



Jockeying for position

Responding to increased competition from a growing number of disruptive competitors

Introduction

In my recent white paper, [The Circle of Life](#), I explored the four forces of change that are impacting Banking and the wider Financial Services sector and that should be considered when developing risk mitigation strategies:

1. Capitalisation

Insufficient reserves to deal with downturns or incidents within prescribed tolerances to avoid the taxpayer bailouts of the past.

2. Regulation

Increased regulation from several organisations domestically (Bank of England, Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA)) and internationally as well as the fines and penalties they can levy to organisations that they deem as non-compliant.

3. Competition

Particularly from those embracing technology and new business models that appeal to consumers who are willing and eager to self-educate and self-serve online.

4. Obsolescence

The opposite of Futurism or investing in science & technology to safeguard your future, leading to long term decline that cannot be reversed.

A run for one's money

The phrase to 'jockey for position' is commonly used to refer to manoeuvring or competing to gain an advantageous position. The allusion is to horse racing and the jockeys' skilful manoeuvring and horse handling to gain a more favourable position may also transfer to the current 'form' in financial services.

Since the financial crisis a decade ago there was a consequential loss of trust in the incumbent players. Furthermore, there was general dissatisfaction with their levels of service and integrity, so much so, that both the PRA and the FCA made the promotion of effective competition part of their objectives. Add to that the fact that five banks controlled 85% of the UK current account market and the sector was ripe for disruption. The consequence of the sectors recent past is that there are currently many more horses and jockeys in the race.

This article looks in more detail at competition and how firms are responding to increased competition in the sector, both from their own kind (interspecific) and perhaps more challengingly from non-traditional businesses (intraspecific).

Looking through the lens

Intraspecific and intraspecific competition are still two large categories and to better understand how the future may look it might be worth looking at competition through a number of different lenses.

Technology

I won't dwell on the march of digital and how this is reshaping consumer behaviour and interaction with the providers of the products and services they consume. Many other authors and their articles have delved into the what, the why and the how. It will suffice for me to say that digital is here to stay and it has changed the face of financial services in the last five years.

In the UK, where there is a thriving fintech scene, traditional models of finance management, banking, investment, currency transfer and more are being overturned by a wave of digital competitors. With a digital, and often mobile-first approach, this new brand of financial services firm is changing consumer expectations of banking and winning over customers with simpler finance proposition founded on being accessible, transparent, convenient, flexible and putting the customer first.

Needless to say, incumbents have been greatly unsettled by this change and many have adopted ideas and traits from digital challengers in order to remain competitive and as a means to reduce costs (migrating customers to self-service by the lowest cost delivery channel and reducing their face to face presence). There is no doubt that technology has increased competition, but it remains to be seen as to whether the incumbent's legacy systems and bureaucracy will delay their ability to respond or if their scale and deep pockets that enable them to buy in solutions will triumph at the end of the race for profitable customers.

Perhaps the biggest threat to the incumbent's oligopoly to date is from BigTech who can match scale and ability to invest. Amazon, Apple, Facebook and Alphabet (Google's parent company) are in the top 10 biggest companies in the world by market capitalisation. Most importantly, unlike the majority of fintechs, these companies can exploit their own Direct to Consumer (D2C) model as opposed to relying on a partner or affinity to access a customer base (B2B).

Rank	Company	Ticker(s)	Market Cap (March 18, 2019)
#1	Microsoft	MSFT	\$902 billion
#2	Apple	AAPL	\$887 billion
#3	Amazon	AMZN	\$856 billion
#4	Alphabet	GOOG, GOOGL	\$824 billion
#5	Alibaba	BABA	\$471 billion
#6	Facebook	FB	\$458 billion
#7	Intel	INTC	\$243 billion
#8	Cisco	CSCO	\$236 billion
#9	Oracle	ORCL	\$192 billion
#10	Netflix	NFLX	\$159 billion

Source: <https://www.visualcapitalist.com/biggest-tech-companies-market-cap-23-years/>

We have become used to the option of using PayPal (originally a subsidiary of eBay), and perhaps to a lesser extent Amazon Pay, when checking out after making a purchase online. In fact, PayPal offers a very customer friendly shortcut that on many sites avoids the need to sign in or register an account with the retailer. Such convenience could be surpassed with the launch by Apple of their 'Titanium' credit card in partnership with Goldman Sachs. The fact they have now 'joined up' and will together control elements of the payment ecosystem has the potential to shake up the traditional card payment monopoly. With the benefit of hindsight, will we see this as a seismic shift to the status quo?

