they must compete with a multitude of other providers, as our loyalty to banks and financial providers is more spread about these days.

The key challenge for the challengers is diversifying their product portfolios whilst continuing to create innovative and customer-first experiences in adjunct financial sectors.

Having been so disruptive in the niche areas in which they've established themselves, it will be interesting to see how their emergence into more traditional service offerings will shake things up. Clearly, those neobanks that are able to create a deep level of brand trust alongside innovative products and experiences could become the customer's main source of financial services, and in doing so will see a significant rise in profitability and truly challenge the incumbent banks. In summary, the race is not won by the new kids on the block – not yet.





HOW THE MARKET HAS OPENED UP

The open banking regulation has compelled banks, for the first time, to allow access to their data by other parties, under the Second Payment Services Directive (or PSD2). For the consumer this is great news, allowing us better visibility and control of all our financial products and ownership of our underlying financial data that up to now had been the bank's property. Banks have been pushed to adopt open banking by regulators, but rather than seeing this as a negative, banks should look at the opportunities that open banking provides; financial providers can collaborate with third parties using APIs in order to offer more innovative services aggregated under their own brand, offering mutual benefit.

This new regulation's effects will mainly be felt and seen through:

- Consumers having control over their data, thus being able to move this frictionlessly to other financial institutions;
- Ability for banks and fintechs to build new services;
- Aggregation of account information, giving a single view.

Only the largest banks in the UK are currently required by law to make customer data available through open banking, with smaller providers opting in according to their preference. It has been part compliance

exercise, part innovation opportunity for the big providers.

Last year, Barclays enabled customers to add current accounts from other banks into their existing mobile app, with over 6 million customers using this. However, a considerable number of studies cite as few as 22% of the UK population even knowing what open banking is⁴.

Having only been in place since January 2018, the full impact and customer benefit of open banking is yet to be seen. The first forays into open banking have been simple aggregation, rather than ground-breaking new products.

Whilst there has been little innovation to date in open banking, some third party providers like Yolt, owned by Dutch ING Bank, are developing aggregation and personal finance management services outside of the mainstream banks, and are ones to watch in the development of new customer-centric services powered by open banking APIs. This is actually leading to a commoditised view of banking - if every bank can aggregate all my accounts, what is the differentiation between banks?

2 WHAT THE PEOPLE WANT

A FEEL-GOOD FACTOR TOWARDS BANKING

With the significant changes taking place in banking services, we conducted an online survey of 1,000 UK adults in May 2019 to gain a greater understanding on issues and opportunities for digital banking.

Our research uncovered some interesting results that are often contrary to industry and media perceptions.

An overwhelming majority of consumers (69%) feels positive about their current, often incumbent, bank or their building society, with only 7% not happy about their providers⁵. But there are still issues to be addressed to better cater to customer needs and desires.

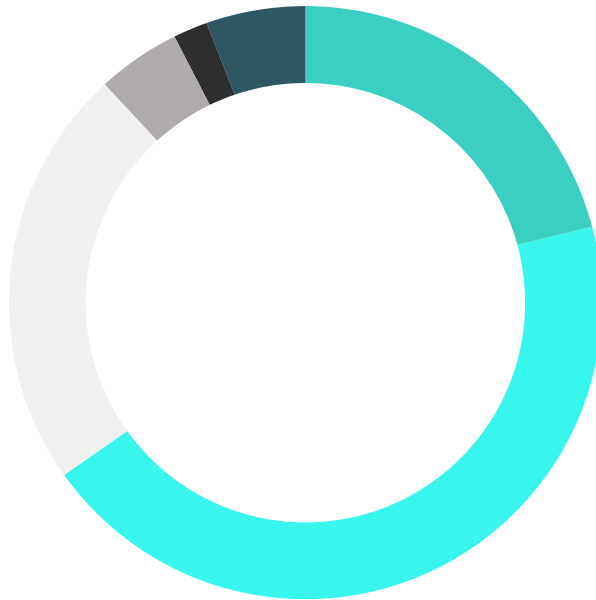
Unsurprisingly, whilst the majority of our respondents bank digitally, a large proportion still want to use branches, but their biggest pain point is queueing, with 2 in 5 finding it a challenge, and over a quarter demanding more staff present in branch.

