Keep Calm and Carry On

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Polaris Partners

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Is the worst over for British banks?

Ever since the crisis hit, the professional Jeremiahs have been forecasting doom: banks to be permanently nationalised, the payments system to be run as a utility like gas or electricity, challenger banks to elbow the incumbents briskly out of the way, technology to make all of it redundant....

But it hasn't happened. And not only has none of it happened, there are signs that the industry is emerging from its long journey into night.

Consider the threat from Silicon Valley: Marc Andreessen, the technology entrepreneur, talks of "a chance to rebuild the system. Financial transactions are just numbers; it's just information."[1] And his view seems to be backed up by the research: according to eMarketer[2], by 2018 mobile proximity payments in the US, which include payments made using a phone to make a physical transaction at the point of sale, will reach $118 billion, up from $3.5 billion in 2014. The same survey forecasts that by 2018, retail m commerce transactions in the US will reach $133 billion, up from $58 billion in 2014. Wildly excited, the commentariat has no doubt that the m revolution will upend banks around the world.

All very alarming. But what's the reality?

According to industry sources in the US, the much-ballyhooed Google Wallet has gone nowhere near matching the hype which surrounded its launch in 2011. Nor has the unfortunately-named ISIS Wallet, the lovechild of AT&T, T-Mobile and Verizon.

So will Apple Pay be the game-changer product which finally ousts the banks from their domination of the payment business? With the break-through feature of fingerprint validation at POS, on the face of it this would be the one to watch – especially given Apple's formidable reputation for innovation and customer loyalty.

But look a little closer: Apple doesn't make the payments at all. To do that, it relies on partnerships with MasterCard, Visa and American Express, together with a raft of US banks and issuers. Even more surprising in the Age of Big Data, Apple doesn't know the value of the transaction, or what it was for[3]. That information, so valuable to merchants, continues to reside in the hands of the issuers. Turning the case on its head, one could argue that Apple is simply replacing for banks the expensive business of issuing plastic.

In fact, no-one as yet has seriously challenged the banks' grip on the payment system. Even PayPal, for all the fabulous $30 billion valuations that Wall Street puts on its spin-off from eBay, relies on the existing infrastructure to underpin its product.

So maybe technology isn't going to topple the banks.

What about the more conventional challengers? In the UK, this would be Metro, Virgin Money, and Aldermore, together with the financial services offshoots of the big retailers, and the P2P lenders.

Taking them in order, Metro's IPO in January of this year valued the business at around £770 million; on 15 October, Aldermore pulled its planned IPO, which would have valued the company at around £800 million. Two days later, Virgin Money postponed its own IPO, at a valuation of £1.5 billion to £2 billion. Both cited "market conditions". Compare these value estimates with Lloyds at £54 billion, RBS Group at around £41 billion, and Barclays at £36 billion. There's a lot of blue water here.

As to the P2P lenders, Zopa has become the first British contender to top $1bn of lending, reporting in August that its loans so far this year were up more than 90% on the comparable period in 2013. So how much did they actually lend? £148 million[4]. Very good, of course; but as these things go, it's not a lot. There are also questions about how "alternative finance" will perform once today's ultra-low interest rates start to rise – and delinquency rises in step.

Emphatically, this is not to belittle the new arrivals, who are bringing much-needed innovation and competition to retail banking (note that RBS and Santander have both taken a small stake in P2P).

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[1] *Financial Times*, 14 Oct 2014
[2] http://www.emarketer.com/Article/Consumers-Bullish-on-Mobile-Payments-Future/101126
[3] *USA Today*, 5 Oct 2014
[4] *The Independent*, 12 Aug 2014

Recently-released performance figures tell a positive story:

- Year on year to the end of September, Metro deposits were up 118%, lending up 146%, and customer accounts up 71%[5].
- For the half year to the end of August, Tesco Bank added 14% more customers, boosted home loans by 48%, deposits by 9% and personal loans by 5%[6].

But we should see them in context: Zopa, for example, accounts for just over 1% of the UK personal loans market[7].

Bank nationalisation?

Now only a dream on the far left: the Government has already reduced its stake in Lloyds to 25%, and still plans to sell down its 79% holding in RBS when the time is right. There is very little likelihood that any future Labour administration would want to change this policy, given the State's need for cash. Barclays, of course, refused to take any taxpayer help following the crisis.

