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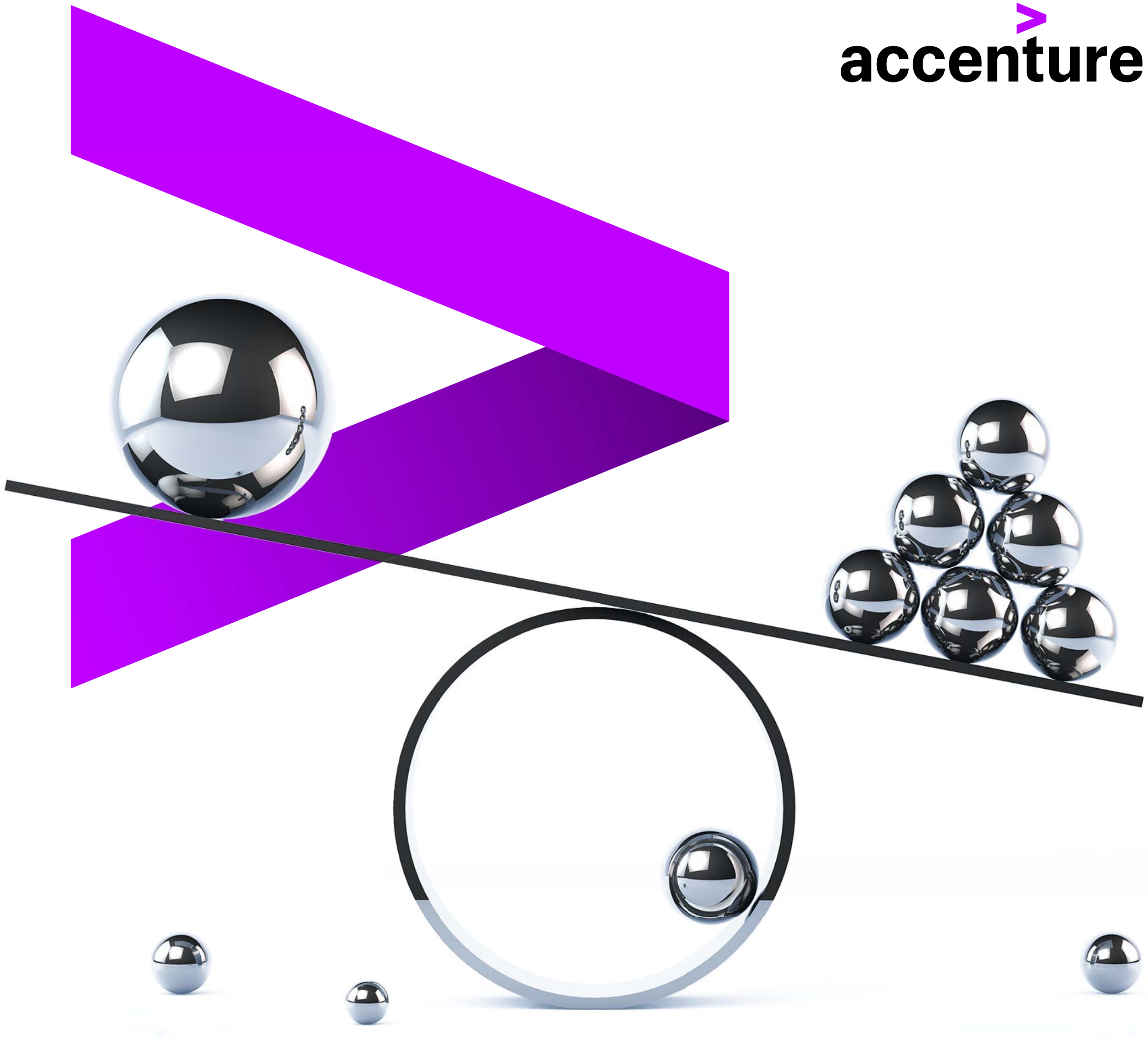
TOP 10 BANKING TRENDS FOR 2019