Our research shows that branches are here to stay if they can adapt to customer needs today, and that many customers want a blend of physical branch and digital service for their banking for the future.





How do you feel about your bank?



- Very positive 20.8%
- Somewhat positive 44.3%
- Neither positive nor negative 23.0%
- Somewhat negative 4.6%
- Very negative 1.8%
- N/a (don't have a bank) 5.5%

WHAT'S TO BECOME OF THE BANK BRANCH?

Self-serve digital platforms offer huge cost efficiencies for banks, and much greater control – and convenience – for customers. As we all know, branch closures are increasingly common: throughout 2017 and 2018, over 1,800 branches (1 in 5 of all outlets) in the UK were shut⁶.

But contrary to popular belief, they're unlikely to become obsolete, at least not any time soon. Our survey shows consumers still like to go to branches, and talk to real people. And it's not only the older generations: 28.1% of under 25s really value advice from real humans (sorry robo-advisors).

Why are consumers heading to the branches? Sometimes they have to, for cash transactions and paying in cheques, for example; sometimes they need to, for triaging problems that can't be resolved via digital channels; and sometimes they want to, to talk and get advice. 42% go to their bank branches to talk to a real person.

Our interview with Nationwide's Director of Innovation and Ventures confirmed this, they noticed young members prefer to set up their accounts in branches, despite having a possibility of easily doing it online. It's about delivering services and experiences that meet customer needs, at whichever life stage they're currently at, and whichever touchpoint they choose to engage with.

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Our branches are increasingly digitally-enabled, and we're seeing a blurring of the lines between what we perceive as digital and physical. The role of the branch will further evolve, and customers will increasingly expect financial institutions to work with other partners to deliver services and experiences they want. As an industry, we have a very important role to play to ensure our consumers feel secure, regardless of the number of partnerships or technology used.

”

Emma Huntington, Director Innovation and Ventures



So, what should the role of the branch be in the future? With the new cross-sector advances like Amazon Go's checkout-less store or the first fully self-service Sainsbury's, we're clearly moving towards human-less experiences. But how can we retain the human touch in the era of automation?

First, better self-serving options and a better blend of digital/physical solutions to shorten the queues. Banks have been relatively quick to adopt self-service kiosks, with some (such as NatWest and Barclays) going as far as opening fully self-service branches with a handful of advisors on-hand.

But customers are ready for the next step now in branch, with 1 in 5 demanding better self-serve options and almost 15% wanting more personalised support and advice.

The ability to use a customer's device for identification in-branch could help financial services providers deliver quicker and more personalised experiences. For example, if a customer has a bank app on their phone, geolocation technology could enable a bank to detect when they walk into the branch, and serve up personalised, predictive experiences based on what they know about the user.

Second, banks need to become less transactional to attract customers to their branches. There needs to be a balance between self-service and in-branch customer engagement.



1 in 5 want better self-serve options at their branch



CAPITAL IDEA



In the US, Capital One has opened over 30 coffee shop style branches. Combining a relaxed atmosphere, local produce and a community feel, and of course general helpings of Peet's Coffee, these spaces are designed to provide accessible, friendly advice to customers. So-called 'digital lifestyle coaches' roam the floor, helping customers with their online banking.

According to Ryan Laudenbach, Seattle Market Lead for Capital One Cafés, the layout of the cafes is "designed to facilitate discovery, conversations, hospitality, education, and community events."

From comfy seating and free wi-fi to bookable meeting rooms, they're certainly trying something new – something more human. When so many others are closing branches with alarming frequency, Capital One may just be showing the rest of the sector how to realise the next generation of the bank branch.

Meeting utilitarian objectives is no longer enough to remain relevant. One of the themes that we believe defines the future of bank branches is the ability to build physical spaces that hold meaning. A space where customers

visit to get curated advice on money, savings, investment, mortgage, and financial planning. A space where they would simply like to hang out.

FUSING PHYSICAL AND DIGITAL

The need for a slick digital offering is clear, though it's also clear that the branch has its place, and that consumers need it. Almost half (42.9%) of consumers valued the branch

as somewhere to talk to an advisor. Only 7% of respondents have never been to their bank branch, though the survey comments were revealing:

What purpose does the bank branch serve for you?