One word of warning however is that it is difficult to expand without trust and the Cambridge Analytics affair still weighs heavily on Facebook's reputation with consumers and regulators. This may be sufficient to create additional scrutiny of and regulatory hurdles in their plans to create Calibra, their proposed digital wallet using a crypto currency calibrated to multiple currencies. Perhaps they are not irrevocably damaged but they may miss this particular wave of dramatic competitive change.



Customer segment or 'mindset' being targeted

Due to their history of being all things to all people, traditional players and certainly the largest organisations cover multiple customer segments. For example, RBS's ultimately unsuccessful deconstruction of Williams & Glyn was complex partly because it involved Corporate, Commercial, Small Business, two categories of Private Banking and Mass Market segments spread across just two million customers.

The essence of the big incumbent banks is that they do 4 things for their various customer segments:

- Transaction services – current accounts, debit & credit cards
- Savings – the range from instant access to term and cash ISAs
- Lending – mortgages, personal loans, overdrafts and more complex credit products
- Specialist services and advice (pension, investments, protection, wills, trusts and other private client offerings).

Being all things to all people requires a depth and breadth of expertise and gaining that expertise may present a barrier to competition on a like for like basis. Anyone trying to compete across all segments and for all products needs to have the capital, the systems, regulatory permissions, people with relevant expertise and sufficient scale. All of these essentials are hard (and expensive) to come by!

Product or Proposition?

Whilst the incumbents have sufficient scale and customer numbers to try to offer a full product set and to be all things to all people there are a number of mid-size and smaller players that almost certainly are not. This is clearly illustrated by Yorkshire Building Society withdrawing their current account in 2017 and reverting to a simpler and more traditional building society model of savings and mortgages.

Neo or challenger banks tend to be more focused and launch with a niche product or proposition e.g. specialist lender (Aldermore or Shawbrook), relationship manager proposition (Handelsbanken), transaction hub that also represents a data play (Monzo). Gathering significant quantities of transaction data enables insights into customer behaviour and preferences that should provide opportunities to personalise services and offerings to that customer or people with similar behaviours and preferences – an Amazon recommends with ‘bells on’.

Other challengers seek to replace or remove part of value chain such as disintermediation of the existing ecosystem. For example, Square’s business model is predicated upon providing payment processing, analytics, and, increasingly, lending capital to merchants.

Brand values

In addition to offering disruptive and competitive products and services, banks are also trying to distinguish themselves from the competition by implementing distinctive brand values.

For example, just last year, Monzo updated its core brand mission to “Monzo makes money work for everyone”. The idea being that the average customers’ interaction with money should be as simple and intuitive as possible.

Similarly, Handelsbanken, a relatively niche player in the market has distinguished itself by setting its stall out as a local relationship bank. They have dedicated account managers that understand the local market and community; they get to know their customers well and give expert advice. It is clearly doing something right and recent results from an independent survey carried out as part of a regulatory requirement for the Competition and Markets Authority (CMA) reveal that Handelsbanken has performed outstandingly across the various customer satisfaction metrics.

More traditional banks have been trying to match pace with the modern branding practices of new competitors like Monzo, Revolut, Atom and Starling. One strategy employed by larger banks has been to invest in multiple brands. As competitors brands strive to connect with customers in more specialized ways, they have been looking for ways to stand for something different from the master brand. For example, Halifax (part of the Lloyds Banking Group) is relaunching its brand with an updated logo and visual identity, as well as a new marketing campaign, as it looks to make the brand more contemporary, relevant and appealing to younger home buyers.