A Potential Tipping Point



CONTENTS

Introduction	2
1. Unbundling and fragmentation—the cracks are beginning to show	3
2. The best and the rest—is this the year profit as well as value diverges?	3
3. The bar for advice rises from products to promises	4
4. The twilight of U.S. community banking?	4
5. The Chinese are coming	5
6. The tipping point for fintechs in the United Kingdom	5
7. The beginnings of build and migrate	6
8. Head (and brain) in the clouds	6
9. Time to make your move ... the chess clock is running down	7
10. Welcome, “platform” police	7

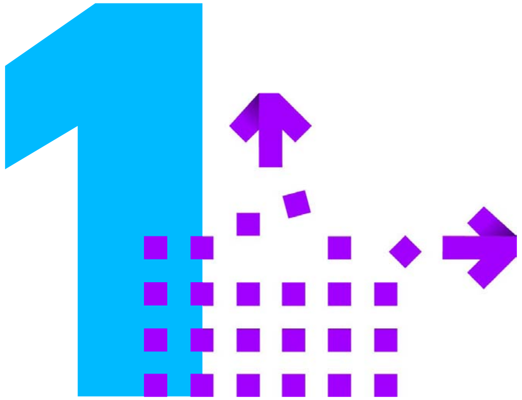
As the calendar turns to 2019, it’s almost obligatory that management consultants publish their predictions about the year ahead. Despite our confidence as self-appointed seers, there is, of course, very little about the evolution of a complex and global industry like retail and commercial banking that is driven by planetary cycles. However, the new year is a useful prompt to step back and take stock of the trends and forces that are shaping the industry and speculate about how they might play out over the next 12 months.

Unlike the Billboard charts, there isn’t a new set of songs to populate the top 10 every year. So, some of the issues and themes described below are continuations of trends from the last few years. Many are also interconnected in ways that could either cross-amplify or dampen their impact on the industry. However, taken in totality, there is a sense that 2019 may—with the benefit of hindsight—turn out to be a critical year in the evolution of the industry, and a year in which the old world definitively gave way to the new. My hope is that, though these predictions will undoubtedly be specifically wrong, they will generally be right in terms of what bank executive teams should be paying attention to and planning for.

While it is convenient to talk about the global retail and commercial banking industry, I am fully aware that reality is actually a series of individual markets. The evolution of those markets is defined by the combination of macroeconomics, regulatory regimes, local competitive forces, and customer behavior. Some markets will evolve slower, while others are already over the top of the digital disruption rollercoaster and picking up speed on the downslope. Where country-specific issues are relevant, I will call them out, but hopefully most of the following trends and predictions are somewhat universal in their application.

So, what’s worth paying attention to in 2019?

ALAN MCINTYRE, SENIOR MANAGING DIRECTOR, ACCENTURE GLOBAL BANKING



Unbundling and fragmentation—the cracks are beginning to show.

Banking has traditionally been a vertically integrated business. Some sectors like wealth management do have a manufacturer/distributor structure, but core retail asset and liability gathering has remained a unified activity in most markets. That industry structure is now beginning to fragment. One driver is the export of Open Banking regulations from Europe to Hong Kong, Australia, Singapore and soon to be Canada. Although different in each market, the common denominator is an intent to create more competition. This fragmentation creates new horizontal business opportunities, ranging from account aggregation (like Yolt in the United Kingdom) to back-office enablement plays (Cross River in the United States and Clear Bank in the United Kingdom) to the more esoteric ("The Narrow Bank" which arbitrages the U.S. Federal Reserve deposit rate for corporate depositors). In response to Open Banking, the U.K. already has 62 registered third-party providers, all of whom plan to take advantage of a fragmenting value chain. And when a seven-year-old specialist payments acceptance start up, like Stripe, commands a valuation within touching distance of an industry stalwart, like Deutsche Bank, it's a sign that horizontal specialization can be very attractive. So, in 2019, we will undoubtedly see more fragmentation, but we will also see banks immediately attempting to re-bundle those components into attractive and holistic customer propositions.

The best and the rest—is this the year profit as well as value diverges?