"I feel it's a place that should survive certainly for the older generation"

"My bank (Tesco) is very limited with what I can do with my account in-store, so I do everything online"

"I love playing try to find a branch that they haven't shut down yet"

"It shut 2 years back – now I have too much cash in the house"



It's no great surprise that people are upset about branches closing. As with all B2C industries, a strong omnichannel offering is becoming the baseline. Being able to start the buying process online, and visit a physical shop or branch and complete the transaction there, for example, should be a basic part of the customer experience. Technology is the conduit for this joined-up experience (e.g. staff know where you got to in the process using digital channels, and are primed to help, before you even walk in the door).

It's fair to say the reason consumers are flocking to neobanks in their millions is because they're offering something which appeals to their very modern needs.

The alluring flexibility and possibility associated with digital tech has encouraged these new financial players to design the products people (particularly millennials) want to use, even enjoy using, and can do so unencumbered by legacy systems.



The challenger banks have brought the trends that have been borne out of an increasingly digital-first, product oriented, customer-first, modern-day world into banking. Rather than traditional vs digital, really what the fintechs have done is taken a new lens to what customers expect – the baseline of experience you should get in financial services and banking.



Steve Hicks, Head of Product - Digital Platform



MONZO MAKES WAVES



“Monzo is arguably the UK's biggest fintech success story to date. Just look around any London underground station and you'll see hordes of commuters tapping in and out with their bright coral cards. Millennials are mad about Monzo; they make up its biggest market and help to drive its popularity, which continues to spread like wildfire. In 2018, Monzo welcomed its millionth customer and secured new finance through customer crowdfunding, boosting its value to more than \$1bn (£787m). Not bad for a digital bank that first launched in 2016.”⁷

The inventors of ‘hot coral’ made headlines again recently when in May 2019 they reached 2 million customers. How did they get it so right? The key takeaway to design your service offering around your customers – then tell them about it. Monzo used (and continues to use) marketing campaigns that hit the spot strongly with the millennial market. And they know the value of a good teaser. What will they do next? You'll have to join the waiting list.

BRANCHING OUT



Metro Bank hit the high street in 2010. Its opening was the first new high street bank to launch in the UK in over 150 years. Metro prided itself on disrupting the traditional bank branch model, with later hours, Sunday opening and even allowing dogs in (and dog treats too).

They also have offered a number of services that other banks don't, such as money counting services and safety deposit boxes.

However, a glaring difference, and one not easily made up for by new players, is that of trust. Traditional banks are deeply familiar to us, creating a trust that cannot be rivalled by any new entrant. Trust takes time. So who in the traditional space is leveraging that history in combination with a strong digital offering?

Goldman Sachs has seen great success by offering a digital-only bank, Marcus, which has taken in over \$8 billion in deposits in just 8 months. The brand's approach "highlights a crucial strategy for success: identifying

genuine pain points for consumers ... [coupled with] deep resources and consumer trust."⁸

Somo investigated the issue of trust and what data people were prepared to hand over to institutions in return for personal value in an earlier white paper, "Trust and Data Acquisition in a post GDPR world." You can download this white paper to learn more from our research at <http://bit.ly/somotrust>.