The significance of brand value can be gauged by the fact that CYBG, the owner of Clydesdale and Yorkshire Banks and Virgin Money will pay £15m per annum to use the Virgin name and will rebrand Clydesdale and Yorkshire Banks, as well as app-based bank B, as Virgin Money by the end of 2021.

Ownership

We should also look at ownership and business models to understand just how competition might reshape the financial services sector in the short to long term. There are a number of different investors' expectations at play – from a short-term focus (eg hedge funds or private equity backed businesses) to long-term as displayed by member owned organisations (such as building societies and other mutuals).

Short-term focus

Hedge funds or private equity backed businesses usually expect the return on their investment will be from selling all or part of the investment at a pre-determined time in the future. Future growth and unique IP or data may be more important than current profitability to maximise the share price multiple on sale.

FTSE listed firms

Institutional investors such as pension funds own swathes of the equity in FTSE listed financial services firms. Whilst they will usually state that all equity investments are for the medium to long term, within their own and managed funds, they will have a spectrum of customers with a mix of risk appetites:

- From those accepting higher risk in return for greater growth and/or income
- To those happy with lower, but less volatile, returns for those with a lower risk appetite.

Private listed organisations

Much depends on the group of investors' objectives and they can be more aggressive and look for growth to generate a larger goodwill element in a future sale or in the case of some (eg multi generation family owned businesses, such as Weatherbys Private Bank and C. Hoare & Co), they can from time to time choose to accept lower returns in return for retaining control of a majority shareholding.

Long-term focus

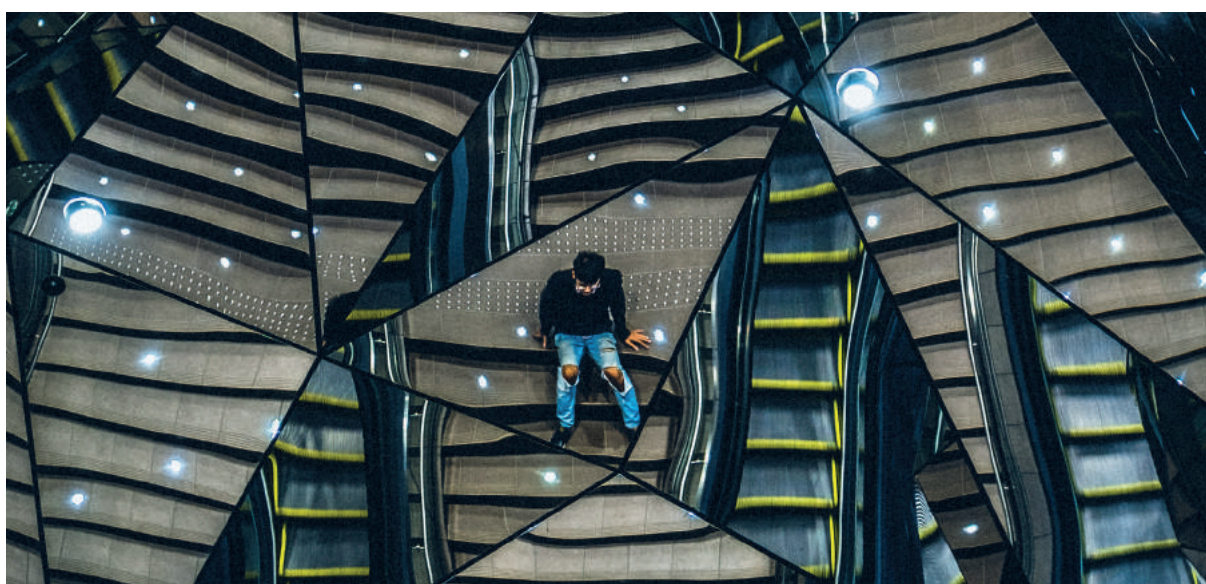
Mutuals are an example of this and are able to offer benefits to their members yet fall short of the returns that commercial investors are inclined to expect.