Similarly, there seems to be no chance that a Government of any conceivable political complexion would want to take over the payments system and operate it as a State-owned utility. Nevertheless, and who knows how far it was gesture politics, the Coalition created the Payment Systems Regulator (PSR) on 1 April 2014. Starting supervisory work in April next year, the PSR's brief is already causing nervous headaches in City boardrooms:

- To promote effective competition in the markets for payment systems and the services they provide
- To promote innovation in payment systems
- To ensure payment systems are operated and developed in the interests of service users

The rise of the regulators

As it happens, the creation of the PSR points to one of the biggest barriers to entry for a new competitor: the sheer mass of regulation with which banks now have to deal. Add to the PSR the other posse of UK supervisory bodies (the FCA, the CMA, the OFT, the PRA, the BoE), their counterparts in Europe (the EBA, the ECB, the EC), and then stir in the ever more ambitious extra-territorial grasp of US regulators, and there's small wonder at the bankers' in joke that these days the only department recruiting is Compliance.

Put it all together and, hard to get into, tough to make a major impact on, maybe retail banking is more resilient than the prophets of doom would have us believe.

And there's some good news.

Not only are the existential threats receding, business is looking up. A joint CBI/PwC survey[8] has found that financial services sales in the UK are growing at their fastest pace since before the recession. According to the report, in the past quarter, sales were close to their level in 2007. Further, "The net balance of companies reporting increased business volumes stood at 49%, with 60% saying they were up and just 11% recording a fall. This is within touching distance of the 51% net balance recorded in 2007."

So the bankers can relax?

Well, no. Somehow, the industry has to get its pricing right, both to eliminate the product cross-subsidies, and compensate for the choked-off revenue streams from fees and card earnings. At the same time, it has to find the resources to update creaking legacy systems, let alone to compete with the newcomers. Also, it's still not clear how to strike a balance between the hugely expensive branch network[9] – needed for attracting new customers, bringing in deposits, and serving the wealthy – and the "you-do-it" technology needed to shift costly routine tasks from the bank to the customer.

But if we can go back to the WW2 language of our title, to paraphrase Churchill on a different occasion, "This may not be the beginning of the end. But it is the end of the beginning."

News Flash

All of Britain's banks have passed the EBA stress test.

[5] *Financial Times*, 22 Oct 2014

[6] *Financial Times*, 23 Oct 2014. The company said that marketing costs from the launch of the Tesco personal current account were "expected to broadly offset underlying profit growth for the full year"

[7] http://www.pymnts.com/news/2014/zopas-p2p-volume-exceeds-1billion/#.VEZGO_nF-w8

[8] http://www.pwc.co.uk/financial-services/publications/cbi-pwc-survey.jhtml

[9] Lloyds Banking Group has just announced that it will close 150 branches over the next three years

About the Author
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With more than 20 years of experience in the payment card industry, Roy was previously with American Express, where as VP and General Manager, he launched the highly successful commercial card business in the UK, going on to lead product rollout across EMEA and latterly Latin America/Caribbean.

As a consultant, Roy works with banking and payment card clients around the world, identifying and advising on best practices in customer marketing and relationship management. He has also undertaken assignments in media, utilities, airlines and retail.

He has developed and audited coalition and bank loyalty programmes in the UK, Ireland, the Netherlands, Spain, Canada, Dubai, Kuwait, Australia, Singapore, Spain, Israel, Turkey, Saudi Arabia, Brazil, Chile, Venezuela and Mexico.

Roy has also advised on airline FF programmes, and has been the rewards lead in the MasterCard Advisors pool.

He speaks fluent Spanish, reasonable French and is the author of Marketing Planning for Financial Services (Gower Publishing). He has a B. Com, holds an MA in Management Studies and is a Fellow of the RSA.

About Polaris Partners

Polaris Partners is a young company led by directors with decades of experience as senior managers and consultants. We specialise in helping businesses reach their sales and marketing goals.

Most of our work is in the financial services and leisure sectors, but we’ve also completed major engagements for household names in utilities, travel, media and retail. Our clients span the world: we’ve undertaken projects on every continent, and are comfortable working on-site when necessary.

“No job is too big, no job is too small.” In our case, the cliché is true. We’ve advised banks on the strategic management of their payment card portfolios, we’ve helped start-ups write a business plan, we’ve built strategic alliances between leisure sector leaders, we’ve put sales forces on the road.

We have great respect for the numbers – data analysis and financial modelling are important tools for us – but we also believe in the power of creativity.

To learn more, please visit our website at polarispartners.co.uk