HOW BANKS CAN USE THE LATEST TECH TO THEIR ADVANTAGE

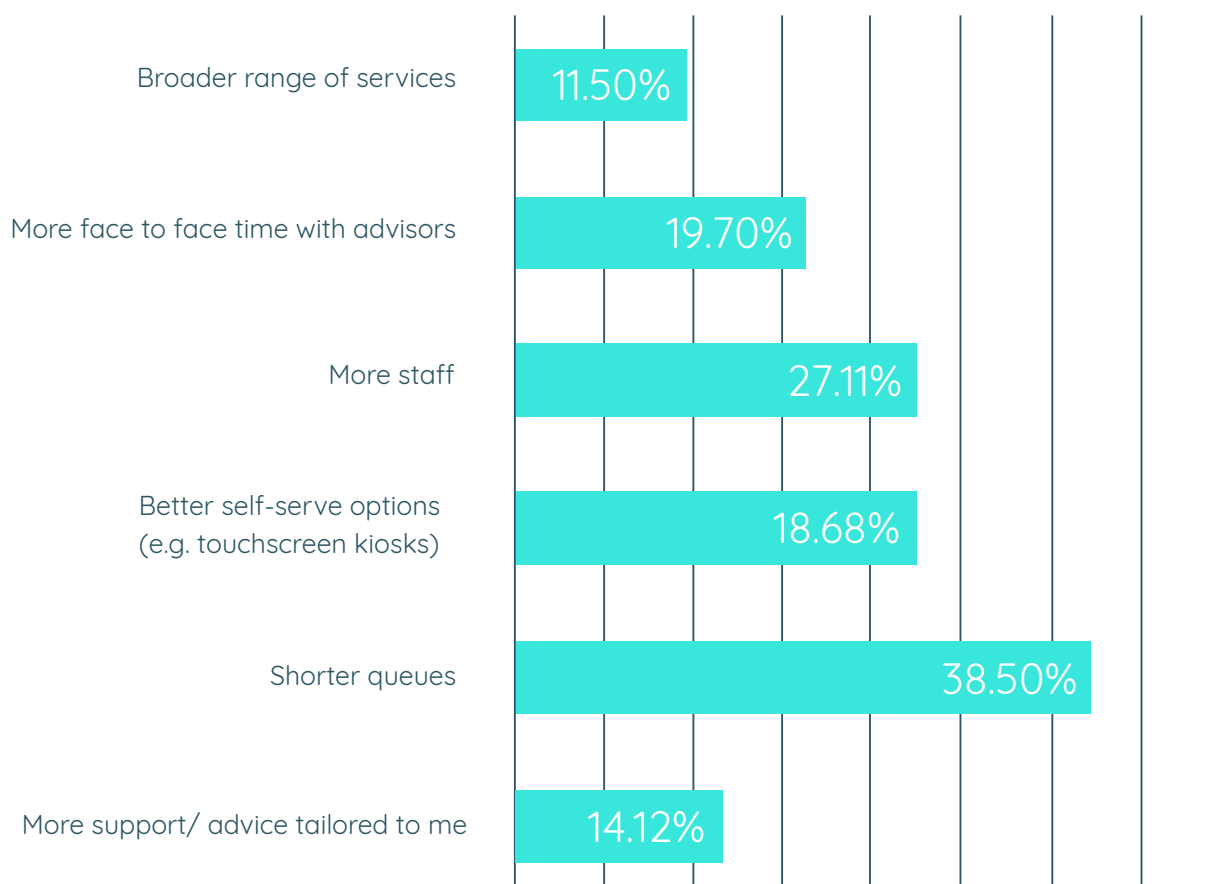
Financial advice, product information and educating users on the best way to manage their money can all now be delivered online; and with a little help from AI and machine learning, the experience could be as seamless as talking to an advisor in-branch.

This could help to free up time for branch staff to add value to their customers, interact with them side-by-side (e.g. on a tablet), up-sell services and contribute to building physical spaces that hold meaning.

Geofencing is another technology whose untapped potential could provide a boost to customer engagement. Based on the user location, apps could automatically suggest the closest branches and, with the right footfall analysis or crowd analytics tool, the waiting time can be estimated based on the number of people currently in the branch.



WHAT CAN BE DONE BETTER?



What would you like to see at your local bank branch?

The number of relationships consumers hold with banks has sky-rocketed in recent years – a direct correlation with the demand for convenience and the boom in new fintech solutions. A generation ago, the market consisted of a handful of institutions, with an average consumer committing to only one trusted financial provider.

Today, the thriving fintech scene and increased competition have had a massive impact on who (and how many providers) consumers trust with their money.

Our research shows that the average consumer now holds between 3 and 4 relationships with various financial services providers; the number of relationships accumulates as we get older, with about 1 in 8 of respondents 35 years and older having 7 or more providers.



No. of financial providers (average)



“The perception is that younger audiences are fickle and less loyal to brands yet our research clearly shows this is not the case, with the over 45s having the largest number of relationships with different financial providers. So it would appear that millennials are not all signing up for every new bank that opens, they stick with the single one or two,” says Rebecca Crook, Chief Growth Officer at Somo.

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CHOOSING A PROVIDER

Best offers or services that meet customer needs is the most popular reason for how banks or building societies are chosen, with family recommendation and ease of doing business second and third. For the youngest

group, a family recommendation is the most influential factor in determining bank choice; however, our findings show that for those aged 35 and up, service provision takes the front seat.