Breaking the myths

1. Nirvana has until recently been increasing share of wallet and the number of products a customer holds with your organisation - Open Banking and API platforms break this stranglehold as consumers can easily access products from multiple financial services providers and don't need to put all their 'eggs in one basket'.

2. Only banks can make payments - this myth has been compellingly broken by PayPal and Apple with their 'Pay' offerings and it looks as if the payments space will suffer further disruption as technology evolves and bypasses point of sale terminals in particular. For example, Bancontact has introduced a mobile application in Belgium to streamline its payment experience. Using their mobile app, customers can identify by scanning a QR code presented at the time of payment. Each transaction is then confirmed with a PIN.

3. Current accounts control the relationship - not any more as although a banking app may be front page on your smartphone screen this competes with other popular apps for 'front of mind'. This means that the card linked to your electronic wallet, (often a secondary bank), Spotify or Amazon may take a larger role in a consumer's day to day life than the account to which their salary is paid in to!



4. New customers get the best deal as loyalty is a given - there is a growing sense that this is becoming a point of principle for many customers and may be the thing that breaks what is often called the lethargy that has led to the largest players retaining their dominant market shares. Banks rolling over term deposits on tiny deposit interest rates and insurers offering poorer policy premiums to existing customers than to acquire new customers beware.

5. The branch is dead - while it is true that mobile banking has replaced some of the functionality previously offered by the bank branch, the branch still has a role to play as an advisory centre, community space, brand advertisement and financial education resource.

6. Digital and social media are replacing traditional marketing channels - while more consumers are doing their shopping using digital and mobile channels and social media marketing can be effective, these channels serve to compliment and supplement traditional channels as opposed to replacing them. Indeed, in recent months both Monzo and Hey Habito have leveraged traditional marketing channels to accelerate customer growth.

Give & take

Competition may just be the initial phase like jockeys, who in the early stages of a race, test themselves and their peers to establish the pattern that will play out to the end. In fact, we are already seeing competitors becoming suppliers to incumbents with alliances and partnerships being formed. Time will tell whether they are yet in their final form however and many may yet lead to true partnerships or joint ventures.

For example, a strategic joint venture by Virgin Money and Aberdeen Standard Investments is transforming Virgin Money's retail investment proposition to drive significant growth in funds under management and capital-efficient returns.

Other players will also look to consolidation and look to gain scale and to bridge capability gaps via merger or acquisition activity. CYBG's successful £1.7bn deal for Virgin Money is indicative of this strategy. In recognising the complimentary elements of their respective offerings, the marrying of the two propositions creates potential for greater scale (potentially the 6th largest UK bank) and market presence, providing, of course, that integration is not too much of a distraction and can be undertaken effectively.

The success of collaboration and consolidation, however, hinges on the 'strategic and cultural fit' and the ability of the buying firm to seamlessly integrate a new partner or acquired firm. Failure to do so may result in a series of issues which negatively impact the potential opportunity.

HG Wells wise words seem to fit whichever side of the track you are on, incumbent behemoth or upstart challenger:

“Adapt or perish, now as ever, is Nature's inexorable imperative”

If you want to discuss any aspect of developing your strategy or the translation of the strategy into an effective and results orientated change programme then please get in touch with me or Hyder Cheema.



Ewen Fleming
Consulting Partner

07733 236 559
ewen.fleming@jcca.co.uk



Hyder Cheema
Consulting Senior

0203 7144 350
hyder.cheema@jcca.co.uk

Where sharp minds meet

Aberdeen

01224 212222

Dundee

01382 411790

Edinburgh

0131 220 2203

Elgin

01343 547492

Forfar

01307 465565

Fraserburgh

01346 518165

Glasgow

0141 222 5800

Huntly

01466 794148

Inverness

01463 796200

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London

0203 7144 350

Perth

01738 634001

Stirling

01786 459900

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