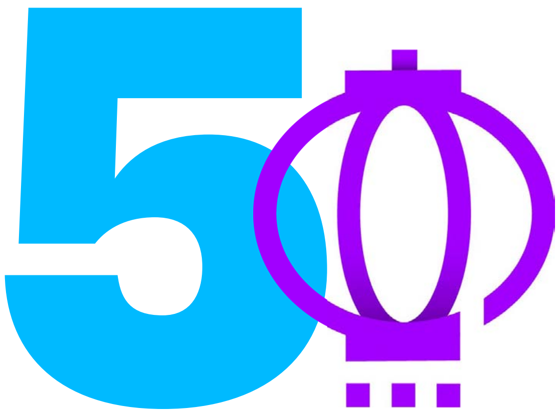
Successful tech companies, whether they are Amazon or an "A round" startup, need to tell a compelling story about the future. Those that can build confidence in the evolution of their business model can command a "future premium" that is often more than 50 percent of their valuation. We are beginning to see a similar phenomenon emerge among traditional banks. Digital leaders, like DBS, BBVA and JPMC—banks that tell a good story about their digital transformation—are getting a future premium of around 25 percent, while the rest of the banking industry is still struggling to get their current business valued at book. Still, compelling stories of digital transformation haven't yet translated into current profitability levels that are noticeably different from the rest of the industry (although DBS claims 50 percent more profit from its digital customers[1]). In 2019, digital leaders among traditional banks should aim to show that the investment, creativity and ambition that has created their premium valuation will also result in higher enterprise ROEs. If they can, the gap between the best and the rest will widen. If they can't, the conclusion of investors may be that for the foreseeable future, the rotation from the old to the new will be no more profitable than executing well in the old, and we may see the bursting of some digital bubbles.

The bar for advice rises from products to promises.

Asking Erica, Alexa or any other AI assistant to do some banking for you has fast become table stakes. But what passes for advice often feels a bit like parental scolding. "Did you know you spent $50 on Starbucks last week?" or "Don't buy those new sneakers or you'll go overdrawn." What is likely to emerge in 2019 is a new class of digital advice that focuses on true financial wellness. These advisory services will draw both on banking and non-banking data to provide hyper-relevant advice and suggestions. Because banks see your payments flow, they not only know what you are spending, but also what others are spending. This will allow them to identify that you are paying more for your utilities than your neighbor, or that you are paying full price for your car lease, rather than taking advantage of current refinancing offers. Of course, banks need to make sure that their own house is in order first by ensuring best advice for their own products. But beyond that, they are ideally placed to promise their customers that they, if given a chance, will make the totality of their financial lives better and more rewarding. That is where the advice bar will be set in 2019.

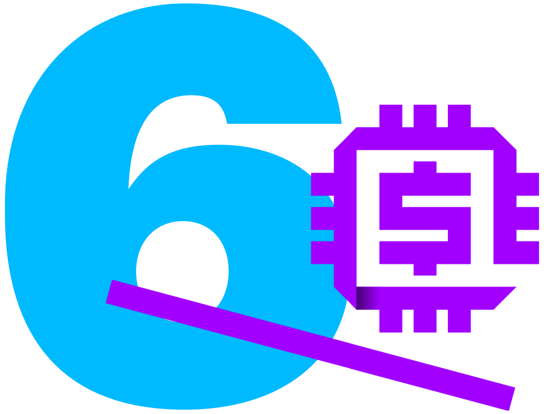
The twilight of U.S. community banking?

These should be golden days for smaller U.S. banks. The economy is booming, interest rate spreads have widened, credit losses are minimal and compliance costs are at last coming down. Profitability is certainly up, but the existential threat for these banks is now a lack of growth. Being small and local isn't the competitive edge it used to be. Instead, players with a compelling digital customer experience are winning big on both sides of the balance sheet. In deposits, the big three of Bank of America, JPMC and Wells Fargo have only 24 percent of U.S. branches, but they took nearly 50 percent of new deposit account openings last year.[2] In contrast, regional and community banks have 50 percent of branches but took only 20 percent of deposit growth in the last three years.[3] In credit, outside the top 25 banks, the loan assets of U.S. banks shrunk by over $30 billion in 2017[4], while digital-only originators, like Kabbage and On Deck (backed by institutional money), and direct credit investors, like Apollo and Blackstone, continued to boom. The traditional response of smaller U.S. banks would be higher levels of mergers and acquisitions to reduce costs, but the new challenge in 2019 is to figure out how smaller banks can offer better digital services without spending billions of dollars. If they can't, they will continue to lose customers to their bigger competitors, and 2019 may see us enter the twilight of the community banking era in the United States.