AT THE CLICK OF A BUTTON

While a quarter of respondents still prefer to bank in branch, and only 6% via telephone, the large majority (63%) of UK banking customers chooses to manage their banking online.

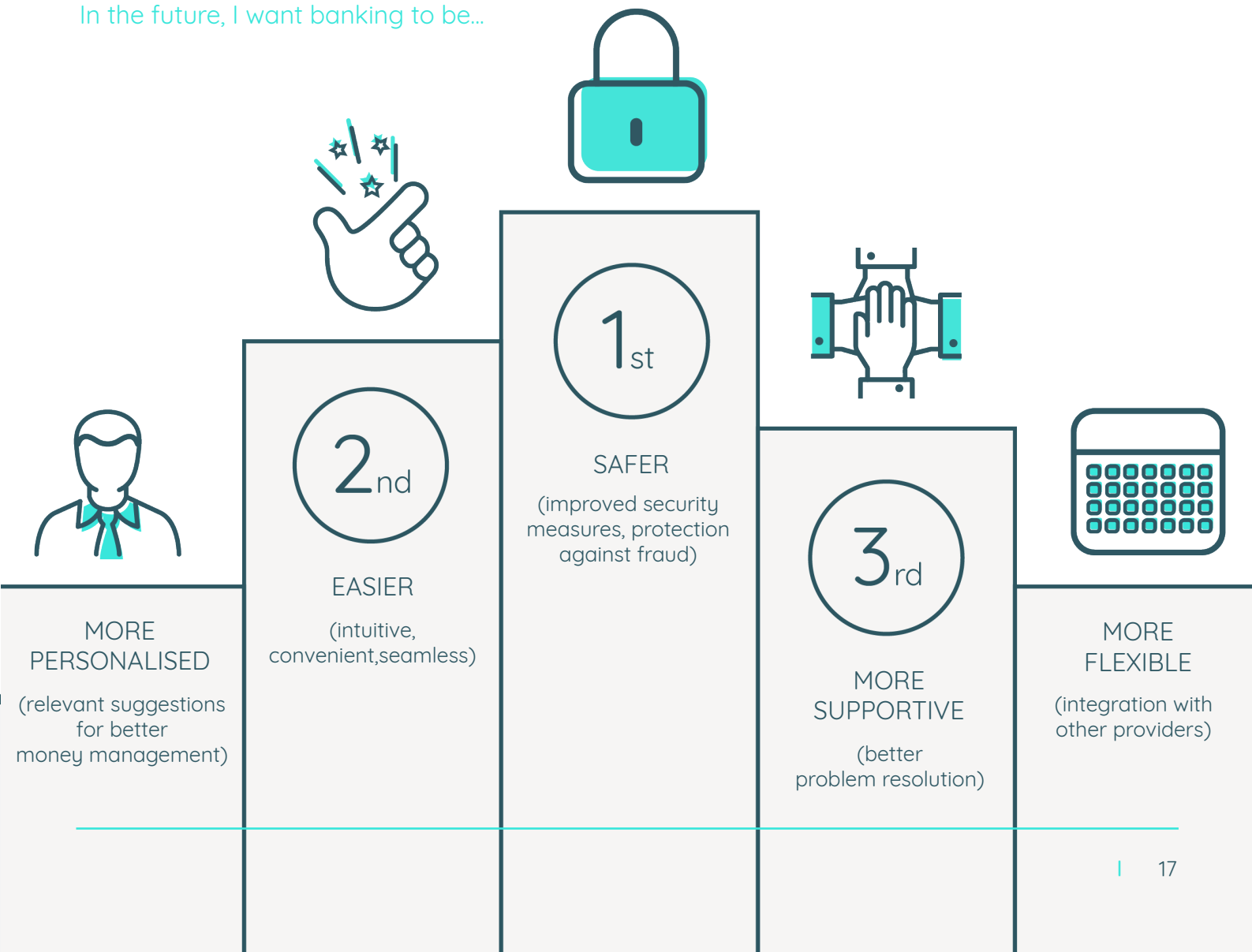
Interestingly, it's not the youngest ones that are most digitally-focused. Our research showed 18-24 year olds are almost twice as likely to interact with banks in-person as 25-34 year olds, and in line with much older cohorts.

There also seems to be a strong regional divide, with Scotland and Wales streaking ahead when it comes to customers' preference for digital interactions, though it's likely this is influenced by the availability (or lack thereof) of branches in these areas.

How can brands ensure they're meeting their customer needs online? After security, user experience (UX) is the most important consideration for users when it comes to interacting with banks – but this changes with age.

Our age analysis showed that 18-24 year olds ranked 'ease' as the top priority at the same rate as 'security'; for this group, a great user experience is a secure user experience. Older cohorts are much more concerned about security than user experience – possibly due to greater fear of technology and scams, but also due to slower adoption of more secure user experiences e.g. biometrics, face identification etc.

In the future, I want banking to be...



3 THE ROLE OF BANKS IN SOCIETY

SHOW ME THE MONEY: CAN WE EXIST WITHOUT CASH?

One of the increasingly important questions to ask about the effects of digital is whether everyone is included. Who is or might be excluded in this digital revolution? And how do we ensure that those who are not digital adopters do not suffer or miss out on opportunities?

The notion of a 'cashless society' – that is, where digital payments are the only method of transaction, and notes and coins are no longer used – is increasingly making headlines.

Sweden has famously gone (almost completely) cashless, with striking reports of the impact of digital. 'Sweden is the most cashless society on the planet, with barely 1% of the value of all payments made using coins or notes last year,' the BBC reported in 2017.⁹ But the ideals of going cashless are a far cry from the reality. In many cases, those who need access to physical cash are the underprivileged. This is as true in the UK, as the Access to Cash Review investigated.



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There has been a phenomenal shift towards digital banking and payments globally, and Britain is one of the furthest ahead. But although the demand for face-to-face banking has reduced, there are many people who still need it. Similarly, although cash use is falling rapidly, there are around 8 million adults in Britain who still need cash, because digital payments don't yet work for them. Our world-leading status as a digital innovator is fantastic for Britain, but we need to make sure our products and services are designed for everyone.

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Natalie Ceeney, Chair of the Independent Access to Cash Review *INNOVATE/FINANCE*

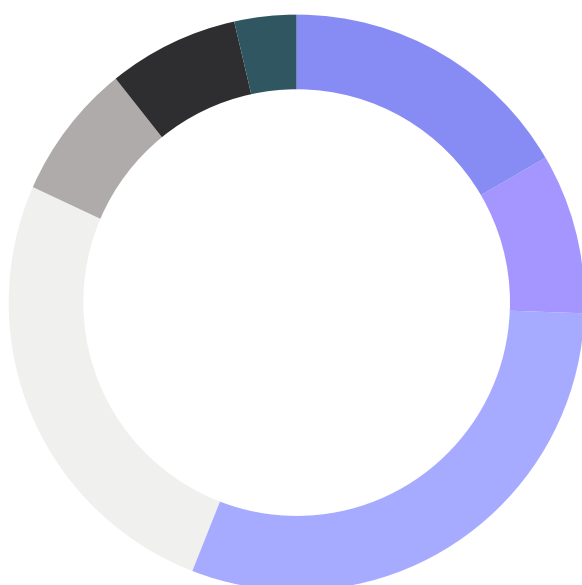
We were interested to find out whether banks were helping people feel confident and well-informed about handling their personal finances – or indeed if this was even seen as a responsibility of banks.








Most felt it is down to the individual to take responsibility for understanding how to manage money (a fair shout), though schools and banks are considered at least in part responsible. Given the option to add

their own text through the ‘Other’ option, the overwhelming majority (97%) of respondents said ‘parents’.

A single outlier cited ‘media’ as also responsible for educating people on finances. Another that perhaps sums up the general sentiment: ‘parents, then banks through the school in senior years’.

Whose responsibility is it to educate people on managing their money?



-  Banks 32.2%
-  Local councils/government 17.3%
-  The individual person 58.5%
-  School 49.5%
-  Independent industry advisors 14.8%
-  N/a (no opinion/don't know) 14.3%
-  Other 6.6%



PROVIDING GREATER CONTROL OVER YOUR FINANCIAL OPTIONS

Quite simply, being ‘financially literate’ means being able to make informed decisions about how to make best use of the financial resources you have. But as digital technology morphs the financial landscape, another divide has appeared: that of digital literacy.