5 The Chinese are coming.

The stunning transformation of retail financial services in China is becoming a well-known story. Between Alipay and WeChat pay, China now has well over a billion regular users of mobile payments who last year conducted two-thirds of all global mobile payment transactions, and Ping An is redefining data-driven approaches to financial services. Viewing this phenomenon from a seat in the West, it's tempting to say that what's happening in China doesn't affect us. That is what Finland would have said in 2015 when it had only half a million Chinese tourists. In 2019, Finland is likely to have five million Chinese tourists staying twice as long and spending at least three times as much, in part because thousands of merchants now accept QR code-based mobile payments. Like Finland, Chinese influence is changing Singapore (which is adopting a QR-based interoperable system for low-value payments) and shaping consumer payments in India (through Ant Financial's stake in market leader Paytm). The next targets are the rest of Southeast Asia and Africa. With Ant Financial now worth $150 billion and scaling its transaction processing system to handle 100 billion transactions per day[5], it's only a matter of time before innovators from China also reshape the Western banking industry. The questions to ask now are how much of that change will be visible in 2019, and will it come from direct interventions (like Ant's aborted attempt to buy MoneyGram) or from Chinese firms working in partnership with Western institutions (like Alipay's partnership with Standard Chartered for remittances)?



6 The tipping point for fintechs in the United Kingdom.

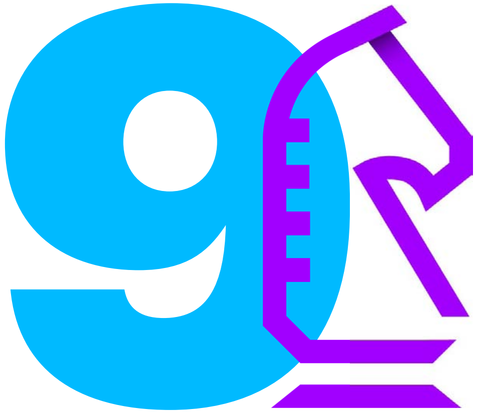
Whether or not Gandhi ever said, "First they ignore you, then they laugh at you, then they fight you, then you win", it's a sentiment that many U.K. bankers might recognize. Accenture research shows that the United Kingdom is the most disrupted traditional banking market in the world, with 15 percent of revenue and over a third of new revenue going to new entrants.[6] The combination of eroded trust and a regulator keen to stimulate competition has enticed a plethora of financial institutions to enter the U.K. market, including Monzo, Starling, N26, Revolut and Marcus from Goldman Sachs. These start-ups have now signed up millions of customers. However, the vast majority of these are secondary accounts with typically less than 20 percent of start-up customers using neo-banks for their primary checking. The reaction of incumbent U.K. banks has been to launch their own digital challengers (RBS claims to have six in development) and upgrade their core digital services. The U.K. has clearly moved from the ignore and laugh phase to the fight phase of the dubious Gandhi quote. Market share data in 2019 will start to give us an indication of whether new entrants have enough momentum to win long term, or whether the antibodies of traditional banking will be strong enough to fight off this infection from digital newcomers.

The beginnings of build and migrate.

One of my 2018 predictions was that few big banks would risk ripping out their antiquated core legacy systems, but instead would look to wrap them in digital services that enabled more speed and agility. While I was right that there wasn't a lot of core replacement in 2018, we have seen plenty of interest in core alternatives, like Mambu, Thought Machine, Leveris and Finxact. In 2019, we are going to see a lot of build activity on these new systems with banks around the world experimenting with new technical architectures that are digital to the core. However, so far, these solutions are mostly targeted at relatively simple retail and SME customers. The big question for 2019 is whether we will see any traditional banks take the leap and move from a parallel digital build to a full migration of their legacy core banking systems to one of these new solutions. I think we will, and I think some smaller U.S. banks, frustrated by their current technology providers, will be first out of the gate. So, 2019 still won't be a year of rip and replace, but it could be a year of build and migrate.