We interviewed the Director of Innovation and Ventures at one of the country’s biggest building societies, Nationwide. She made clear the intent of legacy institutions like hers to put inclusion on the agenda.

“

Nationwide has 15 million members. We look after the needs of a broad proportion of society, so we think a lot about increasing financial capability and serving a diverse range of needs. Our recent initiative ‘Open Banking for Good’ was designed to help financially squeezed by leveraging the power of open banking. The industry needs to make sure the power of technology isn’t only in the hands of the digitally savvy or the early adopters. One fundamentally important aspect of digital technology is how you leverage it for the benefit of all your customers and everyone in the community, not just an isolated few.

”

Emma Huntington, Director Innovation and Ventures



EXPERT OPINIONS

It’s about putting users in control and ensuring they have the know-how to make the best decisions for them. Beyond the usual products and services offered by the bank, this

includes broadening consumer knowledge on basic financial concepts as well as how to navigate the financial system. This is recognised by another of our interviewees.

“

There is some fundamental simplification we need to do; helping people learn about and understand their financial position, the different products that can help them, and the simple changes they can make to ultimately become more prosperous. Outside of this there are also the fundamentals of digital literacy – because if you aren’t digital, you’re missing out on a whole load of opportunities to be financially better off.

”

Steve Hicks, Head of Product - Digital Platform



So, together with the UK Government’s initiatives¹⁰, the big banks are addressing the financial – and digital – skills gap in the UK. But of course enabling people to become better informed is just one piece of the puzzle. Building the right digital products and experiences in the first place must also be a priority.

The role of the bank goes beyond that of a commercial institution; they are part of the fabric of society, offering important anchors in the community, and furthering inclusivity through services that don’t discriminate.

Branches, clearly identified in our research as being valued for education and advice, can play an even more important social role in future.

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The words ‘financial education’ are often used to imply that the problem lies with the consumer, not within the product. It comes from a belief that if only consumers understood more, then we’d all be ok. The reality is that there will always be financial asymmetry between financial services providers and consumers. So yes, we do need to up-skill consumers, but let’s not kid ourselves that we will ever level the playing field or take away our responsibilities to design products which are suitable for those who need to use them.

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Natalie Ceeney, Chair of the Independent Access to Cash Review

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OUR PREDICTIONS

TRADITIONAL BRANDS

1. We predict that inside banks, all internal silos will be broken down, with organisational restructure at the heart of this. Companies will need to match how they operate more to how customers buy products and services.
2. We predict a far greater use of physical spaces to meet the expectation of customers needs as outlined in our research, and a merging of the physical and digital services in these spaces, as well as a move from transactional to educational services.
3. We predict traditional brands will learn from neobanks in how to operate in a world of no constraints, enabling them to innovate more fluidly by building user experiences that remove friction and create new engagement opportunities for customers.

NEOBANKS

1. We predict they will get smarter in how technology provides insights to life stages and matches products and services accordingly.
2. We predict that there will be a much bigger driver to entice customers to make the relationship with them as their primary financial supplier, with an expansion of innovative products in their portfolio.
3. We predict neobanks will learn from traditional brands how, over time, with marketing campaigns and trust-building awareness, will increase to become consumers' primary financial provider.

CHALLENGES FOR ALL

The threat from non-traditional companies such as Google, Amazon, Facebook and PayPal will grow as they increase their services for customers to spend, through a combination of debit, credit and loans. Ownership of the customer's daily spending relationship (akin to a current account) will drive usage and the potential for these companies to add on further financial products and services, threatening traditional banks' and neobanks' business.



Somo is one of the fastest growing digital product accelerators in the UK, helping some of the largest global brands redefine their customer experiences to become leaders in digital change. This encompasses all digital touch-points, from websites and apps to in-store physical experiences for both consumers and staff.

Since 2010 Somo has pioneered over 450 products for over 100 world-leading clients – from state-of-the-art start-ups to large corporates like Audi, HSBC, TUI and Vodafone.

Somo is headquartered in London with offices in Bristol and the States (Washington DC and Charleston).

If you enjoyed this read and would like to know more, please contact Rebecca Crook, Chief Growth Officer.

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