Head (and brain) in the clouds.

Another prediction from 2018 was that the debate on migration to public cloud was essentially over. What's interesting for 2019 is how quickly the debate has moved on from the cost and scalability benefits of being in the cloud to data and analytics. At the recent AWS re:Invent conference, there were still hardware announcements, like Amazon's new hybrid cloud. However, much of the focus was on what to do with your data once it's in the cloud and, specifically, the analytical tools available from cloud providers. This move from a bare-iron pitch to the allure of an intelligent brain indicates that the winners in digital banking will be defined by offering creativity and data quality, not the quality of algorithms. We are moving to a world where every banking carpenter will have the same toolbox and be able to access many of the same raw materials. Some will be capable of building beautiful furniture that customers will pay a premium for, while others will turn out shoddy, mass-produced items that lack differentiation. The chisels and saws that cloud providers will offer won't be the competitive differentiator, rather distinction will come from picking the right piece of wood and knowing how to create something of value from it that will matter in 2019 and beyond.



Time to make your move ... the chess clock is running down.

There's now a whole cottage industry devoted to what Amazon will do in banking. The speculation in 2018 that Amazon would white-label current accounts from JPMC in the United States set hearts aflutter in many bank boardrooms. There's reason to think that 2019 may be the year in which big tech will be forced to show its hand with respect to banking. In Europe, PSD2 regulations will really start to have an impact on the payments market and major retailers (including Amazon) will need to decide whether they want to offer account-to-account payments that bypass card networks. In the United States, while white-label checking is still a possibility, we are seeing Uber, Amazon and Walmart follow Starbucks' lead and focus more on prepay accounts that internalize payments by offering incentives to use proprietary apps. But, the most fascinating market to watch in 2019 may be India, where almost all the big tech players are competing—for example, Walmart and Amazon remain in a battle for digital commerce supremacy, Ant continues to fund mobile wallet Paytm and Facebook launches WhatsApp payments. 2019 will be a year in which the boundaries between banking and the rest of the digital economy continue to blur, and it may be a year in which we see some of the big tech players make some definitive moves.

Welcome, "platform" police.

My last prediction for 2019 is that the word "platform" will get banned in at least one bank (you might notice it hasn't appeared in any of my previous nine predictions). Often a perfectly useful term gets abused and stretched to the point where it becomes meaningless. Unfortunately, that was the fate of "platform" in 2018. A true digital platform business is an easily accessible, two-sided marketplace that makes money by bringing buyers and sellers together, like eBay, Airbnb or Uber, and driving growth through network effects. Amazon is a semi-platform business because, as well as facilitating commerce, it also aggregates customer demand to sell its own products. Apple also mixes traditional consumer products and platform elements (the App store) while Facebook and Google are almost pure aggregation businesses that focus on capturing your attention and then selling it to advertisers. In 2019, any bank that wants to talk about being a platform business needs to be very specific about the business model it is trying to pursue and stop throwing the word around just to look cool. A pure platform business would be economic suicide for most banks, as it would involve giving up their balance sheet. But as we are seeing in the United Kingdom, hybrid platform models, like Bo or Starling, could be viable. So, if people in your bank start to talk about "platform banking", please keep asking them what they mean until you get an acceptable and clear answer. It could take a while.

END NOTES

[1] Econsultancy, "DBS Bank now earns twice as much income from digital customers," March 31, 2018. https://econsultancy.com/dbs-bank-now-earns-twice-as-much-income-from-digital-customers/

[2] Morgan Stanley

[3] IBID.

[4] U.S. Federal Reserve loan data

[5] Fortune, "Jack Ma's Chinese Fintech Firm Just Raised So Much Money It's Now Worth More Than Goldman Sachs," June 8, 2018.

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[6] Accenture, "Beyond North Star Gazing," October 9, 2018. https://www.accenture.com/us-en/insights/banking/business-models-beyond-north-star-gazing

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